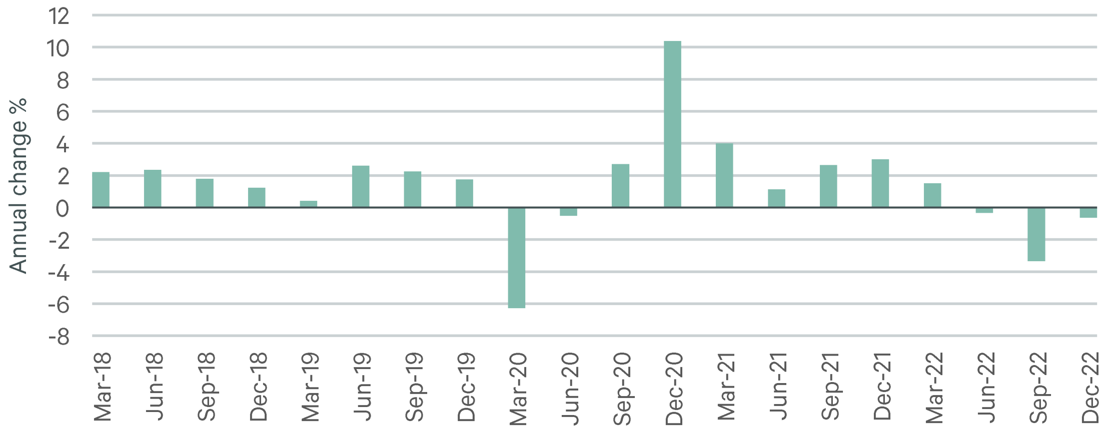
Auckland Property Market Overview

INSIGHTS

- Net office absorption was robust in the second half of 2022, and total CBD office vacancy decreased from 15.6% in June last year to 14.0% at the end of December. Non-CBD office vacancy also decreased, sitting at 7.5% at the end of 2022.
- The total industrial vacancy rate reduced to 0.1% at the end of 2022. In the entire market of 13.6 million sqm, only 7,623 sqm of Secondary space was vacant although, in the under-construction pipeline of circa 384,000sqm, 78,000 sqm does not have occupier commitment and remains available for lease.
- Rents in major regional centres, LFR, Grade A Non CBD office, and Premium grade CBD office are posting good growth rates. Secondary rents are under general downward pressure except in industrial where both Secondary and Prime rents show exceptional growth.
- Higher interest rates had a material impact on our assessments of indicative yields in the past two quarters, although the lack of transactional activity means that we relied heavily on CBRE's market interactions and available bidding statistics rather than sales evidence, and aim to find the middle ground between the diverging expectations of vendors and purchasers. The result saw yields increase by 60-120 bps over 2022.

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



Source: CBRE

Market Indicators

Market Sector	Stock (sqm)	Vacancy (%)	Net Face Rent ($/sqm)	Incentives (%)	Yield (%)
Prime CBD Office	766,710	10.3	400 - 800	8 - 21	4.75 – 8.00
Secondary CBD Office	702,013	18.0	255 - 500	12 - 25	6.25 - 9.25
Prime Industrial	6,118,003	0.0	160 - 200	1 - 4	4.75 - 5.75
Secondary Industrial	7,509,065	0.1	105 - 170	1 - 4	5.25 – 6.75
Prime CBD Retail			1,650 - 5,000	2- 6	5.25 - 6.25
Major Regional	301,473		1,300 - 1,800	4 - 6	6.25 - 6.75
LFR Centre	484,571		240 - 390	4 - 6	6.00 - 6.75

Source: CBRE

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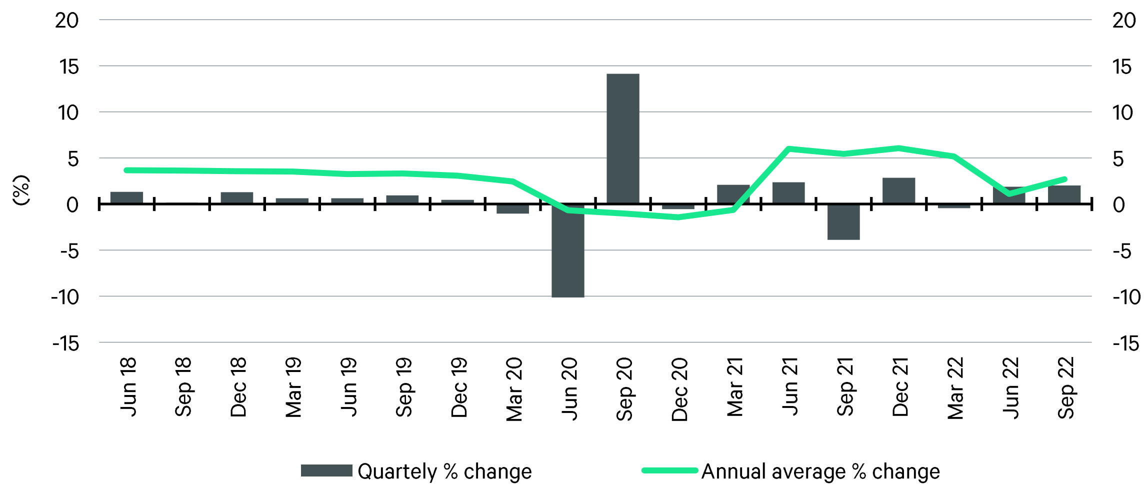
Economy

Despite headwinds, the economy has been resilient in recent quarters. Pending the Q4 data release, in Q3 2022 the New Zealand economy expanded by 2.0% compared to the previous quarter. This followed a 1.9% quarter-on-quarter increase of GDP during Q2 2022, rebounding from a contraction in the previous quarter. In terms of GDP growth by macro industry group, both the goods-producing and service industries registered a quarter-on-quarter increase during Q3 2022 (2.4% and 2.0%, respectively). The industry that contributed the most to growth was transport, which benefited from the borders opening to all visitors.

Inflation stabilised in the second half of 2022 but remains a risk. During Q4 2022, annual inflation remained at 7.2%, the same as during Q3 and close to the Q2 figure (7.3%), which was the highest in a 32-year period. Domestically generated non-tradeable inflation is an important measure because this is the inflation component that the RBNZ can directly influence through monetary policy. Importantly, this inflationary measure was unchanged in Q4 at 6.6%, and below the RBNZ's 7.0% expectation.

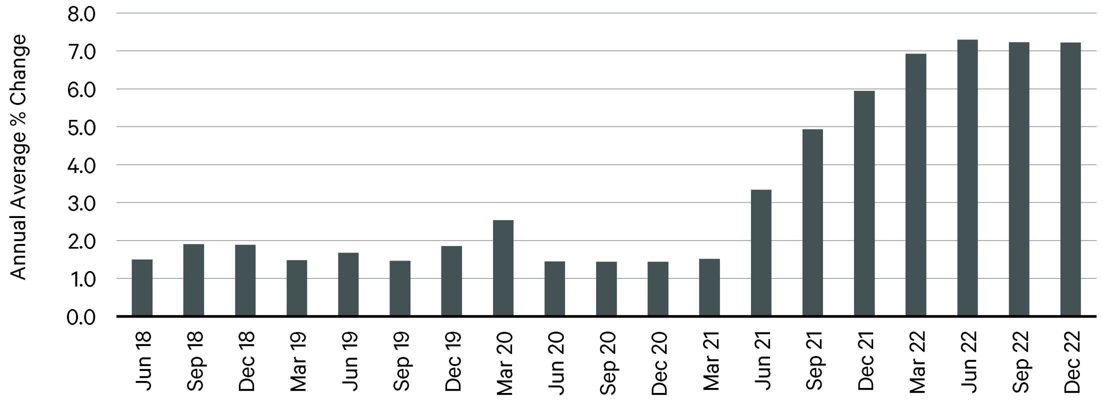
The market has been expecting that CPI will be back within the 3% target ceiling by H2 2024 but a wide range of opinion remains on how quickly inflation will fall in the next few quarters, especially given the rebuild implications of the recent weather events. This uncertainty has imbued a cautious attitude from both the RBNZ and the market, with forecasts showing the OCR increasing by another 50-75 bps to 5.25-5.50% and remaining at this level through 2023. 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, reflecting the prevailing cautious attitude, the rate of decline in 2023 is likely to be modest.

New Zealand GDP Growth



Source: : Statistics New Zealand

Consumer Price Index



Source: Statistics New Zealand

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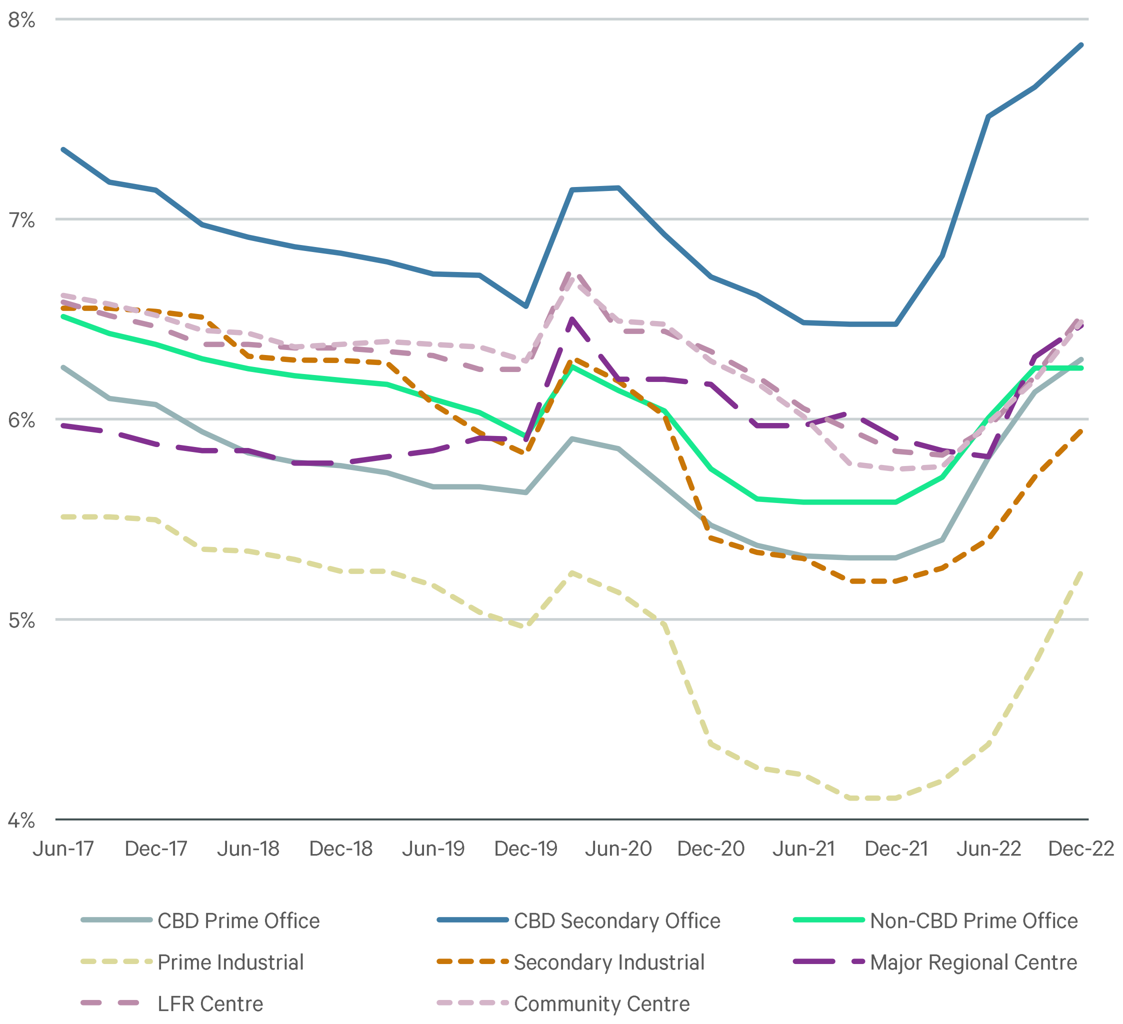
Investment Market

The cumulative hikes in the OCR (275 basis points since mid 2022) have had a material impact on commercial real estate markets and an influence on CBRE's indicative yield assessments for the December 2022 Quarter. The lack of concluded transactions means that the datapoints for the yield index have been set by other observable measures such CBRE's market interactions and available bidding statistics as well as overlaying historic yield spread measures against current borrowing costs.

Debt cost and availability are the two key influences on buy side demand with this pushing the pendulum in favour of those with existing headroom in debt facilities. In the current environment, investors are tending toward value add opportunities, which can still offer a positive carry. Overall, we expect sales volumes to increase through 2023 as some owners feel the impact of increasing debt costs and well capitalised buyers position to buy at lower price points.

While return requirements and the risks around realising these differ from sector to sector, we are still seeing upward yield pressure on all sectors. This reinforces, of all influences, the dominant impact interest rates have on pricing. The industrial sector remained the most favourably viewed asset class, but our assessment shows above average easing in Prime industrial yields (+46 bps) in the last three months of 2022. This is likely because Prime industrial yields were the lowest of all sectors in late 2021 and therefore developed the largest negative carry when interest rates unravelled.

Auckland Indicative Yields by Sector



Source: CBRE

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CBD Office Vacancy

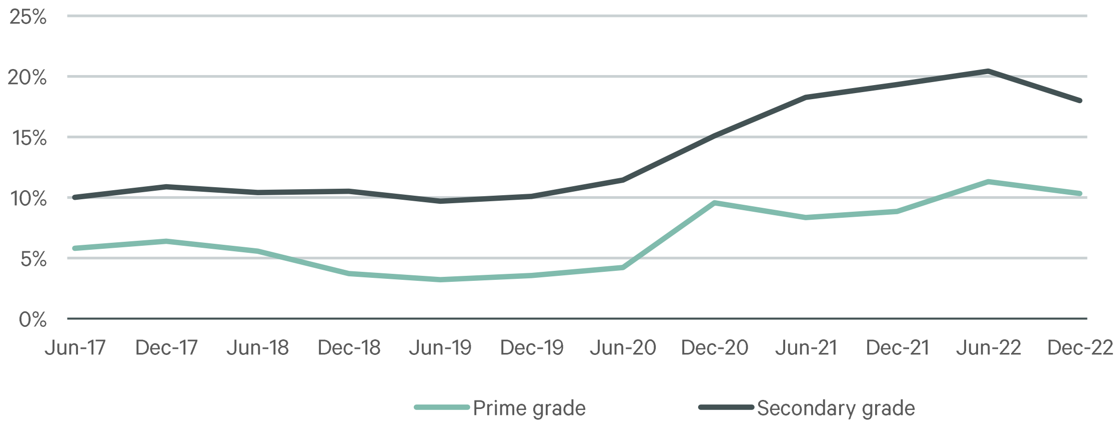
Net CBD office absorption in the second half of 2022 was strongly positive at over 17,500sqm, supported by very healthy demand for Prime quality space options on the one hand, and only a modest loss in Secondary grade absorption on the other. In fact, 6-monthly total net absorption in the Auckland CBD office market hasn't been this strong since the second half of 2015.

In Premium grade, the strongly positive net absorption is the combined result of continued occupier quality upgrades (e.g. Fusion 5, Anthony Harper), expansions (e.g. Precinct Properties, Forsyth Barr) and demand by occupiers that are either new in the market or come from unmonitored stock (e.g. Zim Shipping, FIFA). Grade A net absorption was also positive in the second half of 2022, following a sizeable loss in the first half of the year. The modest loss in Secondary grade net absorption is the result of a weak but positive absorption growth in Grade B and additional occupancy losses in Grade C.

Given the positive absorption, total CBD office vacancy decreased in the second half of 2022, moving from 15.6% in June last year to 14.0% at the end of December.

Premium grade vacancy dropped sharply in the six months to December 2022, from 8.4% to 3.7% and is expected to further decrease on the back of strong occupier preference for high quality space options. In Grade A, despite the positive absorption, vacancy remained essentially stable, influenced by over 7,000sqm of available space having been added to stock with the completion of 131 Queen St. In Secondary grade, the decrease in vacancy is more the consequence of withdrawn vacant stock, although buildings with recent improvements and in the right location seem to attract reasonable occupier demand.

Auckland CBD Office Vacancy



Source: CBRE

Auckland CBD Office Vacancy Change by Grade

		PREMIUM	GRADE A	GRADE B	GRADE C	GRADE D	TOTAL
Vacancy at December 2022	%	3.7%	12.4%	13.7%	18.3%	31.2%	14.0%
	sqm	6,807	72,329	38,164	62,433	25,841	205,574
Vacancy at June 2022	%	8.4%	12.2%	16.6%	20.5%	31.2%	15.6%
	sqm	15,249	72,457	44,145	72,343	25,831	230,025

Source: CBRE

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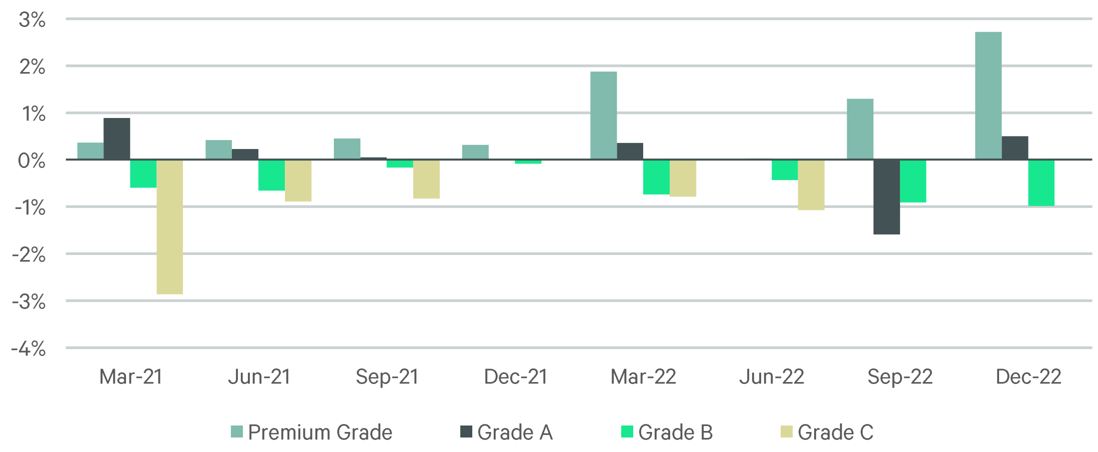
CBD Office Rents

We recorded strong net effective rental growth in the Premium quality segment, supported by continued healthy demand and quickly reducing vacancy. While rental growth was also reasonable in Grade A, it was less widespread, with only 4 of the 18 Grade A buildings in our representative basket experiencing an increase in Q4.

Growth in the last couple of quarters has been the result of mainly face rent increases. Incentive levels have been more stable, albeit the range is wide at 8% to 21% of face rents across the Prime market. This reflects lessor circumstances and motivations that continue to weigh heavily on rental performance at the individual asset level.

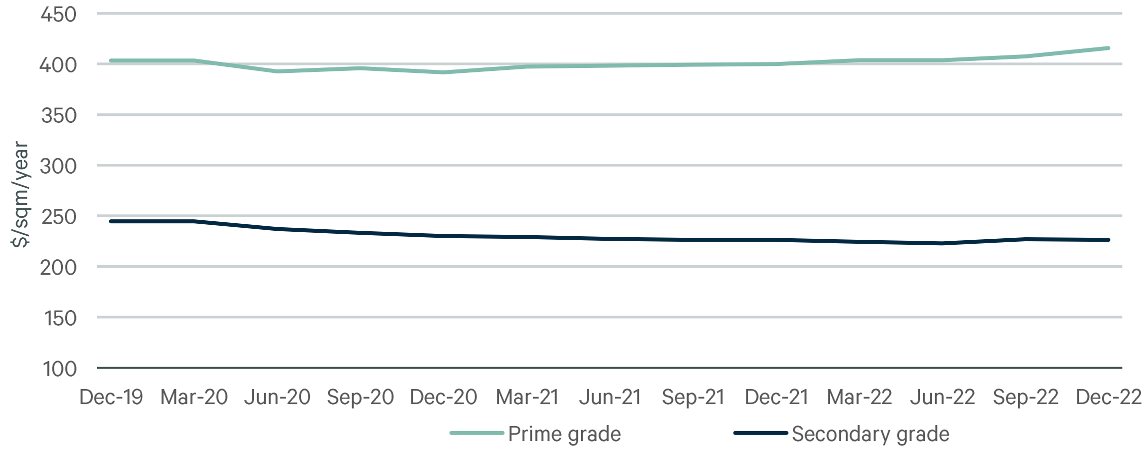
The Secondary grade rental correction is continuing, with indicative B grade net effective rents showing softening in each of our recent quarterly assessments.

Auckland CBD Net Effective Office Rents by Grade – Quarterly Change



Source: CBRE

Auckland CBD Net Effective Office Rents



Source: CBRE

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CBD Office Market Outlook

Vacancy

Our base scenario forecast shows a pipeline of 122,000sqm of new and refurbished space to 2026, while the expected withdrawals amount to about 62,000sqm, resulting in a net CBD office supply pipeline of about 60,000sqm between 2023 and 2026. Occupier demand trends are forecast to continue favouring high quality space options, resulting in Prime vacancy being kept in check with annual fluctuations reflecting the timing of new supply and any impact these may have on backfill vacancies and/or non committed space needing to be leased.

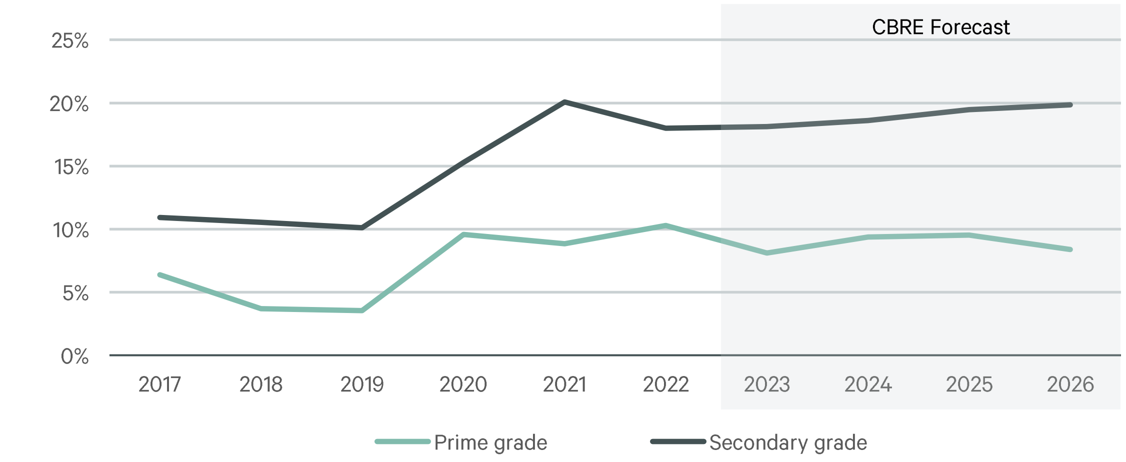
Building withdrawals and take-up of refurbished buildings underpins the forecast short-term improvement in Secondary vacancies, but flight to quality will be putting ongoing vacancy pressure on lower quality buildings over the next few years.

Rents

The Prime grade rental trends reflect quite a polarisation between top end Premium and Grade A stock. Continuing trends established in the past year, Premium grade rent growth is forecast to average 2.3% per annum to 2026 compared to 1.4% for Grade A.

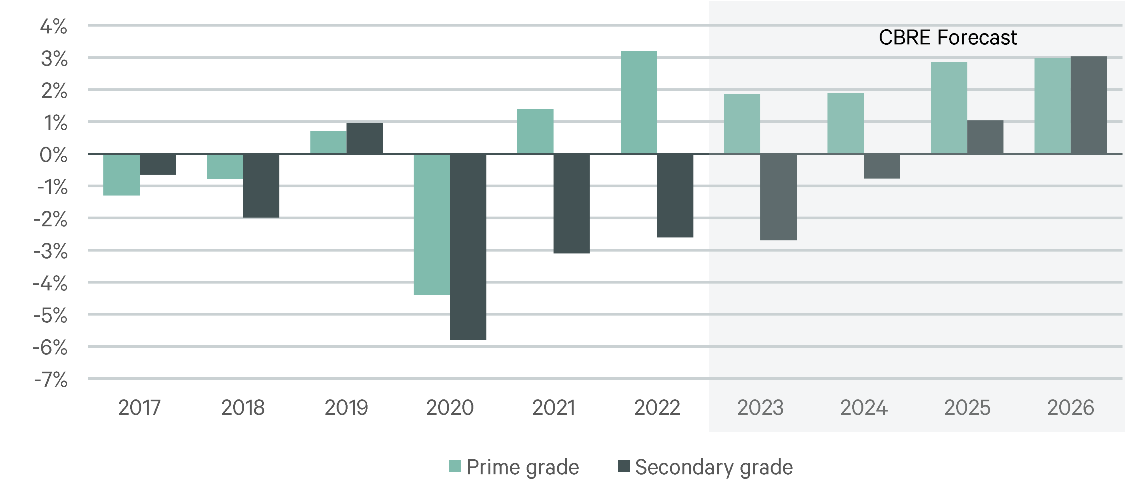
In Secondary grade, downward rental corrections are likely to continue this year. Previous cycles showed Secondary office market rents to be more responsive to GDP growth than vacancy relative to Prime rents. Reflecting this relationship, as economic growth bounces back from H2 2024 onwards, we expect a more favourable Secondary grade rental response despite elevated vacancies.

CBD Office Actual and Forecast Vacancy



Source: CBRE

CBD Office Actual and Forecast Annual Net Effective Rental Change



Source: CBRE

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Non-CBD Office Vacancy

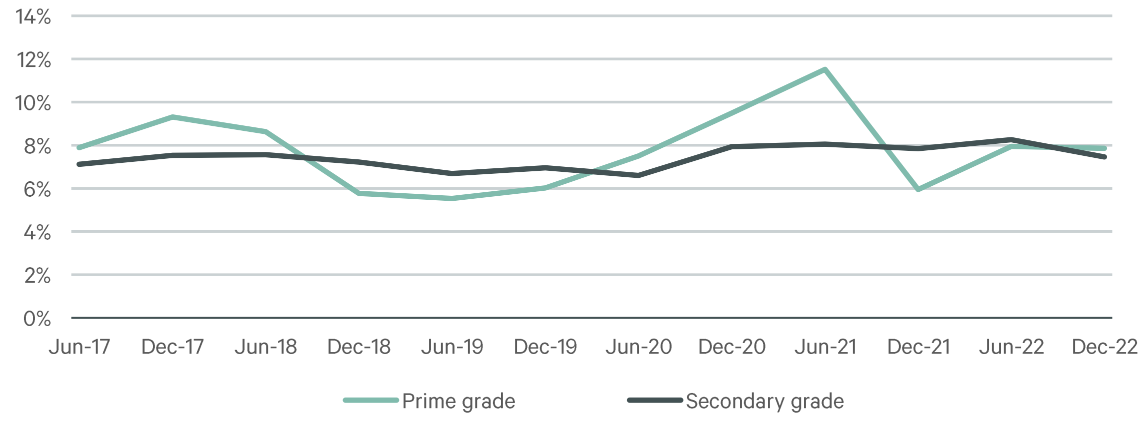
Non-CBD office vacancy decreased in the second half of 2022, with the most noticeable drop being recorded in Grade B (to some extent influenced by building regradings), while Grade A experienced a modest decrease and Grade C/D remained essentially stable.

New supply in the non-CBD office market in the second half of 2022 included the completed expansion of the office component at Ponsonby Central and the third stage of a multi-building development on Universal Drive in Henderson. Additionally, the full refurbishment of 1-7 The Strand in Takapuna has also been completed.

Following an almost 8,000sqm loss in net absorption in the first half of 2022, the latter half of last year was much more positive, with more than 15,000sqm net absorption gain recorded between July and December.

Major moves in Grade A contributing to the overall gain include the tenants in 1-7 The Strand in Takapuna and Serato Audio, who moved to the Ponsonby Central office component from 80 Grey Ave in the CBD. Net absorption in the Grade B quality segment has also improved in the second half of 2022, influenced by healthy demand for the new stock.

Auckland Non-CBD Office Vacancy Change by Grade



Source: CBRE

Auckland Non-CBD Office Vacancy

		GRADE A	GRADE B	GRADE C	GRADE D	TOTAL
Vacancy at December 2022	%	7.9%	7.9%	7.2%	7.2%	7.5%
	sqm	24,627	44,068	48,935	12,383	130,012
Vacancy at June 2022	%	8.0%	9.7%	7.2%	7.6%	8.2%
	sqm	23,410	55,636	49,035	13,266	141,346

Source: CBRE

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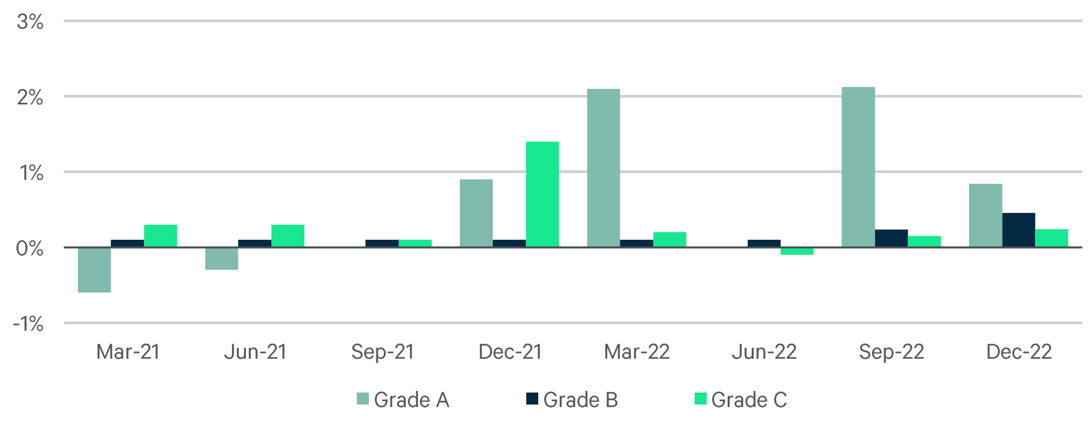
Non-CBD Office Rents

Suburban office rents have been outperforming their CBD equivalents over the past year as they have benefitted from generally more favourable occupancy dynamics.

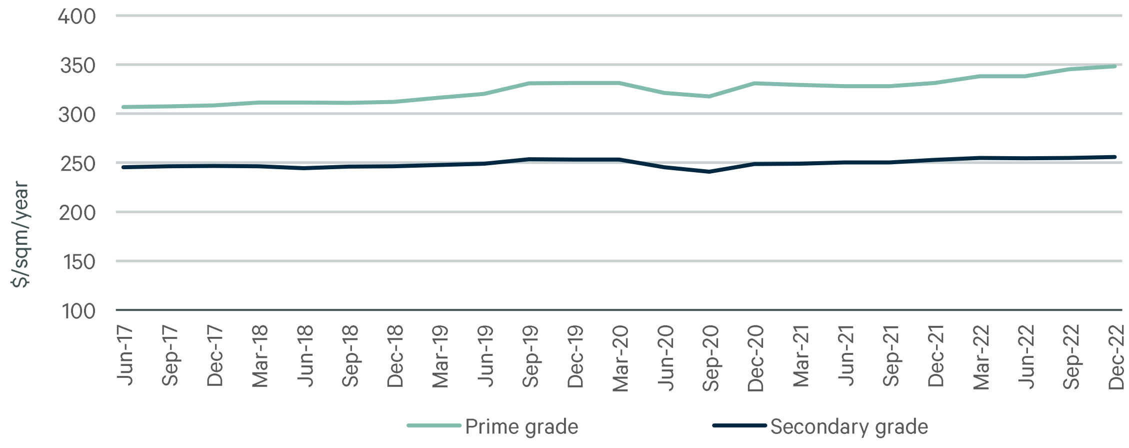
As in Premium grade in the CBD, strong demand for high quality Non CBD office space resulted in a 5+% annual increase in non-CBD Grade A net effective office rents in 2022. While growth is focused on Prime stock, non-CBD Secondary rents are also experiencing some increases. This continues the pattern established in 2021 in suburbs with favourable occupancy and demand profiles, such Manukau, where the best quality offices are Grade B, and occupier interest continues to result in low but incremental rent increases.

Auckland Non-CBD Net Effective Office Rents by Grade – Quarterly Change



Source: CBRE

Auckland non-CBD Net Effective Office Rents



Shift in value from September to December 2020 is driven by extensive quality regrading in our basket of non-CBD buildings.

Source: CBRE

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Non-CBD Office Market Outlook

Vacancy

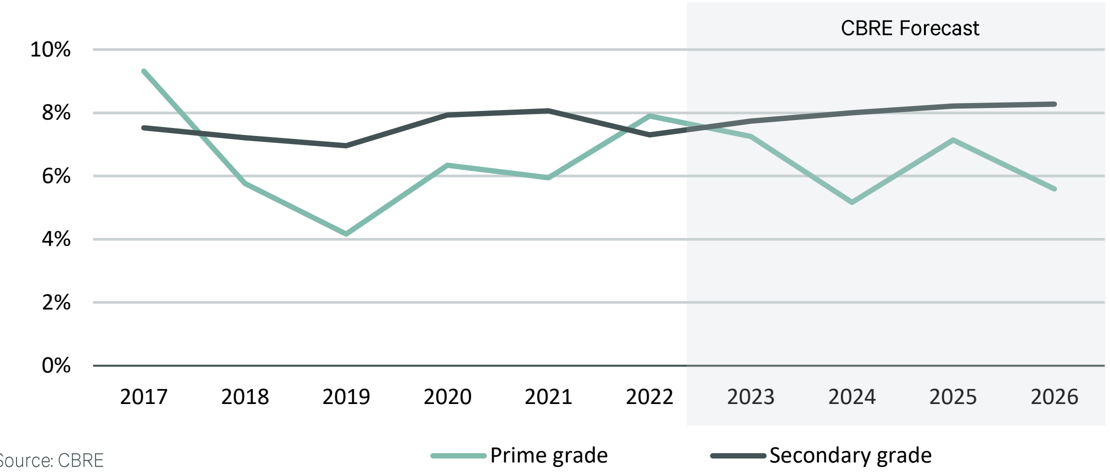
Net supply of circa 75,000 sqm is expected to 2026, although there are several mooted projects in the early feasibility stage that could boost this supply pipeline. As in the CBD, the result for Prime vacancy will be a general downward trend punctuated by occasional spikes as the vacancy impact of some of the supply and associated occupier moves is realised but with more persistently high vacancies prevailing in Secondary buildings.

Rents

We forecast continued non CBD office rent growth over the next five years but with growth rates reduced from 2022 levels. In 2023, Prime rent growth of 2.5% is forecast much of it likely to be in the first half before growth moderates later in the year and into 2024 in view of the more challenging economic backdrop.

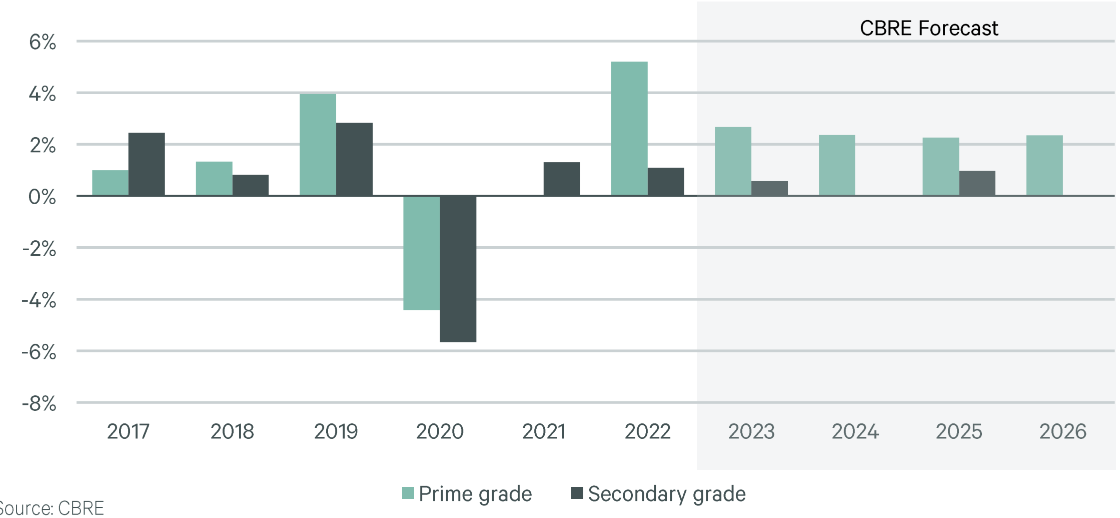
Good quality Grade B options (especially in areas where these represent the best buildings available) and high-quality refurbishments are also expected to attract healthy demand and continue to support our modestly positive rental outlook in Secondary grade.

Non-CBD Office Actual and Forecast Vacancy



Source: CBRE

Non-CBD Office Actual and Forecast Annual Net Effective Rental Change



Source: CBRE

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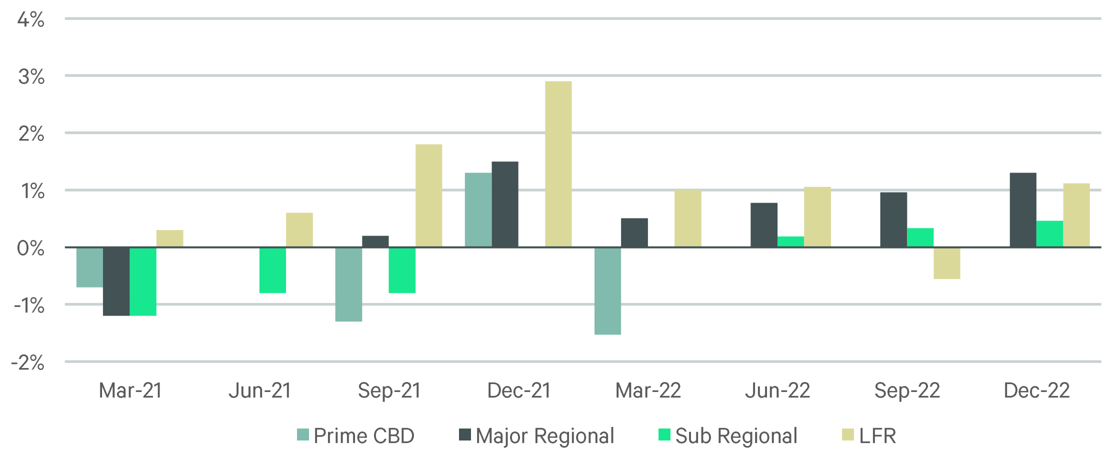
Retail Rents

Shopping centre rents are experiencing steady growth, and over the past year have been supported by a number of factors, including consumer spending boosted by the rebounding tourism sector in addition to rental mechanisms that often involve inflation adjusted increases.

While market conditions have been conducive to strip retail rental growth in some areas (CBD Prime, Newmarket), the leasing deals that we are aware of fell within our current rental ranges, albeit for shorter terms (2-3 years), with the expectation of landlords that by the end of the term, conditions will have improved, allowing a more substantial increase.

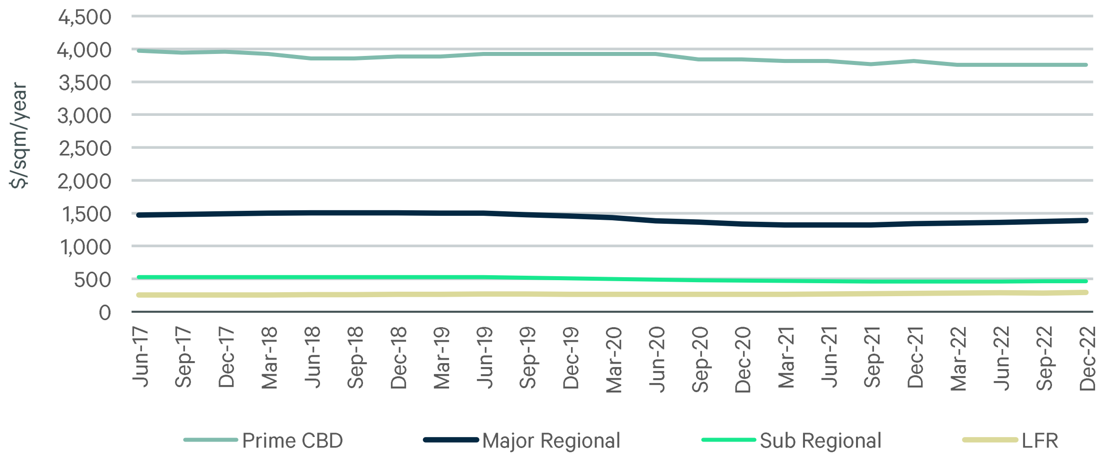
The combined impact of higher interest rates, large increases in the cost of living, and a weaker housing market points to a significant slowdown in household spending. While recent CBRE brokerage interactions with retailers indicates that many are in expansion mode and prepared to look through the spending headwinds as a temporary setback, we expect that both take up and rent growth will soften somewhat over the next 18 months.

Auckland Retail Rents – Quarterly Change



Source: CBRE

Auckland Retail Rents



Source: CBRE

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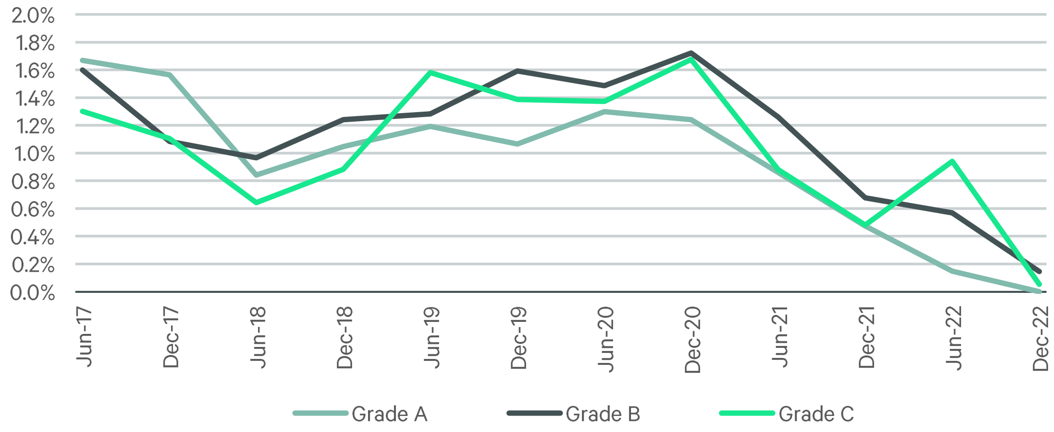
Industrial Vacancy

The total industrial vacancy rate moved from 0.5% in December 2021 to a scarcely believable 0.1% at the end of 2022. In the entire Auckland industrial market of 13.6 million sqm, only 7,623 sqm of Secondary space is vacant.

This is in the context of our definition of vacancy which refers to space that is physically vacant and is available for lease. This definition of vacancy excludes availability of some space. For instance, of the under construction industrial pipeline, which in our November 2022 New Development Monitor stood at over 384,000sqm, 78,000 sqm does not have occupier commitment and remains available for lease. Nonetheless, our survey results show that the current industrial occupier sector is about as tight as a market can get.

Following gross supply of 99,850 sqm in H1, the market rocketed ahead in the second half of 2022. New supply reached 236,257 sqm; 233,277 sqm of Prime and 2,980 sqm of Grade B. Allowing for building withdrawals, total net stock change in H2 was 195,571 sqm, the largest in the last ten years. Total industrial net absorption was just under 223,000 sqm in the six months to December 2022. While the completion of new developments was a major contributor to take up as all the new supply has been occupied without vacancies, all vacant Prime quality premises in the existing stock have also been absorbed.

Auckland Industrial Vacancy



Source: CBRE

Auckland Industrial Vacancy Change by Grade

		GRADE A	GRADE B	GRADE C/D	TOTAL
Vacancy at December 2022	%	0.0%	0.1%	0.1%	0.1%
	sqm	0	5,702	1,921	7,623
Vacancy at June 2022	%	0.1%	0.6%	0.9%	0.5%
	sqm	6,933	22,086	34,540	63,559

Source: CBRE

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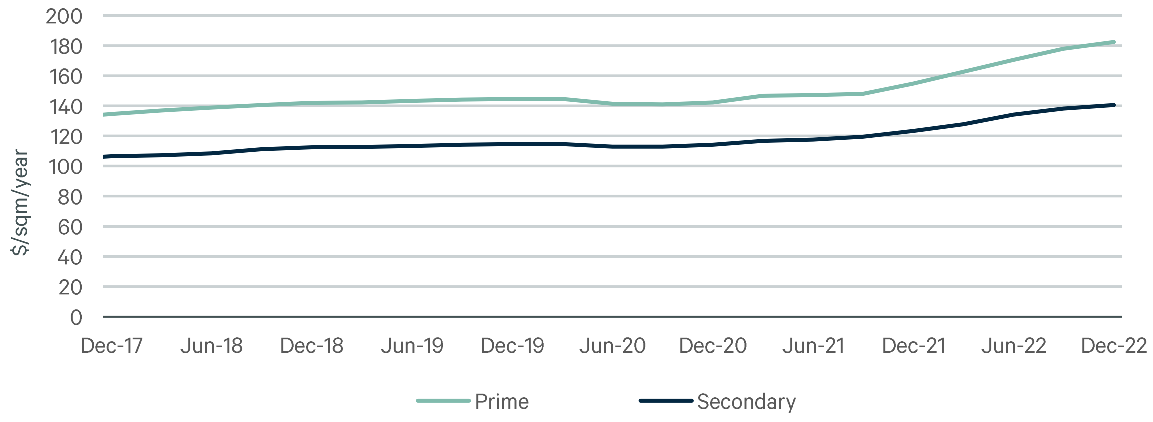
Industrial Rents

Following three consecutive quarters of steeply increasing industrial rents in 2022, growth moderated in the last quarter to 2.5% in Prime and 1.6% in Secondary grade. In addition to new warehouse benchmark rents being achieved, we have also recorded strong growth in office component rents in some industrial suburbs, where these are now approaching bone fide Prime office rents.

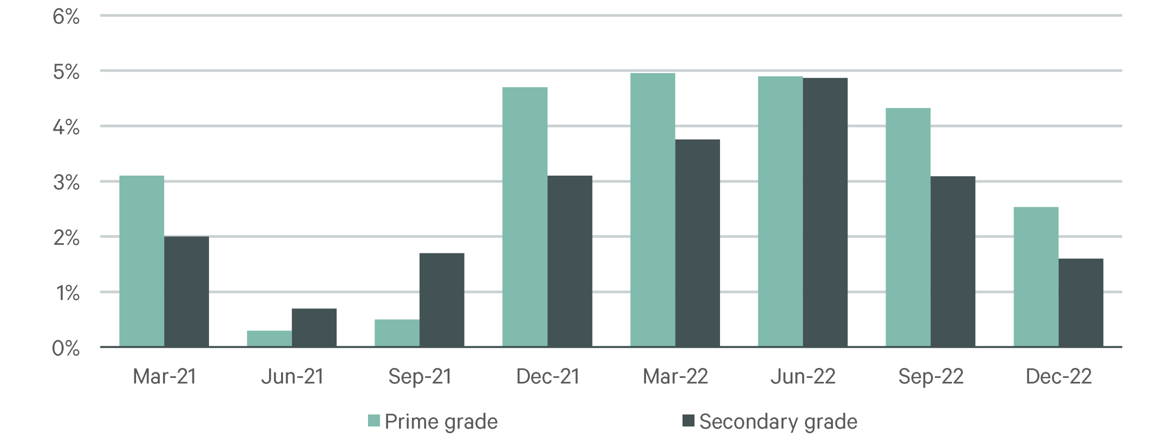
Benchmark warehouse rents for Prime buildings in highly sought-after precincts continue to escalate, reaching into the $190-$200 per sqm range in Q4 although occupier pushback to these levels is also becoming more widespread according to broker feedback.

Combined (office and warehouse) Net Effective Industrial Rents



Source: CBRE

Auckland Industrial Net Effective Rents – Quarterly Change



Source: CBRE

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Industrial Market Outlook

Vacancy

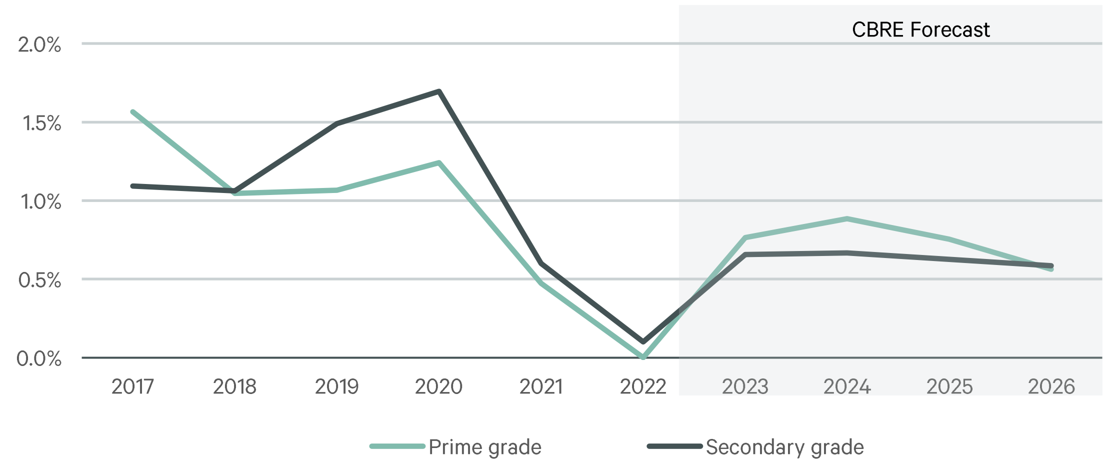
We expect Prime vacancy to show modest increases during the next two years. Our forecasts incorporate industrial demand lowering in line with the level of economic growth by 2024, and will result in a lower supply pipeline, which will help keep vacancy rates in check. We forecast that average Prime vacancy rates in the next five years at 1.1% will still be materially lower than the historical average level of 1.6%.

Rents

Rental trends continue to reflect the momentum they built up based on increasing development costs and the strong supply-demand fundamentals that became increasingly entrenched over the past 12 months. In H1 2023 strong positive momentum will be flowing through rental growth trends but from H2 2023 through to 2024 market rents are expected to be more stable.

Prime industrial is forecast to produce the strongest capital returns of the various Auckland commercial market sectors courtesy of very high short term rent growth. While this is forecast to moderate by 2024, on an aggregate basis Prime industrial market rents are expected to lift by nearly 35% over the 2022-2026 period. Secondary performance is forecast to be somewhat weaker but market rent growth of over 25% is still expected. As a result, both sectors are providing positive capital return prospects even with yields pushing out.

Auckland Industrial Actual and Forecast Vacancy



Source: CBRE

Auckland Industrial Actual and Forecast Annual Net Effective Rental Change

Source: CBRE

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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
Research
M +64 21 595 399
zoltan.moricz@cbre.co.nz

Brent McGregor
Capital markets
M +64 21 870 508
brent.mcgregor@cbre.co.nz

Bruce Catley
Industrial investments
M +64 21 729 004
bruce.catley@cbre.co.nz

Claus Brewer
Industrial sales and leasing
M +64 21 656 650
claus,brewer@cbre.co.nz

Campbell Stewart
Valuations
M +64 21 490 226
cambell.stewart@cbre.co.nz

Bridget Fowler
Occupier
M +64 21 704 677
bridget.fowler@cbre.co.nz

Andrew Stringer
Managing Director, CBRE New Zealand
M +64 21 388 834
andrew.stringer@cbre.co.nz

Deborah Dowling
Metro sales
M +64 21 2480 060
Deborah.dowling@cbre.co.nz

Campbell Pritchard
Office leasing
M +64 21 870 614
cambell.pritchard@cbre.co.nz

Michelle Padgett
Property management
M +64 21 739 039
michelle.padgett@cbre.co.nz

Natasha Sarkar
Structured Transactions & Advisory
M +64 21 940 940
natasha.sarkar@cbre.co.nz

Kirstin Cooper
Workplace
+64 21 283 1303
bridget.fowler@cbre.co.nz

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