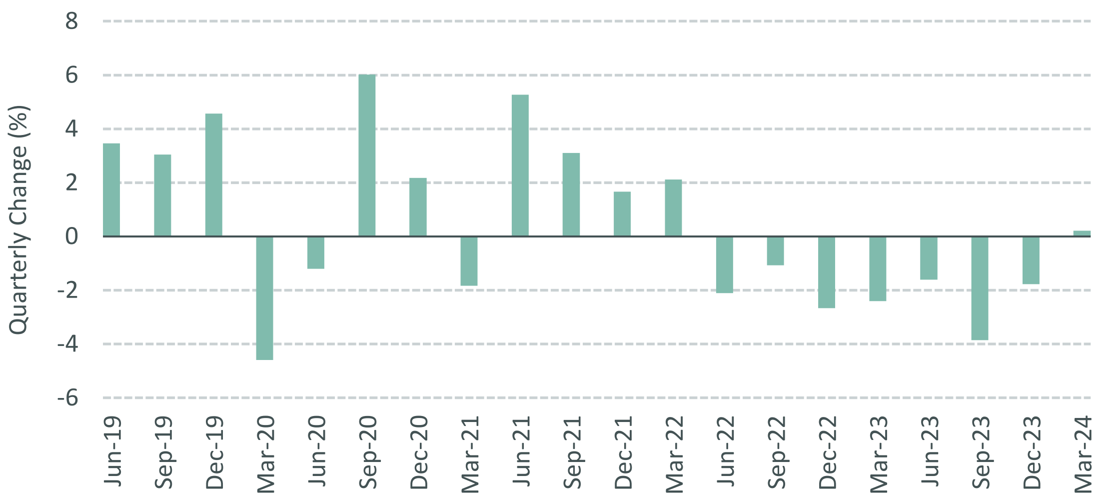
CBRE

Wellington Property Market Overview

INSIGHTS

- As in Auckland, while our recent quarterly data indicates that we are close to the top of the current yield cycle, we expect selling pressure to intensify on some vendors in the coming months. The resulting transactions will provide a clearer indication to where the remaining gap between vendor and purchaser price expectations will settle.
- Rental growth was mostly absent during Q1, except for Prime industrial buildings. Incentives remained unchanged. However, this might change for the office market which could be exposed to higher incentives due to increasing vacancy.
- During H2 2023, office vacancy shifted to the double-digit realm, increasing to 10.2% from 8.3%. This was mostly triggered by high levels of backfill vacancy (mainly in Grade A premises), since the market witnessed a notable volume of supply completions that unleashed a high number of tenant movements.
- The industrial market saw a slight increase in vacancy during H2, rising to 2.5% from 2.4%, triggered mainly by an increase in the lowest quality buildings. Grade A industrial assets remain fully occupied.

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	492,328	5.2	585 – 985	4 – 6	6.00 – 8.25
Secondary CBD Office	897,940	12.9	220 – 650	8 – 14	7.35 - 11.45
Prime Industrial	473,355	0.0	180 – 260	1 – 2	6.00 - 7.00
Secondary Industrial	1,728,123	3.2	120 – 180	3 – 4	6.50 - 8.50
Prime CBD Retail	23,335	1.1	2,000 - 2,800	10 – 11	6.66 – 7.51
Secondary CBD Retail	169,137	8.6	800 – 1,700	10 – 11	7.10 – 8.25

* Stock and Vacancy figures are as of December 2023. Gross Face Rent, Incentives and Yield Range figures are as of March 2024.

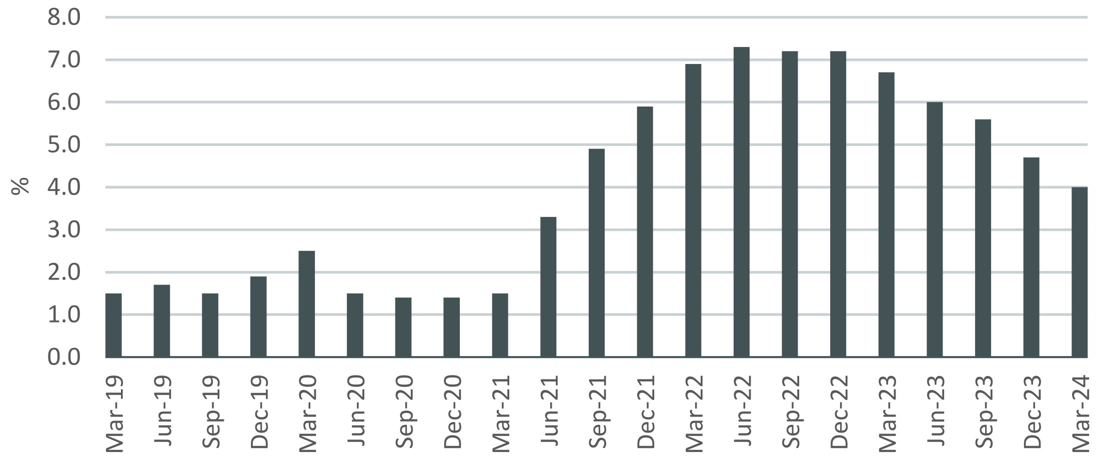
Economy

The RBNZ continues its fight against inflation. The diagnosis in the last two years was clear: mounting pressures were positioning the inflation rate way outside its desired target of 1%-3%. The medicine prescribed by the RBNZ was also obvious: monetary tightening via an aggressive dosage of high OCR to tackle a febrile economy and bring inflation down to non-threatening levels; especially domestic-generated inflation.

As with any prescribed medicine, there are also some side effects. One of them is recession. The New Zealand economy is clearly in recessionary territory. Out of the last five quarters, four registered negative GDP growth, clearly showing a double-dip recession. So far, headline inflation has been consistently slowing down and the unemployment rate has been rising. The inflation rate in Q1 2024 was 4.0%, coming down from 4.7% in Q4. However, the non-tradable inflation component remained highly sticky. Despite this, the medicine is revealing its effect, running slowly through the system, taking the excess steam out of the economy. The effects of the RBNZ's tightening monetary policy are having a clear impact on aggregate demand through weaker consumption by households and lacklustre private investment. Both the market and the RBNZ continue to forecast subdued economic conditions for the rest of 2024.

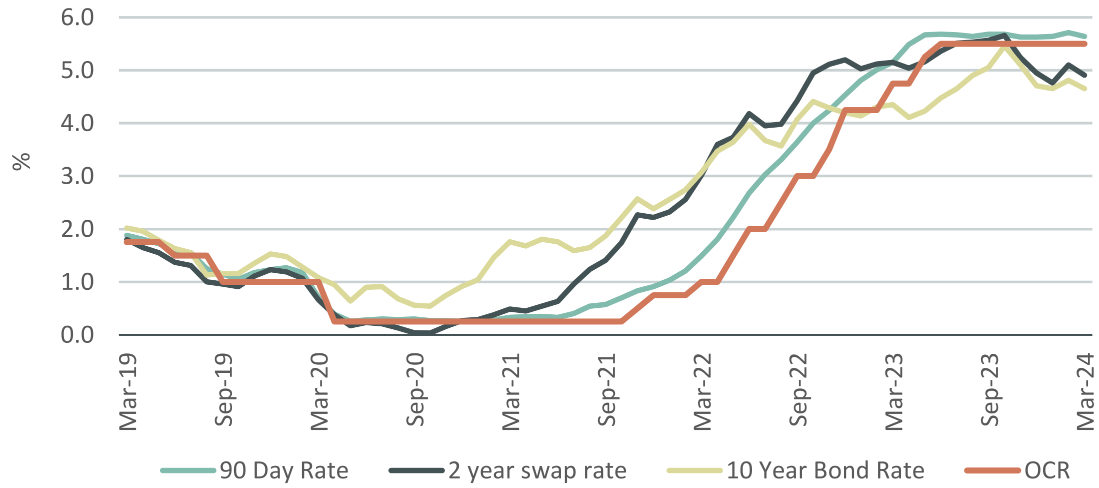
After increasing the OCR by 525 basis points from late 2021 up to May 2023, the RBNZ pivoted to a 'high for longer approach', letting the cycle run its course. Expectations of further OCR rises dissipated as Q1 2024 unfolded. However, the Q1 CPI data will be somewhat concerning for the RBNZ. Domestic inflation pressures remain acute, particularly concentrated in services sectors. The balance of risks is now tilted towards the RBNZ cutting OCR rates later than August, which until now has been the baseline consensus expectation for most economists. The RBNZ will likely await confirmation from the hard data before it pivots to looser policy, which means rate cuts may not be on the table until November.

Consumer Price Index



Source: : Statistics New Zealand

Interest rates (% pa)



Source: Reserve Bank of New Zealand

Investment market

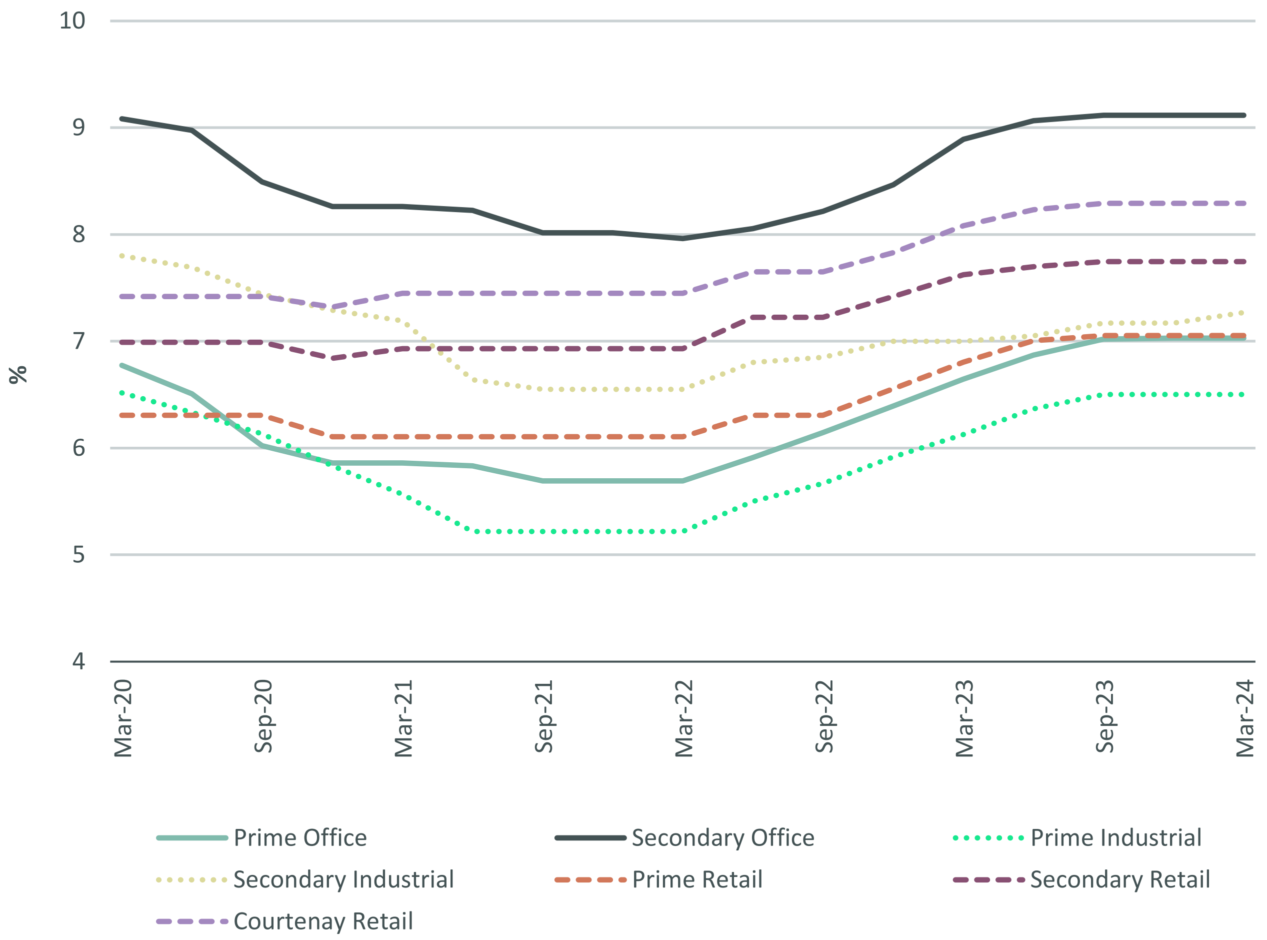
The investment market continued to be characterised by stillness and caution during Q1. There was only a limited number of transactions casting light on current prices. Therefore, CBRE's quarterly yield assessments continued to primarily rely on our market interactions and available bidding statistics and aim to find the middle ground between the expectations of potential vendors and purchasers.

Within this context, CBRE's assessment revealed a plateauing of market yields; the industrial market being the only one exposed to some minor adjustments. This reflects an increasing differentiation between Prime and Secondary and is supported by recent sales evidence pointing to higher Secondary industrial yields than previously assessed.

As in Auckland, while our recent quarterly data indicates that we are close to the top of the current yield cycle, we expect selling pressure to intensify on some vendors in the coming months. The resulting transactions will provide a clearer indication to where the remaining gap between vendor and purchaser price expectations will settle.

From the market peak in 2021 up to the first quarter of 2024, office assets witnessed more yield softening than the industrial and retail markets. During this period, Prime office yields increased by 134 bps, whilst Secondary office yields, characterised by high absolute yield levels, went up by 110 bps. Industrial yields softened by 100 bps, whilst retail yields increased by 87 bps.

Wellington Indicative Yields by Sector



CBD Office Vacancy

The Wellington office market was very dynamic during H2 2023, with a historically significant volume of supply completions triggering a mass of occupier moves. CBD office vacancy moved into the double-digit sphere, from 8.3% to 10.2%. Vacancy had not crossed the 10.0% threshold since the 2016 earthquakes. The amount of total CBD vacant office area went up by 31,437 sqm during this period (from 109,932 sqm to 141,369 sqm), mainly due to an increase in vacant space in both Grade A and Grade B submarkets of the Core CBD and in the Grade D submarket of Thorndon. Prime (Premium and Grade A) vacancy increased from 3.0% to 5.2%, while Secondary (Grade B to D) vacancy rose from 10.8% to 12.9%.

The increase in Grade A vacancy was triggered by a mixture of backfill vacancy and the re-introduction to the market of the largest office building in Wellington. During H2, the Asteron Centre (a 34,330 sqm building) returned to the market after refurbishment and strengthening works. However, circa 5,200 sqm in this building was not occupied, flaring up Grade A vacancy. Moreover, backfill vacancy was generated by the relocation of KPMG to 44 Bowen Street, leaving behind around 3,000 sqm on Levels 8-11 of Maritime Tower (2-10 Customhouse Quay). Also, BNZ vacated Levels 2-4 in Spark Central (48 Willis Street), leaving behind around 4,900 sqm to move to One Whitmore. The rise in Grade D vacancy was due to Inland Revenue moving back to the Asteron Centre, leaving behind 6,298 sqm in 20 Aitken Street in Thorndon. The increase in Grade B vacancy was due to an additional 11,162 sqm of vacant space in 68 Jervois Quay due to the relocation of Datacom to the Asteron Centre.

During H2, total stock increased by 60,790 sqm. The Wellington total CBD office stock in December 2023 was 1,390,268 sqm (around 35% of it being Prime Grade), up by 4.8% compared December 2022. The Wellington CBD witnessed the arrival of a new debutant in the Premium submarket: One Whitmore, a 17,100 sqm building predominantly occupied by BNZ. The other new office building that entered the market in 2023 was 44 Bowen Street in Thorndon (a 11,549 sqm), currently fully occupied by KPMG and NZTA.

CBD Office Vacancy Change by Grade

		PREMIUM	GRADE A	GRADE B	GRADE C	GRADE D	TOTAL
Vacancy at December 2023	%	3.1%	5.7%	7.9%	13.1%	24.9%	10.2%
	sqm	3,009	22,616	33,876	38,677	43,191	141,369
Vacancy at June 2023	%	2.0%	3.3%	5.9%	12.6%	19.7%	8.3%
	sqm	1,534	11,484	25,172	37,707	34,035	109,932

Wellington CBD Office Vacancy

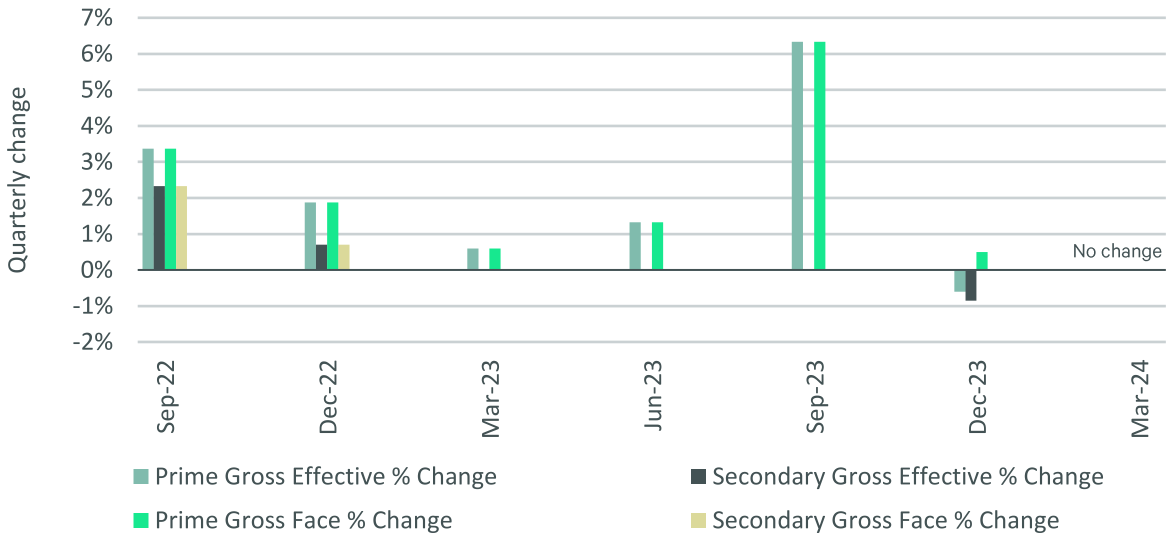
CBD Office Rents

After experiencing good rental growth in previous periods, due mainly to low vacancy and a strong flight-to-quality tendency, the Prime office submarket witnessed stable rents during Q1. Rents in the Secondary office submarket also remained unchanged.

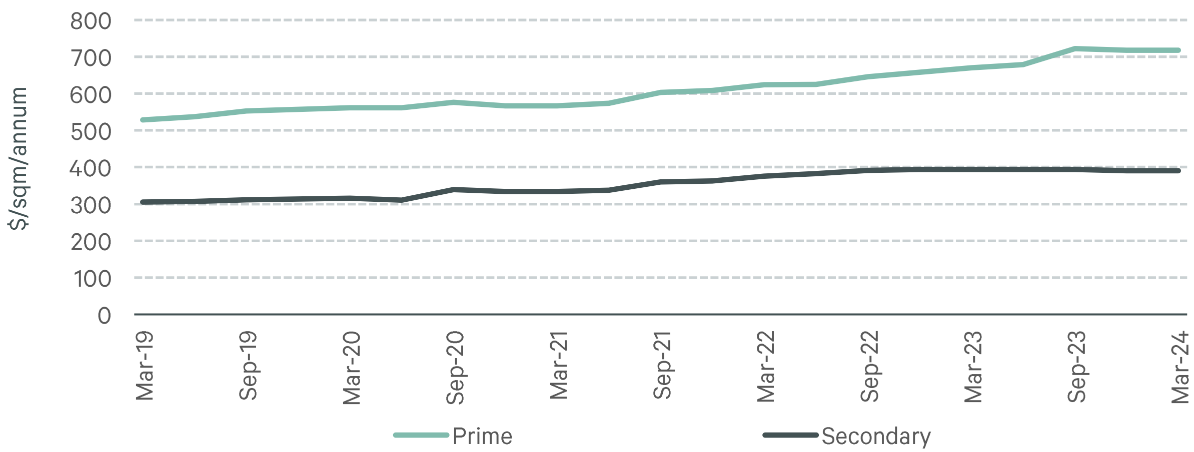
This stability belies the underlying momentum of softening occupier market conditions, and sentiment indicates that incentives will increase, and effective rents decrease, in coming quarters (as indeed happened in Q4 2023). The mounting downward pressures on effective rents is especially acute in the Secondary sector.

Based on CBRE's assessment, indicative market incentives are at 4.8% of face rents in the Prime office submarket and at 9.1% in the Secondary office submarket.

Wellington Office Rents – Quarterly Change



Wellington Gross Effective Office Rents



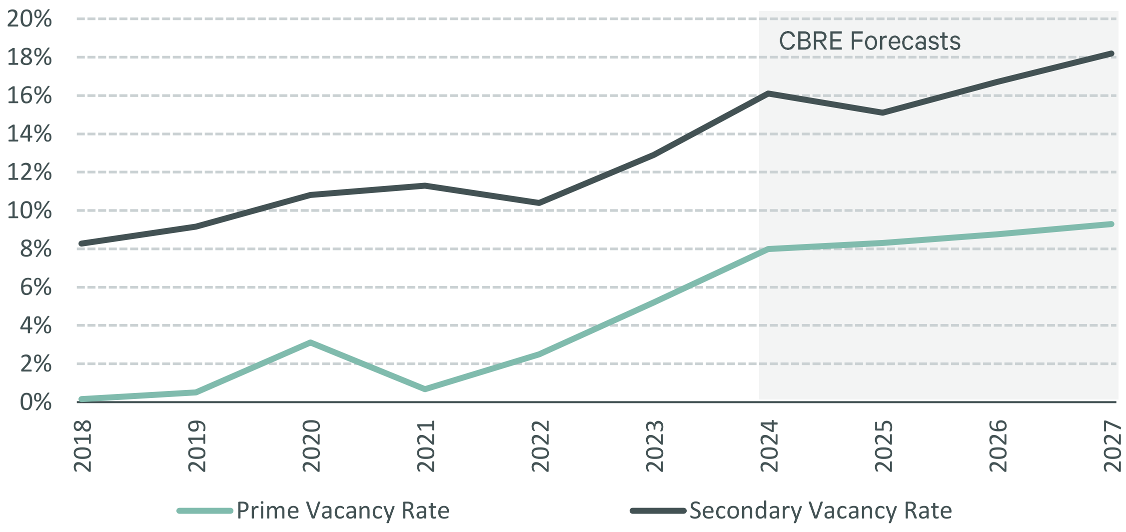
CBD Office Market Outlook

Even tough Wellington's CBD registered strongly positive net absorption during H2 (of 29,354 sqm), driven by high absorption levels in the Prime market as occupiers relocated into the newly introduced stock from existing Secondary buildings, for 2024 absorption is forecast to move into negative territory. However, based on CBRE's forecast, only 2024 will expose a negative net office absorption throughout our forecast period (2024-2027). We expect this year to be tainted by subdued economic growth and the government's efficiency drive, which will force some companies and governmental entities to reduce and/or sublease part of their office space. CBRE expects net absorption to recuperate in 2025-2027, with an annual average of circa 7,400 sqm in our base scenario forecast.

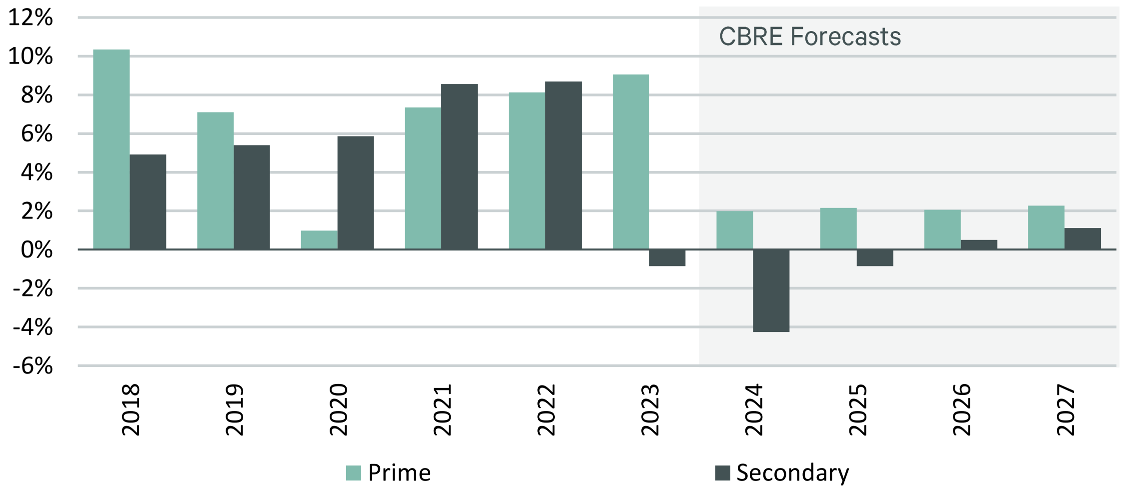
In 2024, five buildings are expected to return to the market after undergoing refurbishment works, supplying the market with circa 30,000 sqm of Grade A and around 11,000 sqm of Grade B. They include 54 Cambridge Terrace (4,980 sqm), 80 The Terrace (10,583 sqm), 126 Lambton Quay (6,120 sqm), Bowen House (14,283 sqm), and 23 Kate Sheppard Place (5,400 sqm). We believe that during the period 2024-2027 the annual average supply of new stock will be around 17,700 sqm. This contrast with what the Wellington office market experienced during the period 2013-2023, in which the average supply of new stock was negative (circa -15,500 sqm per annum).

The above supply/demand conditions will result in elevated vacancies over the next few years. Vacant stock in 2024 is expected to increase by circa 42,000 sqm compared to the previous year, which will increase the vacancy rate close to 13.0% and will constrain rent growth. We still expect modest increases in Prime gross effective rents given the relatively strong demand profile from upgrading occupiers although sentiment is starting to soften, but Secondary rents are forecast to decrease in 2024 and 2025.

CBD Office Actual and Forecast Vacancy



CBD Office Actual and Forecast Annual Gross Effective Rental Change

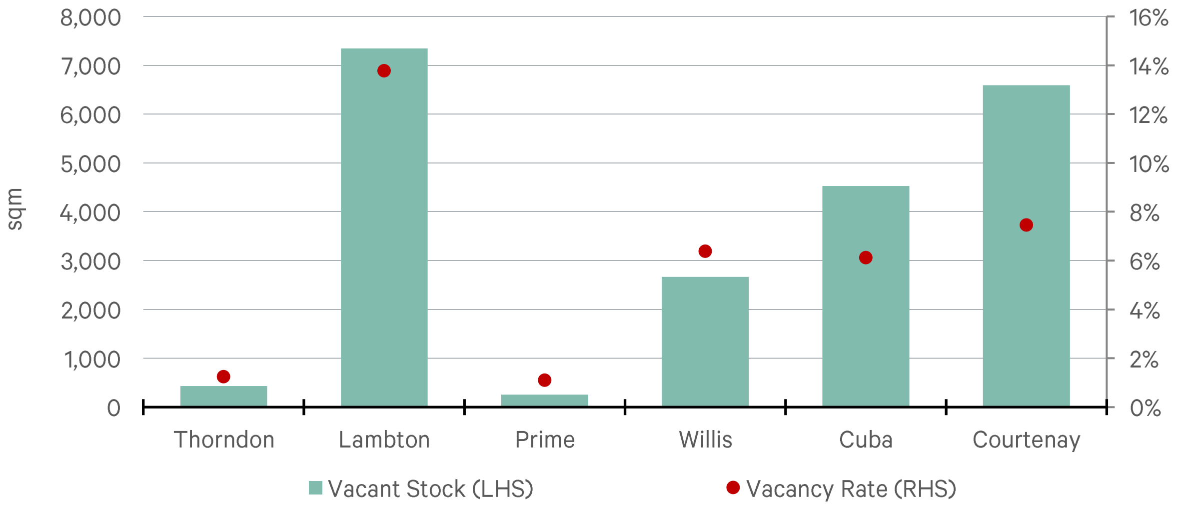


Retail Vacancy

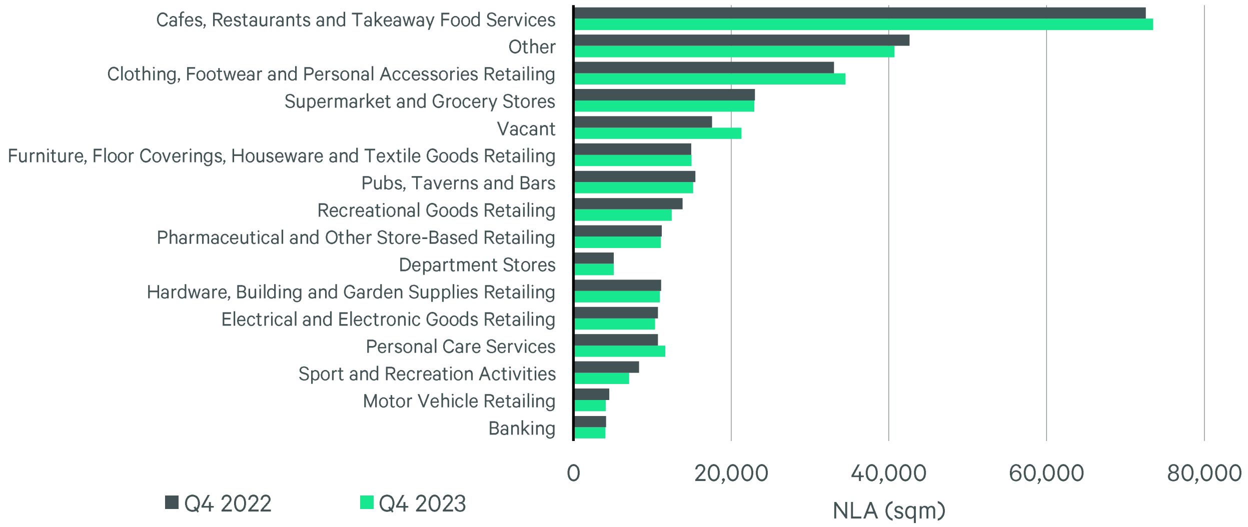
In 2023, the Wellington CBD retail submarket was exposed to higher vacancy levels. The vacancy rate increased from 5.7% to 6.9% compared to December 2022. This was mainly due to a considerable jump in vacancy in Courtenay, which witnessed its vacancy rate increase from 3.3% to 7.5%. The vacant retail area in this precinct went up by 3,674 sqm during this period (from 2,916 sqm to 6,590 sqm).

The three industries that registered an increase in their footprint during 2023 compared to the previous year were 'personal care services', 'clothing, footwear and personal accessories retailing' and 'cafes, restaurants and takeaways food services'. On the contrary, the ones that saw a decrease in this period were 'motor vehicle retailing' and 'sport and recreation activities'.

Wellington Retail Vacancy by Precinct - Q4 2023



Wellington Retail Occupancy by Industry

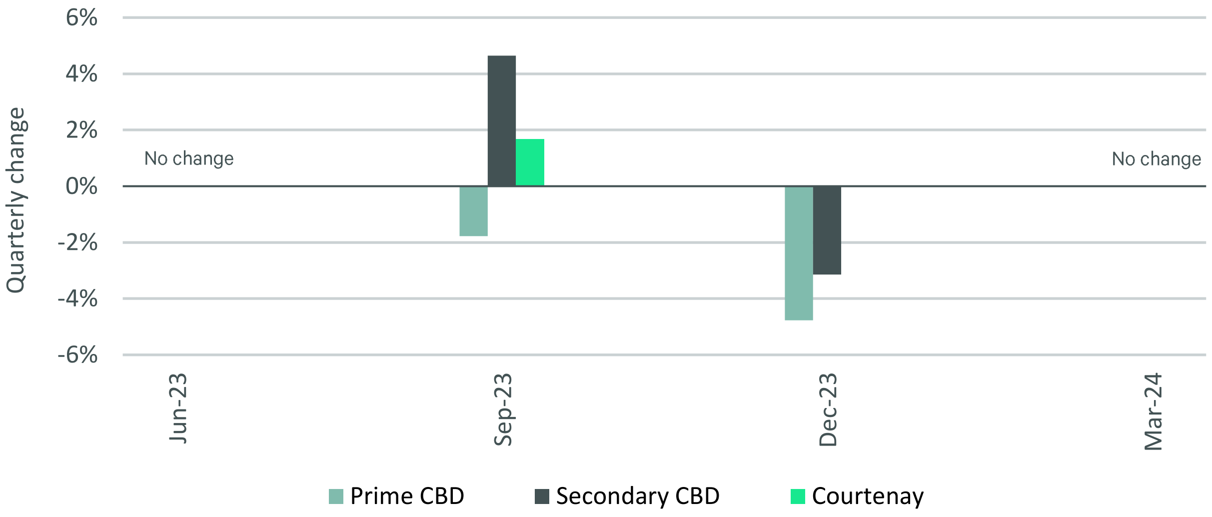


Retail Rents

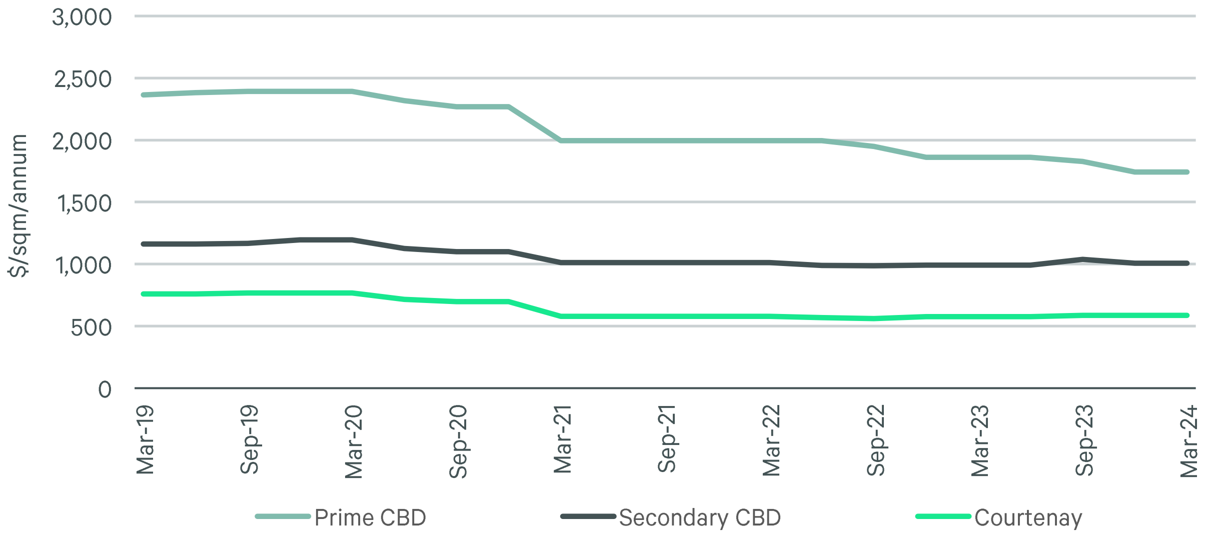
Inquiries for retail space in Prime CBD locations on Lambton Quay as well as in Secondary CBD locations with high foot traffic, mainly around Manners Street and Cuba Street, continued to be active during Q1. At the other end of the spectrum, Courtenay continued to be affected by weak retailer demand. Generally, inquiries are slow to translate into leasing deals and we kept rents stable in Q1 across all submarkets since the lack of leasing activity during this period did not bring about a clearer direction on rental trends.

Indicative market incentives remained unchanged at 11.1% of face rents in Q1. However, within the context of the last 12 months, effective rents in both Prime and Secondary CBD retail submarkets were influenced by an increase in incentives, affecting the former more than the latter. Due to this, gross effective rents decreased by 4.1% in Prime CBD retail locations in the last year, pushed down by landlords trying to lure long-term tenants to sign on the dotted line.

Wellington Retail Rents – Quarterly Change



Wellington Net Effective Retail Rents



Industrial Vacancy

Industrial vacancy witnessed an increase during the twelve months to December 2023, shifting from 2.4% to 2.5%. Total vacant space went up by 3,171 sqm during this period, much higher than the increase in the previous period (only by 222 sqm). This was driven mainly by an increase in vacancy in the lowest quality buildings (by 1,769 sqm), followed by a rise in vacancy in Grade B buildings (by 1,402 sqm). As in the last two periods, Grade A vacancy remained unchanged at zero, showing continuous demand for high-quality industrial space in Wellington.

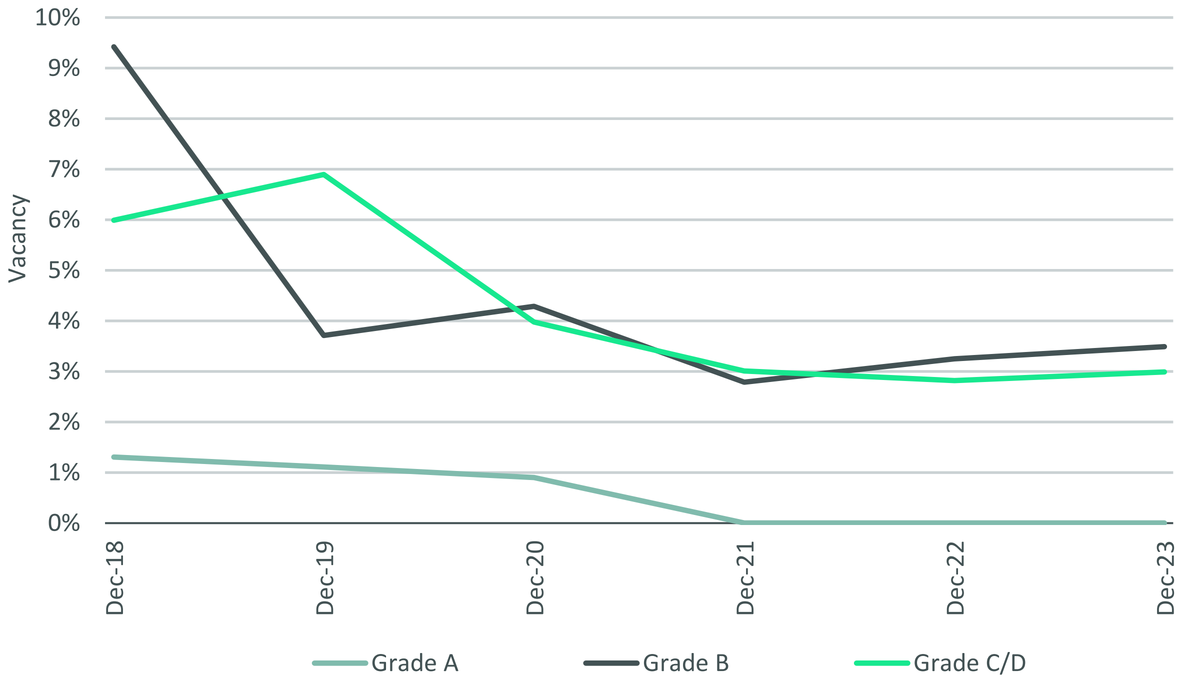
Around 20,150 sqm of new stock hit the market during 2023. In terms of stock withdrawals, some buildings were torn down in Melling on Marsden Street and Pharazyn Street (totalling 5,175 sqm) as part of the Riverlink project, which requires the demolition of several industrial buildings along the Hutt River. In addition, a Grade C/D building of 1,230 sqm on Tirangi Road in Rongotai was also demolished

Alicetown, in Lower Hutt, registered the largest change in vacancy, increasing from 1.5% to 5.2%, largely due to several tenants moving out of 5 Wakefield Street, leaving behind 1,930 sqm of Grade C/D industrial space. Moreover, Porirua experienced the largest vacant space increase (by 3,980 sqm), due to a Grade B building being vacated at 11 Prosser Street.

Wellington Industrial Vacancy Change by Grade

		GRADE A	GRADE B	GRADE C/D	TOTAL
Vacancy at December 2023	%	0.0%	3.5%	3.0%	2.5%
	sqm	0	20,198	34,354	54,552
Vacancy at December 2022	%	0.0%	3.2%	2.8%	2.4%
	sqm	0	18,796	32,585	51,381

Wellington Industrial Vacancy



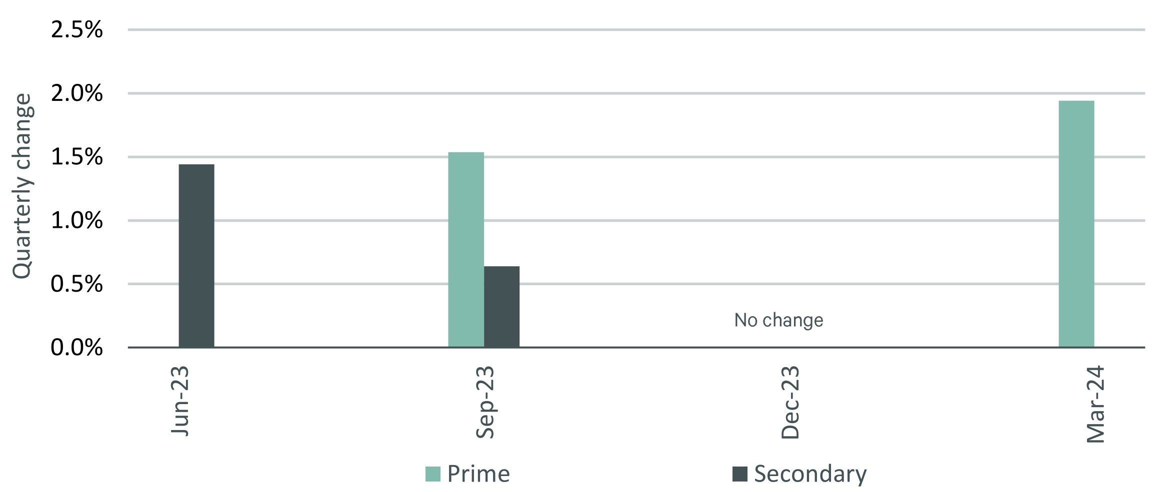
Industrial Rents

The Prime industrial submarket was the only one registering rental growth in Q1 (1.9% quarter-on-quarter growth). Rents in this submarket continued to benefit from low vacancy and a constrained new development pipeline ravaged by high constructions costs, two factors that have underpinned rental growth in the Wellington industrial market in the last year.

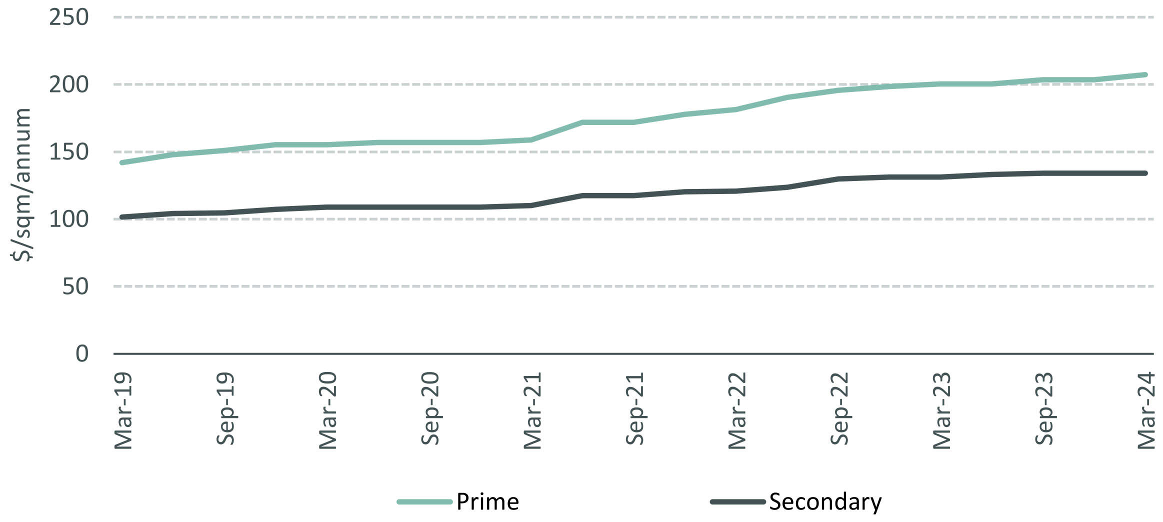
Industrial Prime gross effective rents sat at $207 per sqm, up by 3.5% compared to Q1 of the previous year. Secondary gross effective rents sit at $134 per sqm, up by 2.1% compared to Q1 2023.

Based on CBRE's assessment, indicative market incentives remained unchanged in Q1 2024. The industrial market continues to be an outlier in the Wellington commercial real estate market, not having registered any change in incentives in more than four 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

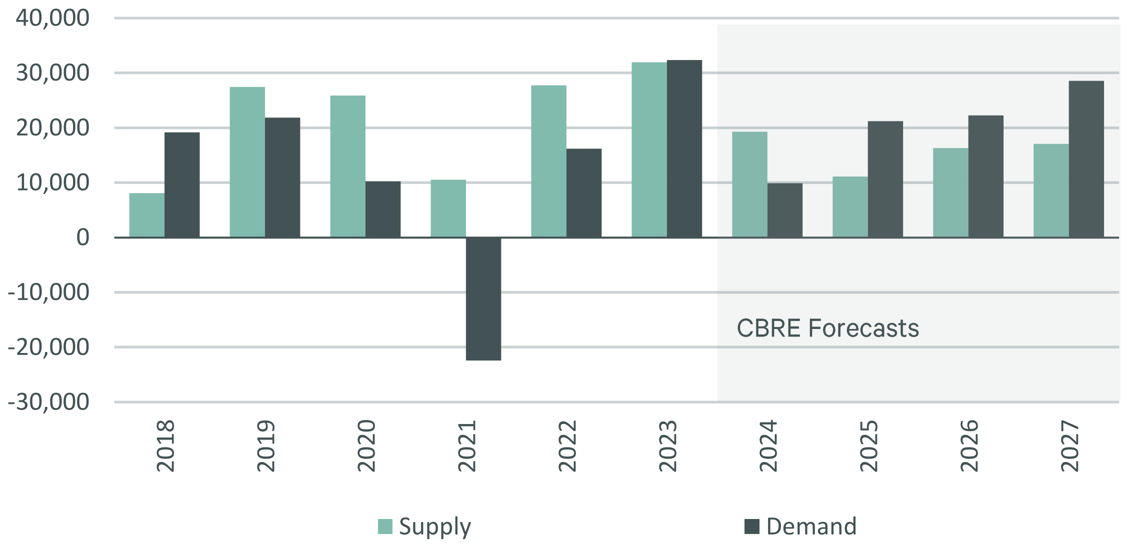


Industrial Market Outlook

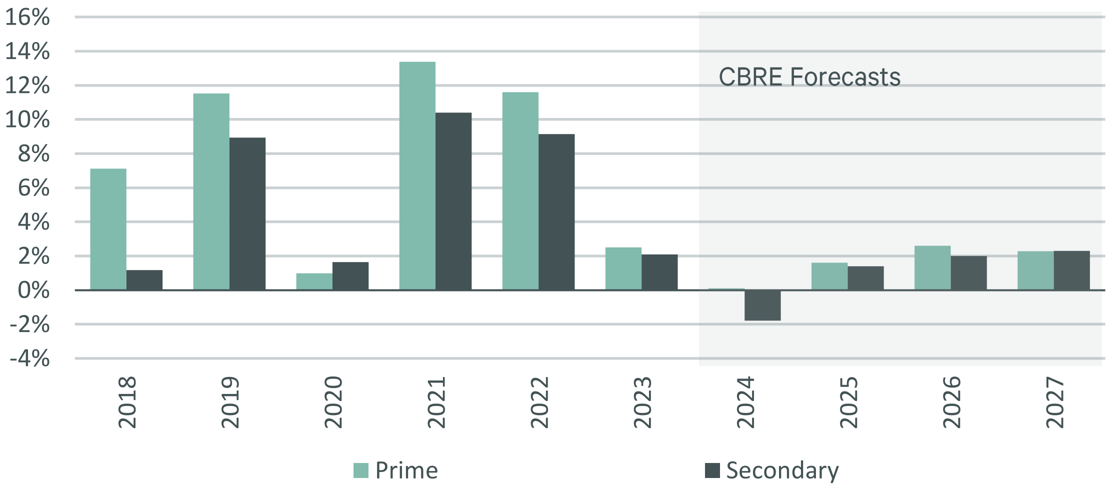
With the passing of the small unit development driven upswing in supply, the pipeline falls away materially in 2024 and beyond although the biggest project due for completion in 2024 remains a small unit development comprising 11,000 sqm across 87 units, called The Works Elsdon in Porirua. With the more difficult environment for new development, we forecast that supply volumes will be modest in 2025-2027.

CBRE expects a sluggish rental market in 2024. As the supply pipeline moderates rental growth driven by required economic rents to support new construction will largely dissipate. This, combined with continued Opex escalations and a subdued demand due to forecast economic headwinds will result in miniscule rental growth for Prime buildings (only 0.1% y-o-y growth) and a drop in rents for Secondary assets (down by 1.8%). From 2025 onwards we expect a modest upswing as the cyclical economic rebound takes shape.

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.

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