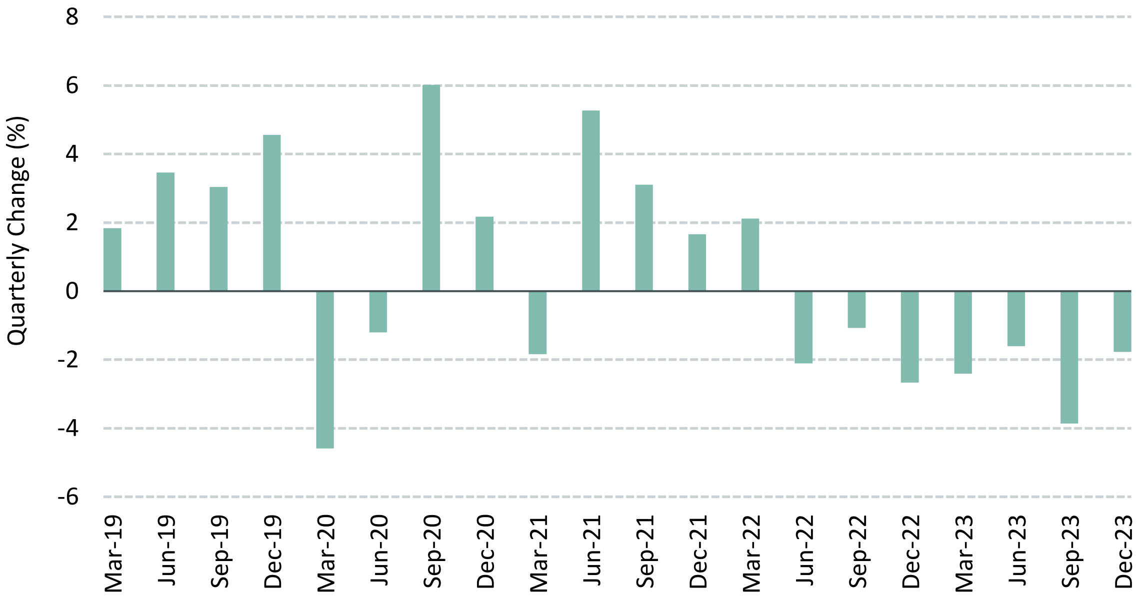
Wellington Property Market Overview

INSIGHTS

- 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 Prime office submarket stock expanded by circa 63,000 sqm during H2 due to the reintroduction to the market of the Asteron Centre and two new buildings: 44 Bowen Street and One Whitmore, the latter being Wellington's new waterfront building, mostly occupied by BNZ.
- 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.
- In Q4 2023, yields halted the softening trend they experienced in the previous quarters. The market seems to be reaching the peak of the current yield cycle.
- Industrial rents remained unchanged during Q4, whilst the Grade A and B office submarkets and Prime and Secondary CBD retail premises experienced a drop in effective rents due to increasing incentives driven by higher competition between landlords to secure tenants.

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 – 250	1 – 2	6.00 - 7.00
Secondary Industrial	1,728,123	3.2	120 – 180	3 – 4	6.50 - 8.25
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

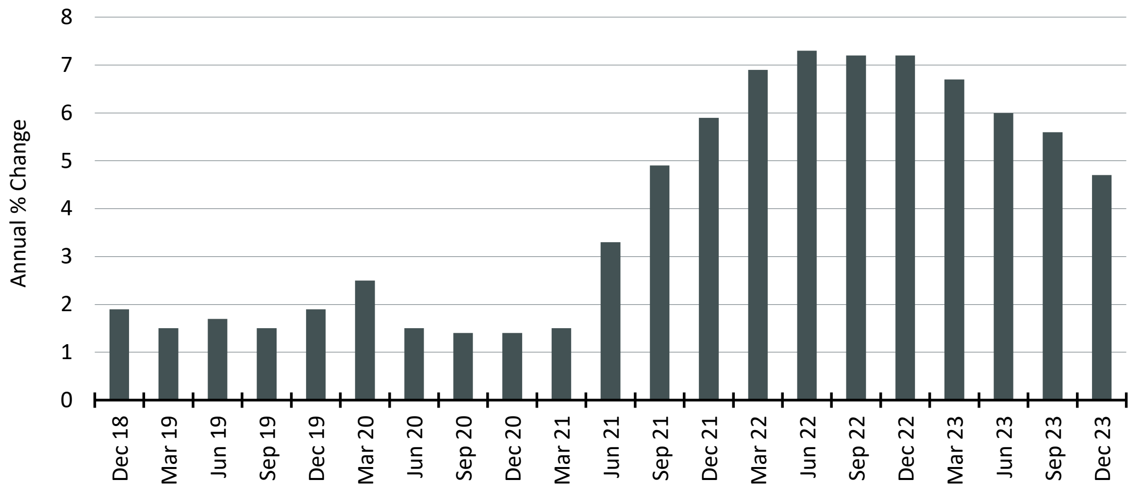
Economy

New Zealand's economy has been cooling off in the last year. According to the latest published data, between Q4 2022 and Q3 2023 only one quarter registered a positive quarterly GDP growth, exposing a clear economic downturn. Economic growth during Q1 was revised down from zero to negative, which means that the country went into a recession between the end of 2022 and the beginning of last year. Also, GDP decreased by 0.3% in Q3 2023, much lower than what the RBNZ predicted. Weaker consumption and investment figures have translated into lower levels of aggregate demand. Both the market and the RBNZ predict that GDP growth will remain subdued until late 2024.

Despite headline inflation slowing down, annual non-tradable inflation in Q4 was higher than what the RBNZ forecasted in its latest Monetary Policy Statement (5.9% vs 5.7%). 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.

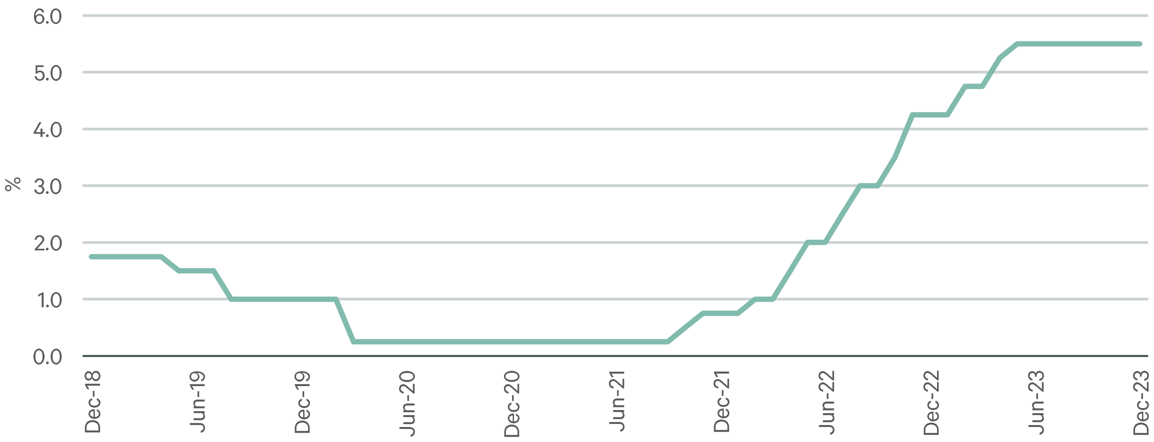
The RBNZ's Monetary Policy Committee has held the OCR at 5.50% in the last four meetings. The last increase was in May 2023, in which the OCR was hiked by 25 bps. However, back in November the market was exposed to a hawkish rhetoric from the Reserve Bank of New Zealand regarding potential OCR hikes, adding more uncertainty to an already hazy investment market. This occurred during a period in which the overall market had started to see beyond the peak of the current interest rate cycle. Moreover, the Q4 unemployment rate figure released at the beginning of February was stronger than what both the RBNZ and the market were predicting (4.0% vs 4.2%). This prompted the market to consider the possibility of the RBNZ pulling once again the trigger of the quantitative tightening gun via a potential OCR hike in the next Monetary Policy Statement at the end of this month, throwing a bucket of cold water over market expectations of interest rate cuts occurring sooner rather than later.

Consumer Price Index



Source: : Statistics New Zealand

Official Cash Rate (OCR)



Source: Reserve Bank of New Zealand

Investment market

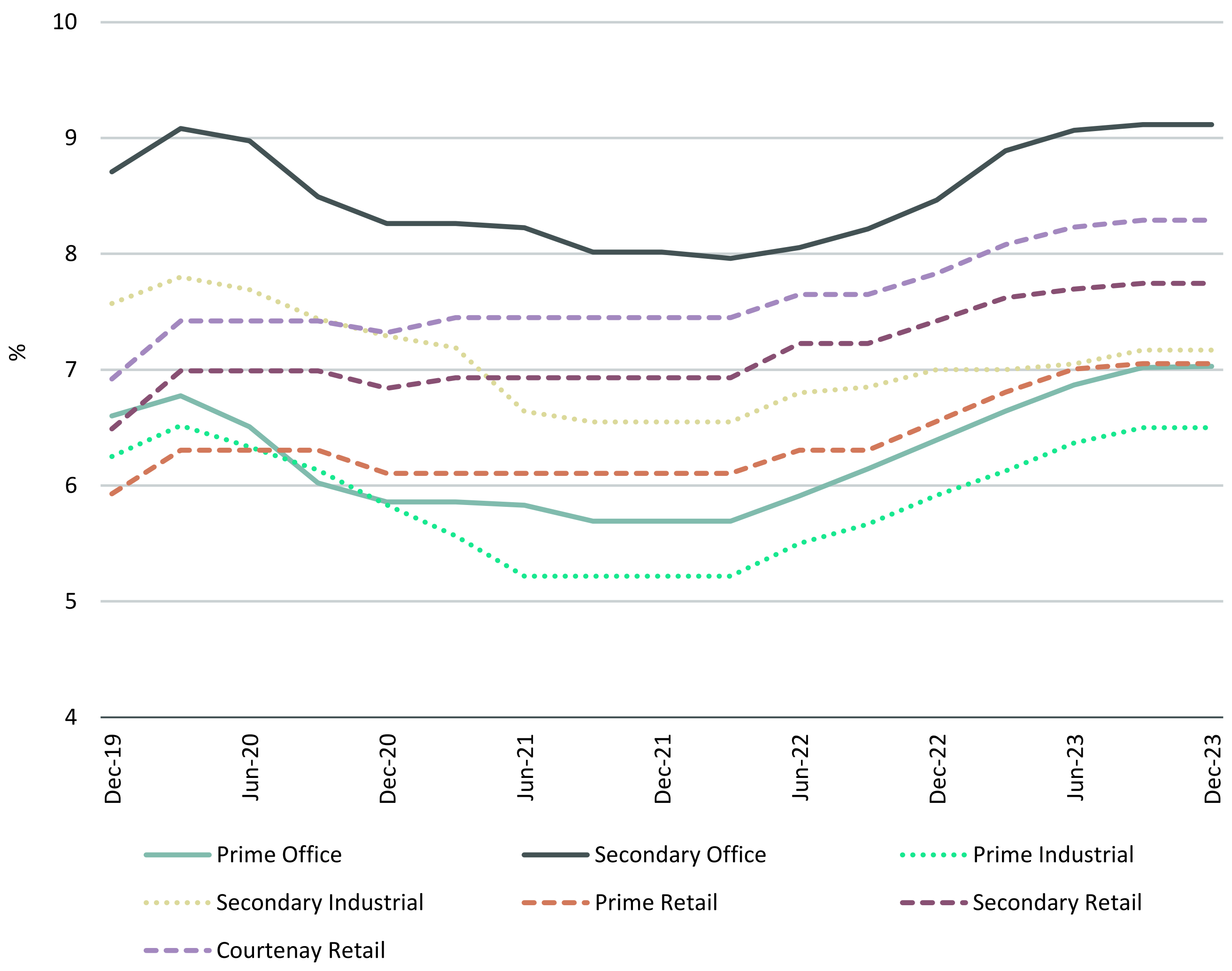
Our read of transaction market trends has not changed materially over the past quarter. CBRE's engagement in sale campaigns continues to indicate elongated due diligence periods, buyers heavily scrutinising assets, and adverse findings tending to lead to material adjustments to price offers, with uncertainty about whether sellers are willing to let assets go at final offer prices. This process reflects the opportunistic approach of many buyers, buyers' greater focus on asset-specific issues around capex compared to more normal market conditions, and the relative pressures faced by sellers to divest.

There was only a limited number of transactions in Q4 casting light on current prices and CBRE's quarterly yield assessments continue 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.

We are starting to witness a glimpse of the current yield cycle's peak, as a result we anticipate some renewed investor interest. CBRE's assessment of Q4 market yields showed a largely stable market, except for some small adjustments at the individual asset level.

From the market peak in 2021 up to the last quarter of 2023, 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 95 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

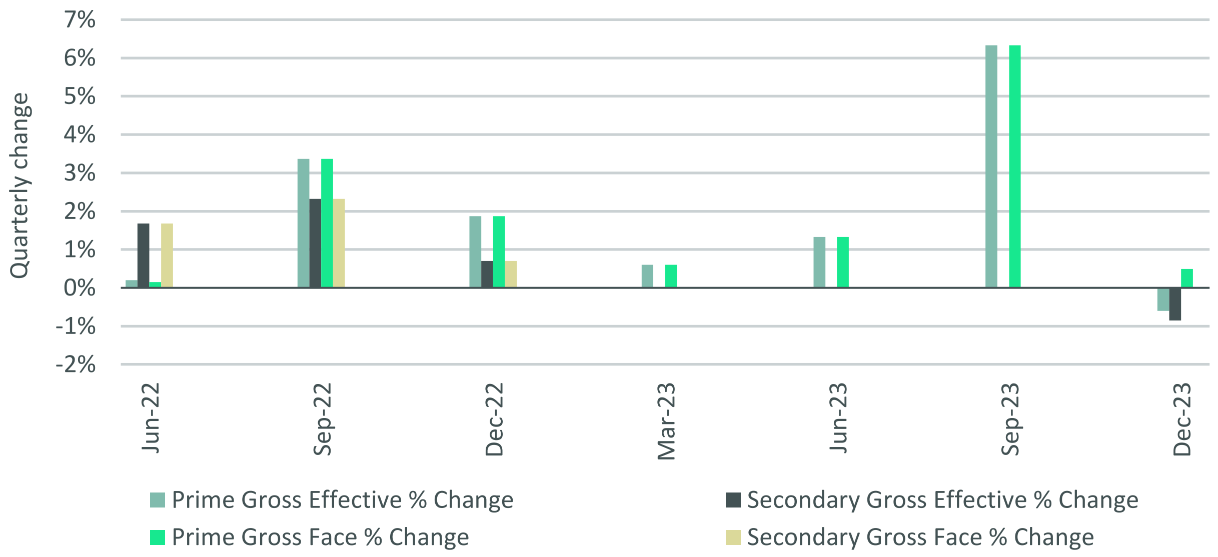
CBD Office Rents

During Q4, rents in the office market took a mixed bag of directions across submarkets compared to the previous period. Each submarket was subject to different factors that affected their respective rental behaviour.

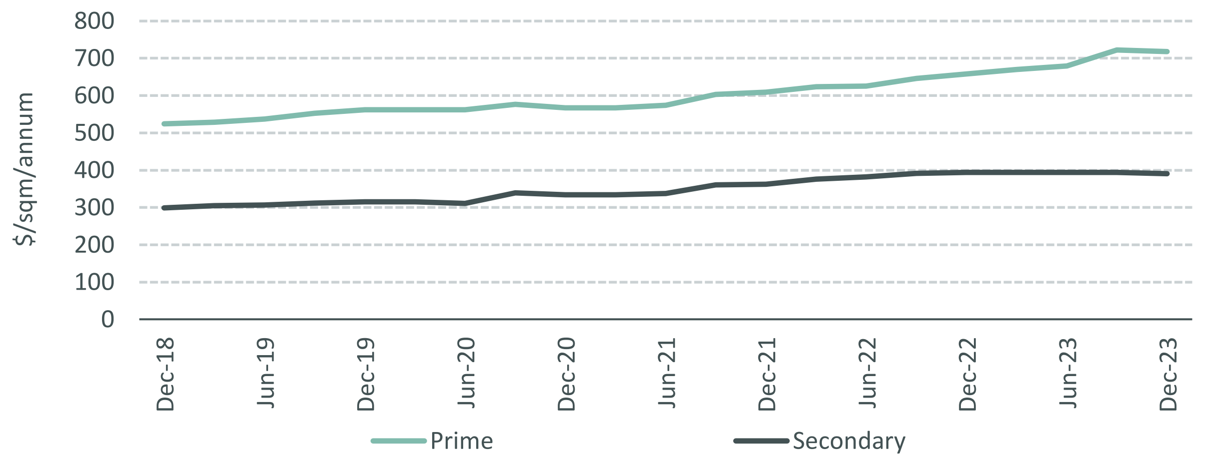
The Premium office submarket was the only one that showed some rental growth during Q4, albeit modest. Overall, this submarket still benefited from the positive momentum of rental growth in the last 12 months (10.7% year-on-year growth), a low vacancy level and a flight-to-quality trend that continues to permeate the Wellington office market. At the other end of the spectrum, low-quality assets in the office market witnessed no rental growth during Q4, mainly because it continued to be infected by low demand and backfill vacancy.

Moreover, some submarkets were impacted by an increase in incentives, which translated into a decline in effective rents and unchanged face rents. Based on CBRE's assessment, indicative market incentives in Q4 increased in the office Grade A submarket (shifting from 4.2% in Q3 to 5.6% of face rents) and in the office Grade B submarket (from 7.2% to 8.3% of face rents), triggered mainly by higher competition between landlords. This caused gross effective rents in Grade A and Grade B submarkets to decrease in Q4 by 2.2% and 1.7%, respectively.

Wellington Office Rents – Quarterly Change



Wellington Gross Effective Office Rents



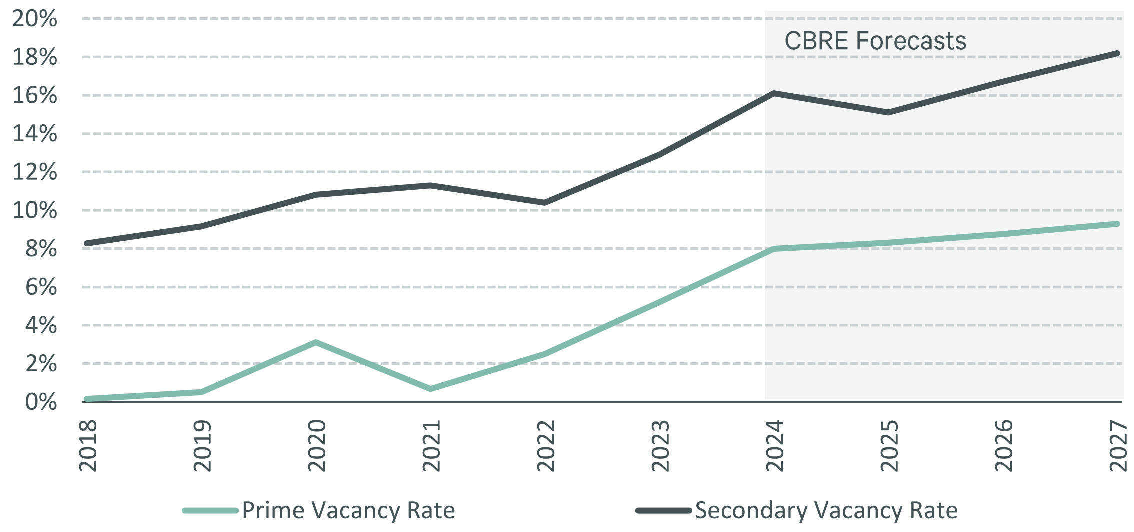
CBD Office Market Outlook

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.

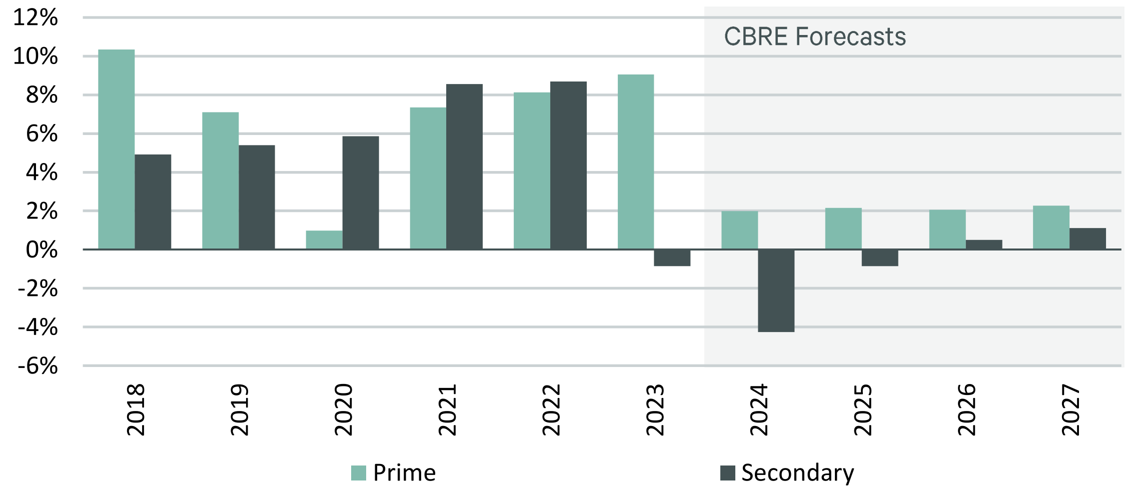
In 2024, five buildings are expected to return to the market after undergoing refurbishment works, supplying the market with circa 30,000 sqm of Grade A and around 11,000 sqm of Grade B. They include 54 Cambridge Terrace (4,980 sqm), 80 The Terrace (10,583 sqm), 126 Lambton Quay (6,120 sqm), Bowen House (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 expect modest increases in Prime gross effective rents given the relatively strong demand profile from upgrading occupiers, 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

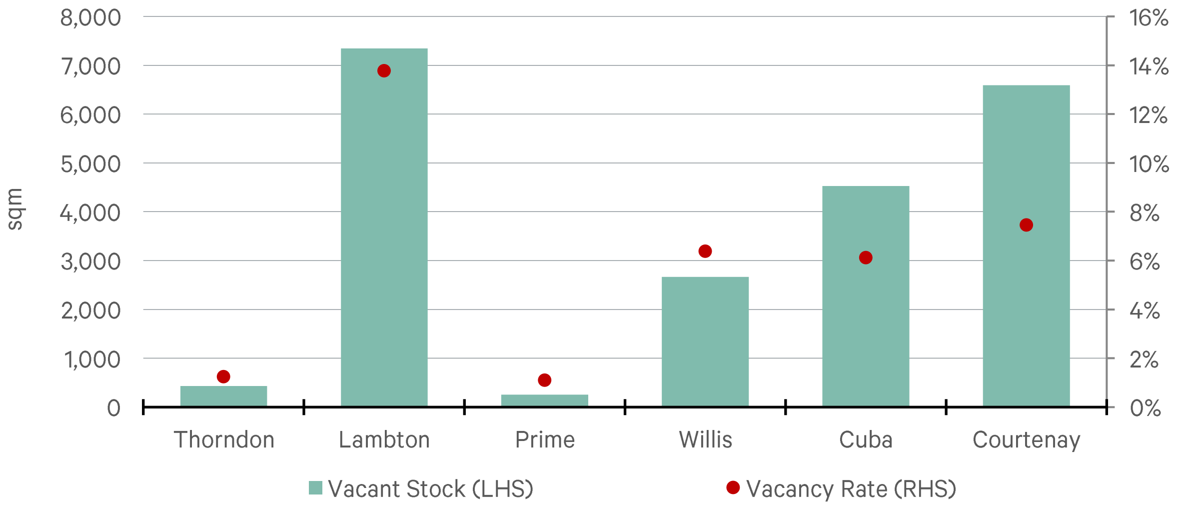


Retail Vacancy

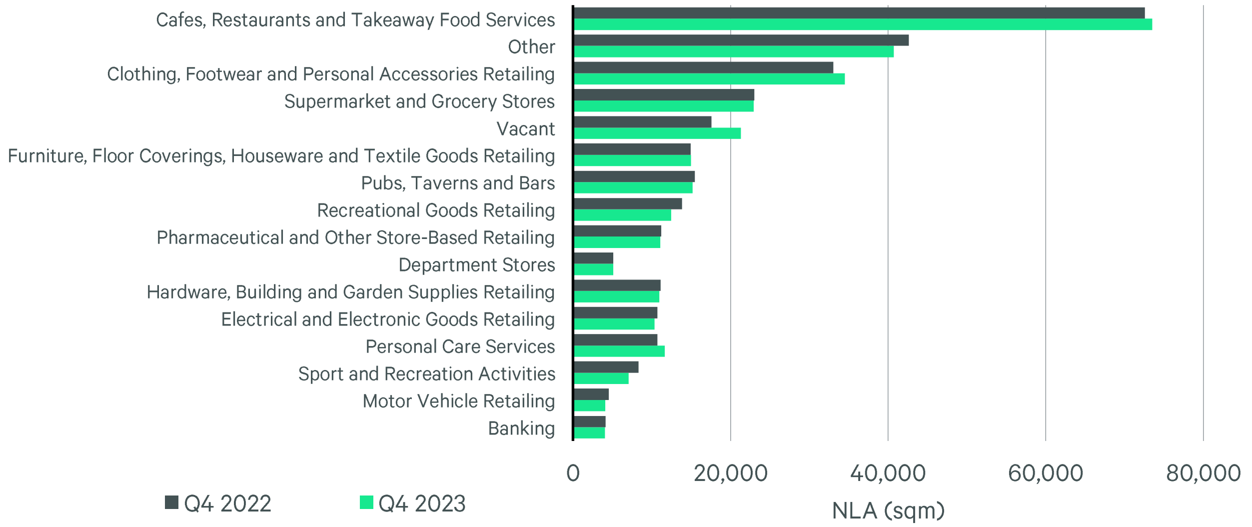
In 2023, the Wellington CBD retail submarket was exposed to higher vacancy levels. The vacancy rate increased from 5.7% to 6.9% compared to December 2022. This was mainly due to a considerable jump in vacancy in Courtenay, which witnessed its vacancy rate increase from 3.3% to 7.5%. The vacant retail 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



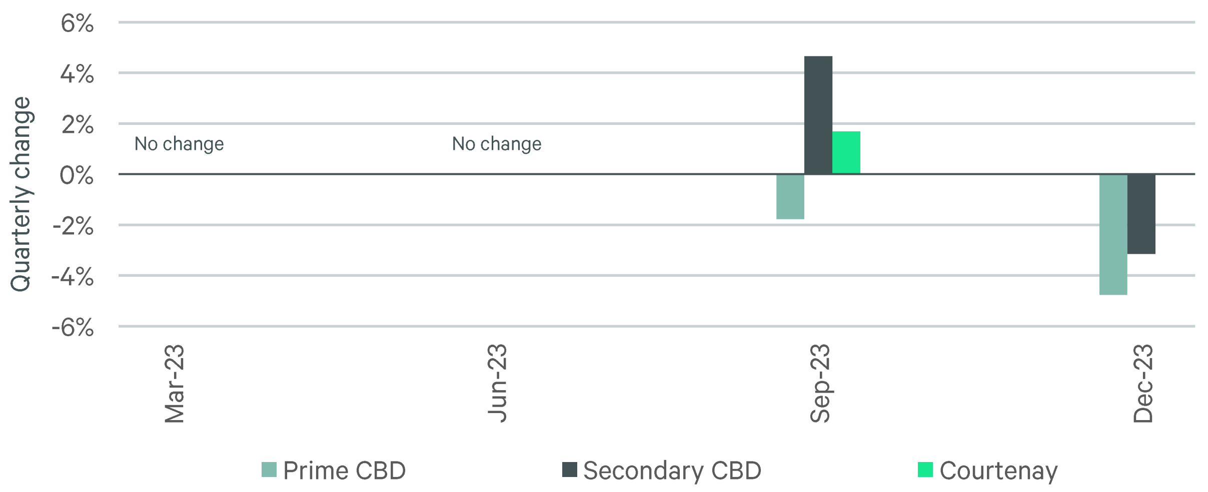
Retail Rents

Demand for retail space on Prime CBD locations in Lambton Quay remained active during Q4, although leasing deals can take a while to crystallise. Secondary CBD locations around Cuba Street and Manners Street are also benefitting from positive demand for retail space, in addition to high foot traffic and low vacancy.

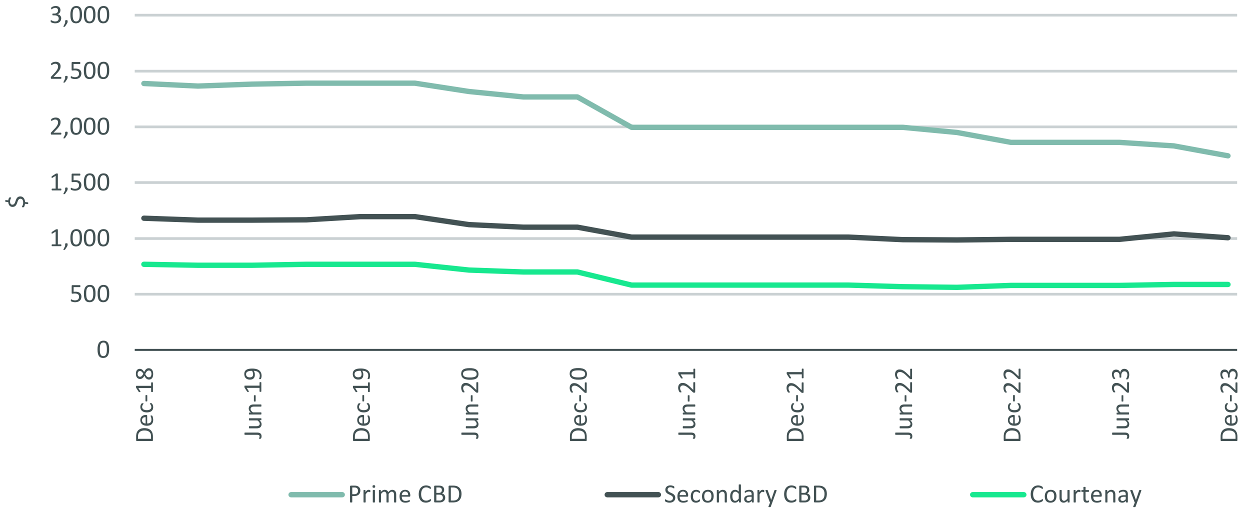
Despite this, Prime and Secondary CBD retail submarkets endured a rise in incentives (from 8.3% to 11.1% and 9.7% to 11.1% of face rents respectively), due to motivated landlords trying to convert enquiries into leases. This caused gross effective rents to decrease by 4.1% in Prime CBD retail locations and by 2.8% in Secondary CBD ones.

We kept rents stable during Q4 in retail locations experiencing lower retailer demand, with little leasing activity to provide a pointer towards rental trends although, given the broader trends, rental pressures are likely to be down. Courtenay continued to be exposed to negative externalities stemming from business closures.

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.

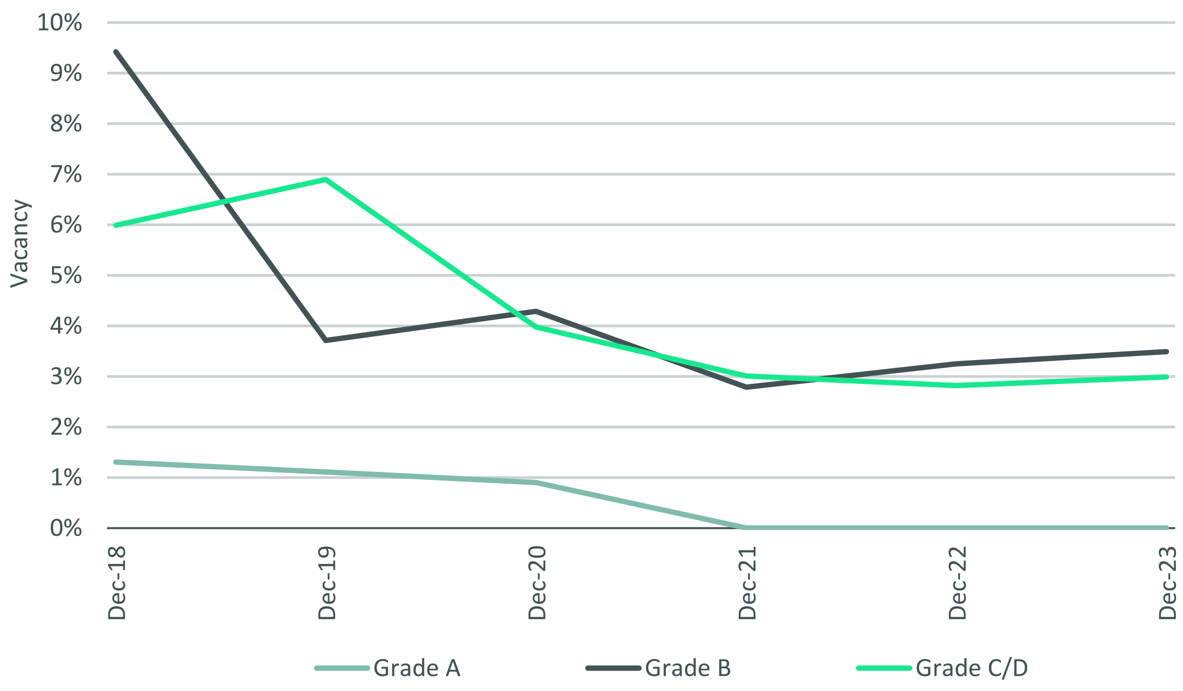
Around 20,150 sqm of new stock hit the market during 2023. In terms of stock withdrawals, some buildings were torn down in Melling on Marsden Street and Pharazyn Street (totalling 5,175 sqm) as part of the Riverlink project, which requires the demolition of several industrial buildings along the Hutt 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



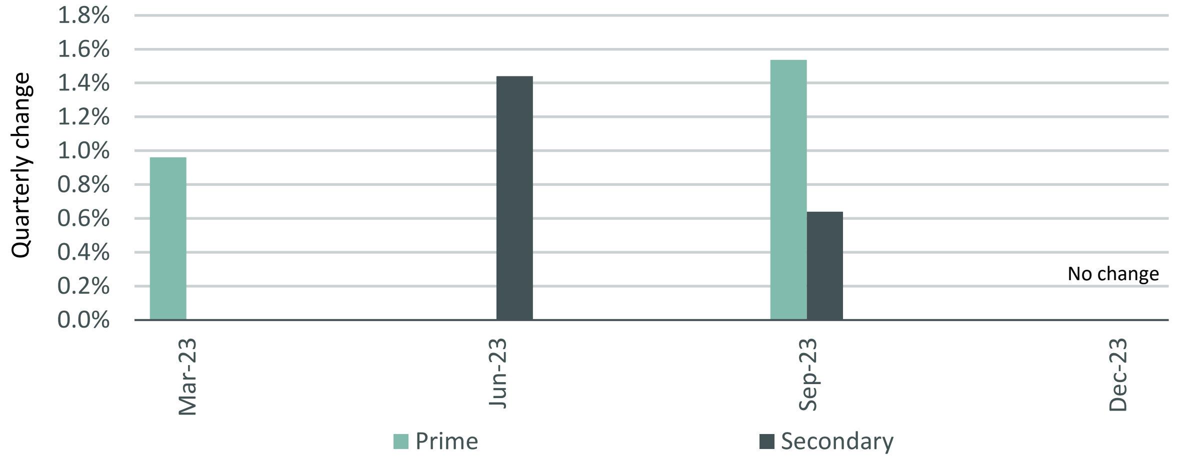
Industrial Rents

Contrary to Q3, industrial market rents did not register any growth during Q4. Even though the Wellington industrial market continued to be characterised by high demand for high-quality stock and low vacancy, no meaningful assets were leased during Q4 to suggest an uplift in rents.

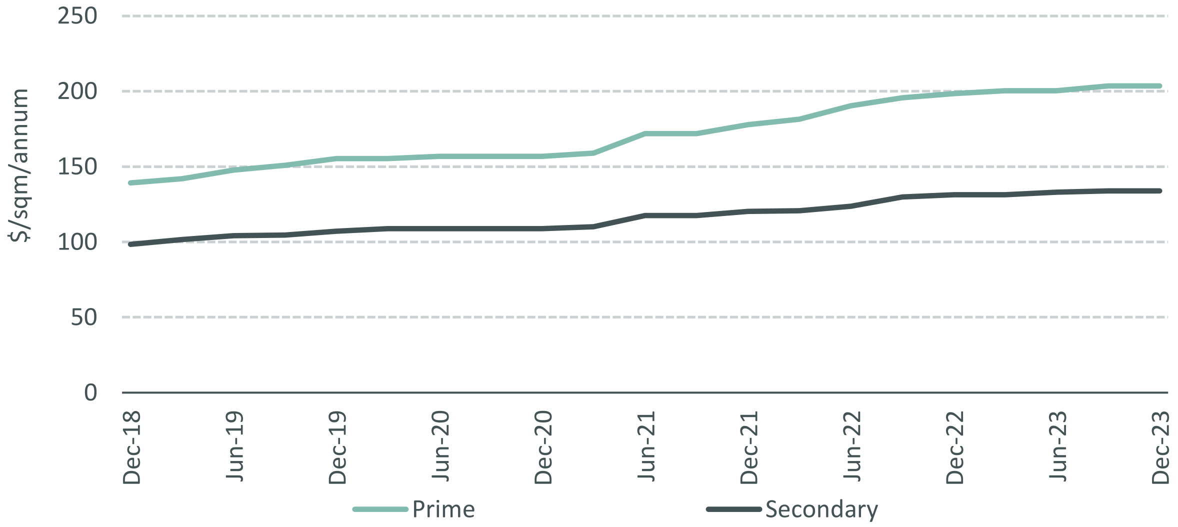
Industrial Prime gross effective rents remain at $203 per sqm, up by 2.5% compared to Q4 of the previous year. Industrial Secondary gross effective rents continued to sit at $134 per sqm, up by 2.1% compared to Q4 2022.

Based on CBRE's assessment, indicative market incentives remained unchanged in Q4 2023. Incentives in the Wellington Industrial market stable 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

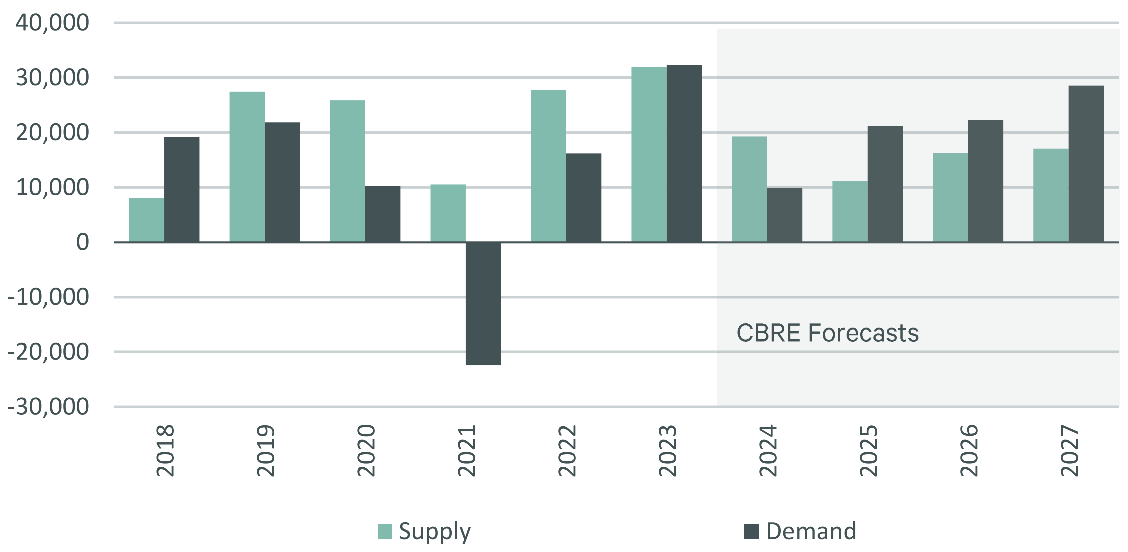


Industrial Market Outlook

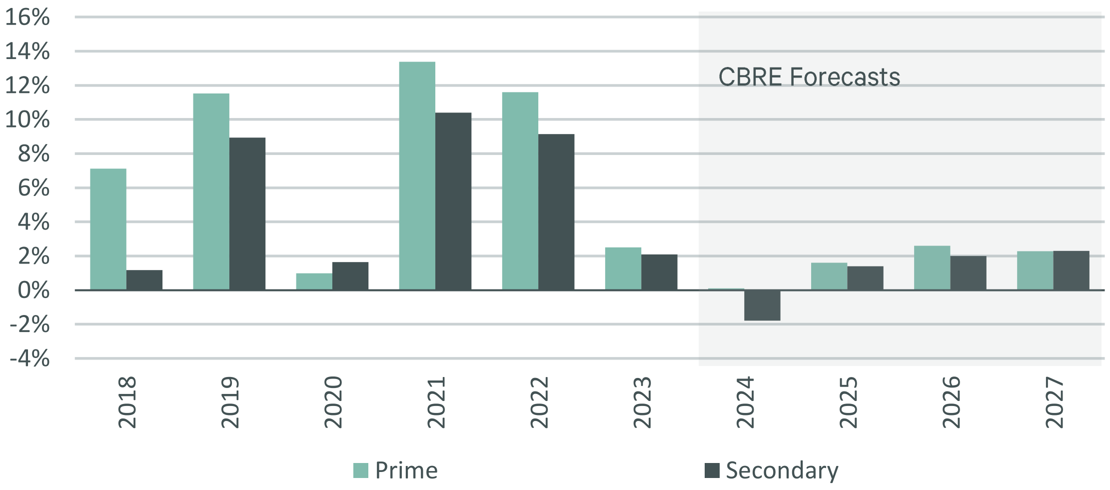
With the passing of the small unit development driven upswing in supply, the pipeline falls away materially in 2024 and beyond although the biggest project due for completion in 2024 remains a small unit development comprising 11,000 sqm across 87 units, called The Works Elsdon in Porirua. With the more 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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