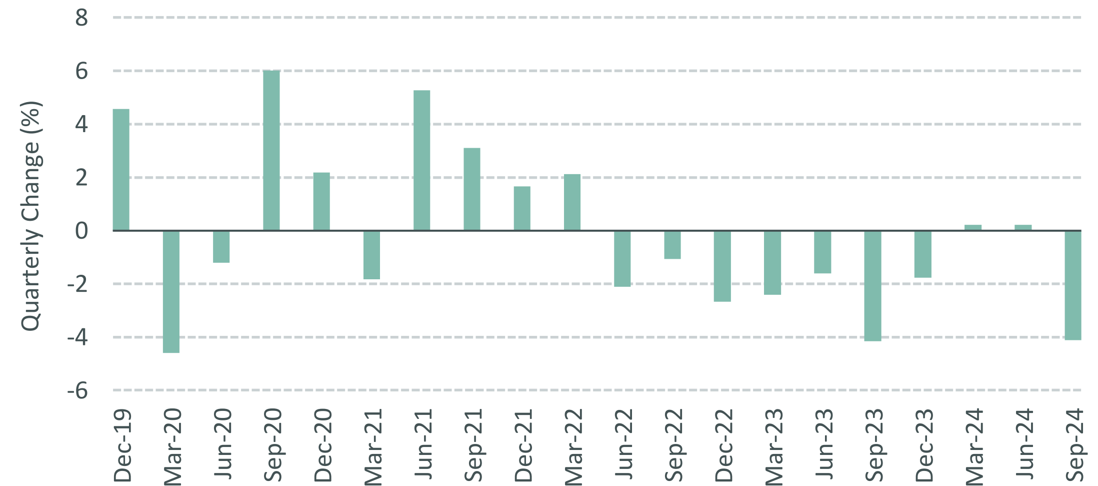
Wellington Property Market Overview

INSIGHTS

- In Q3 2024, gross effective rents in the Prime CBD office submarket increased due to higher outgoings driven by higher property rates and insurance costs. Also, this rise was not fully counterbalanced by the increase in incentives offered in some buildings.
- The Wellington industrial market continued to benefit from increasing face rents during Q3, driven by low vacancies in good-quality assets. In contrast, the retail market witnessed a decline in rents across all submarkets, due to weaker demand and challenging economic conditions.
- The market is expected to become gradually more active after the Reserve Bank of New Zealand shifted from a monetary tightening to a monetary easing policy, reducing the OCR by 75 basis points over the last two Monetary Policy Committee meetings.
- During H1 2024, office vacancy increased from 10.2% to 13.4%, mainly due to vacancies in Secondary buildings. The rise in Grade B and Grade C office vacancy resulted from a combination of tenants downsizing their office space and backfill vacancies.

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	505,923	5.8	583 – 1,075	4 – 12	6.00 – 8.25
Secondary CBD Office	894,170	17.7	220 – 720	10 – 14	7.70 - 11.45
Prime Industrial	493,798	0.0	190 – 269	1 – 2	6.00 - 7.00
Secondary Industrial	1,729,053	3.2	126 – 185	3 – 4	6.50 - 8.50
Prime CBD Retail	23,335	1.1	1,900 - 2,700	10 – 11	6.76 – 7.61
Secondary CBD Retail	169,137	8.6	800 – 1,700	10 – 11	7.00 – 8.35

* Stock and vacancy figures are as of June 2024. Gross Face Rent, Incentives and Yield Range figures are as of September 2024.

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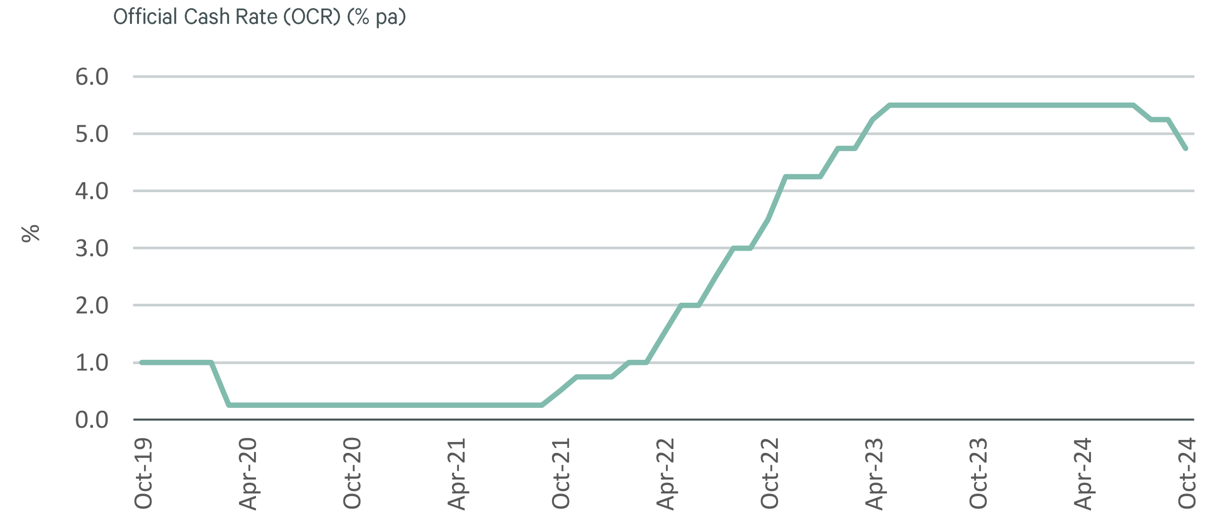
Economy

The effects of the tightening monetary policy implemented by the Reserve Bank of New Zealand from late October 2021 to August 2024 continue to be evident, especially regarding inflation. In Q3 2024, annual headline inflation decreased to 2.2%, landing within the 1-3% RBNZ target band for the first time since 2021. The previously sticky non-tradable inflation is also consistently coming down from its peak, while tradable inflation was negative for the first time since 2020, driven by lower petrol and vegetable prices.

The challenging economic conditions, compounded with decreasing inflation, have given the RBNZ enough justification to decrease the OCR at a faster rate than previously anticipated. Since mid-August, the Monetary Policy Committee has cut the OCR by 75 basis points, leaving the current OCR at 4.75%. Some economists believe that the RBNZ could be incentivized to cut the OCR by another 50 basis points in the next meeting in November, which would leave the OCR at the same level it was at in late 2022.

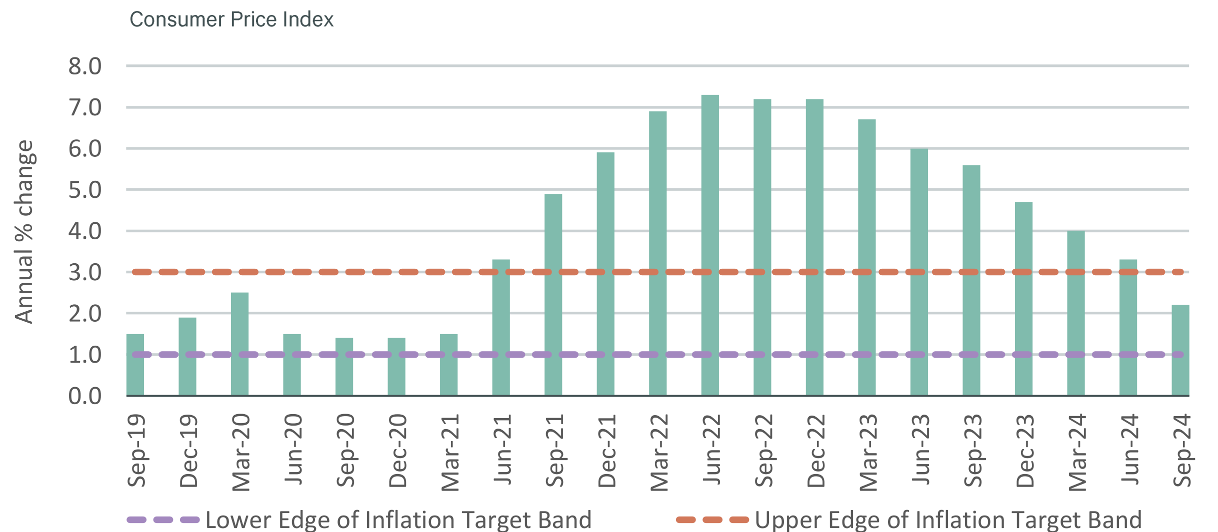
New Zealand continues to confront strong economic headwinds, with subdued economic growth and rising unemployment. Additionally, both the manufacturing and services industries remain in contracting territory. However, the lower-than-expected interest rates resulting from the RBNZ's current easing monetary policy are beginning to signal the potential for an economic recovery in the medium-term.

Official Cash Rate (OCR) (% pa)



Source: : Reserve Bank of New Zealand

Consumer Price Index



Source: : Statistics New Zealand

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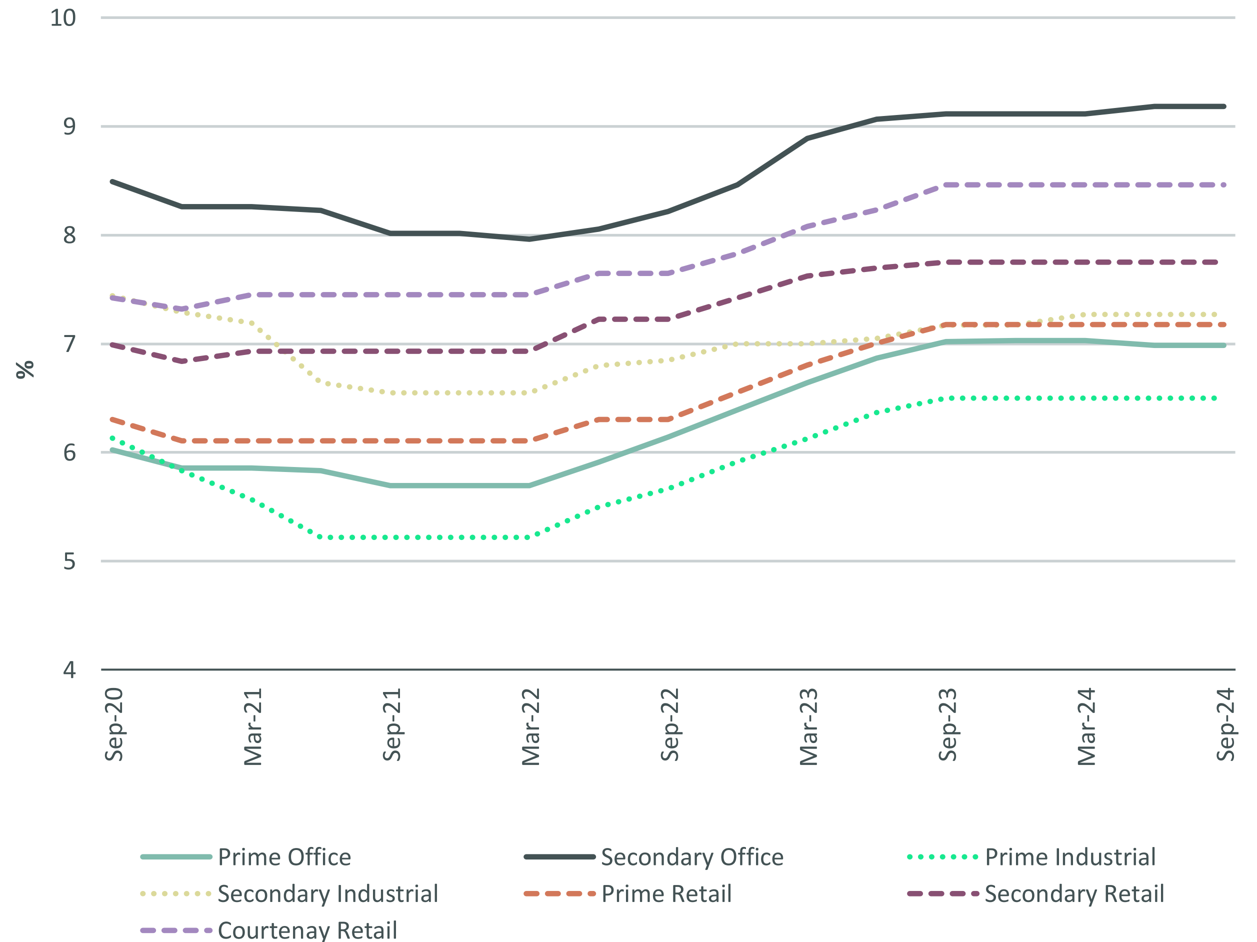
Investment market

The RBNZ's OCR cuts, compounded with sizeable declines in medium and long-term interest rates, has refocused the market to a more transactional mindset. While this change will not immediately firm property yields or produce more sales, the market has reached the peak of the yield cycle. Furthermore, the 75 bps of OCR cuts to date, along with a further anticipated 100+ bps cuts over the next 12 months or so, is alleviating debt cost pressures on investors for both existing and newly acquired debt. This positive shift is fostering increased investor activity and appetite in the market.

In this context, CBRE's evaluation for Q3 showed a general pattern of stable market yields across all sectors. In the last year, only the Grade B office and Secondary industrial submarkets experienced some yield softening, by 14 bps and 10 bps, respectively. Yields for the remaining submarkets and sectors remained stable in the past 12 months.

To enhance forecasting outcomes, we have refined our yield forecasting model through a closer analysis of cyclical turning points to predict yield movements in the next two years. CBRE's econometric analysis indicates yields responded to changes in 2-year swap rates with a delay of two quarters in the last three major market turning points. Our model indicates that recent and anticipated future interest rate decreases will result in declines in market yields for Prime commercial and industrial property by circa 30 bps during Q1 next year even in a challenging occupancy and rental environment. An important point in the context of our market yield forecasts is how the declines in market yields may flow through to actual portfolio values.



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CBD Office Vacancy

Wellington CBD office market vacancy increased from 10.2% to 13.4% during H1 2024, based on CBRE's definition of vacancy which encompasses space that is both physically vacant and is available for lease. The amount of total CBD vacant office area went up by 46,767 sqm during this period (from 141,369 sqm to 188,136 sqm), mainly due to more available space in the Grade B and Grade C submarkets of the Core CBD. Prime (Premium and Grade A) vacancy went up slightly from 5.2% to 5.8%, while Secondary (Grade B to D) vacancy saw a larger increase, from 12.9% to 17.7%.

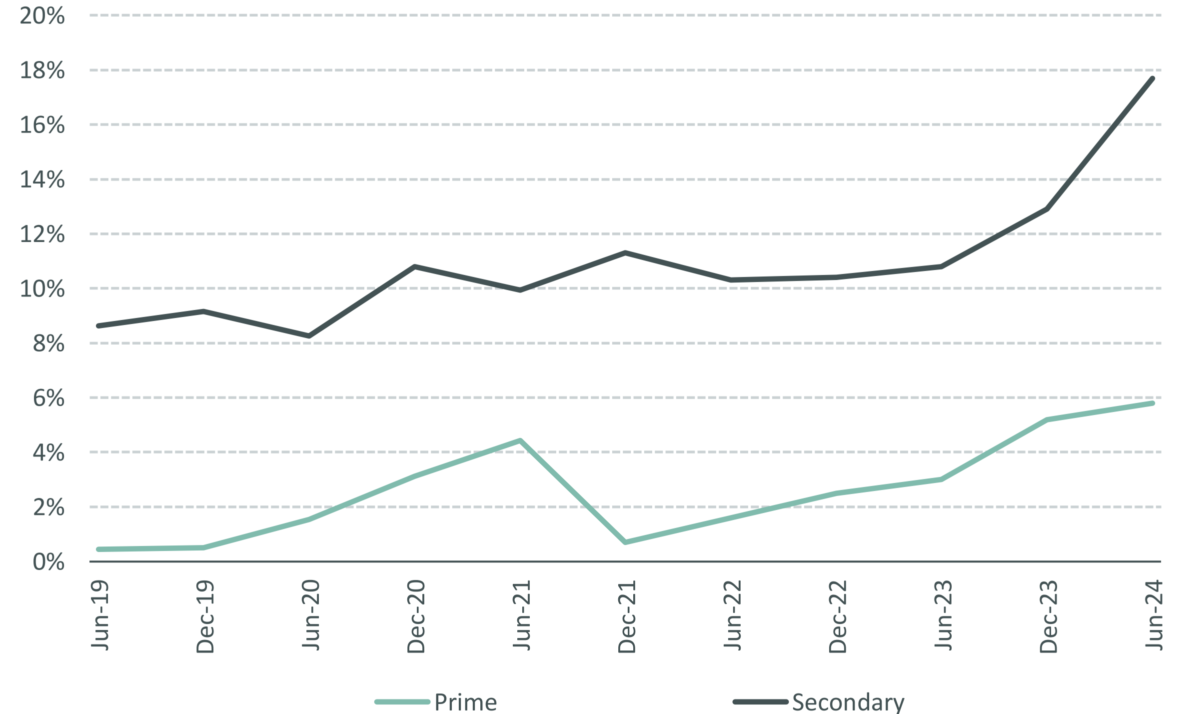
A mixture of downsizing and backfill vacancy triggered the increase in Grade B and Grade C office vacancy. Notable changes include the Parliamentary Services Commission vacating 5,060 sqm over nine levels in the TSB Building, a Grade B building located at 147 Lambton Quay although they still occupy five levels in that building (3,070 sqm). Vacancy was also generated by the relocation of WorkSafe New Zealand to 8 Willis Street, leaving behind circa 4,900 sqm of Grade B office space on Levels 3-7 on 86 Customhouse Quay. Regarding Grade C buildings, backfill vacancy was generated by the relocation of Westpac to Ricoh House at 1 Victoria Street (a Grade B building), leaving behind around 3,200 sqm at 318-324 Lambton Quay. Also, circa 2,200 sqm was vacated at 20-26 Balance Street by the Ministry of Education, Fisher Funds and the Māori Language Commission.

In the first half of 2024, Prime office stock increased to 505,923 sqm, an increase of 13,318 sqm compared to H2 2023. This growth was driven by the re-introduction of Bowen House (a Grade A asset at 1 Bowen Street) after refurbishment, fully leased by MBIE. Meanwhile, Secondary stock decreased to 894,170 sqm from 897,941 sqm, primarily due to seismic works in Featherston Tower (removing circa 2,600 sqm of Grade C office space) and refurbishment of four levels in Morrison Kent House (reducing 2,000 sqm).

CBD Office Vacancy Change by Grade

		PREMIUM	GRADE A	GRADE B	GRADE C	GRADE D	TOTAL
Vacancy - June 2024	%	2.2%	6.7%	15.2%	16.9%	25.4%	13.4%
	sqm	2,147	27,433	65,207	49,016	44,334	188,136
Vacancy - 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

Wellington CBD Office Vacancy



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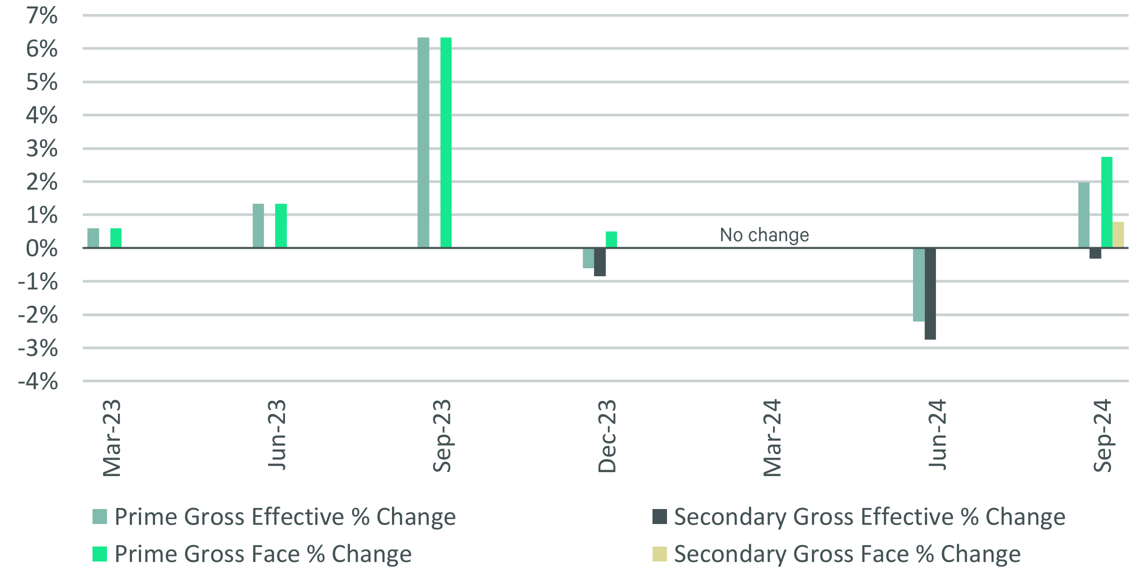
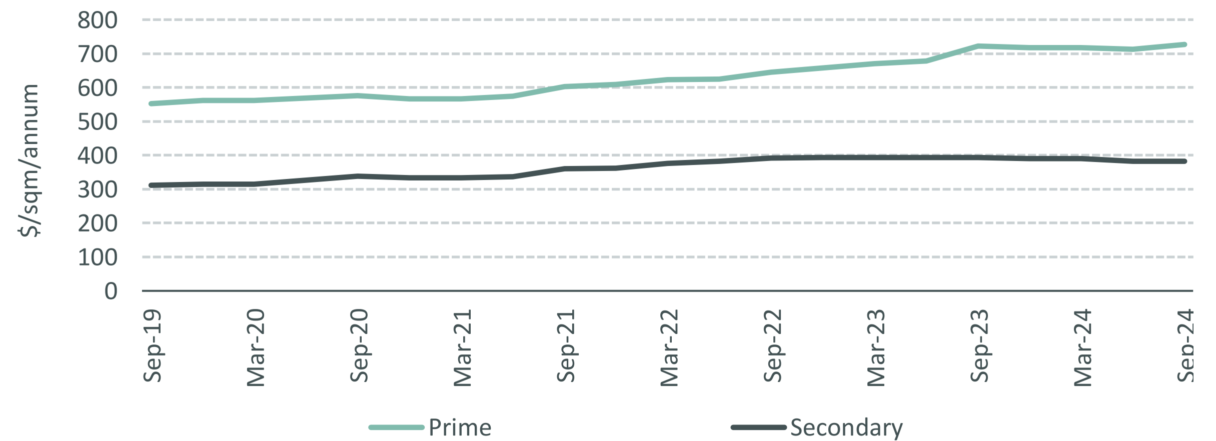
CBD Office Rents

Rental trends were more dynamic in Q3. Rents were influenced by an increase in outgoings during Q3 as the new rates regime came into effect in July together with year-to-date changes to the other components of outgoings. In our rental assessments and basket of buildings, we aim to reflect the typical mix of net and gross leases across various market sectors, which significantly affects reported rents. For example, the Prime office market has shifted towards net leases over the past decade, whereas gross leases are still dominant in the Secondary office market. This distinction means that with net leases, an increase in opex leads to higher gross rents. With gross leases, gross rents stay the same despite rising outgoings, but net rents decrease as these are subtracted from the gross rent.

In Q3, gross effective rental growth in the office market was impacted by higher outgoings (due to higher property rates and insurance costs) and higher incentives. The Prime submarket experienced a 2.0% growth in gross effective rents in Q3, as rising outgoings led to higher gross face rents, which were not offset by the increase in incentives in some buildings. In contrast, the Secondary submarket showed different results. The higher proportion of low-quality buildings on gross leases meant that higher outgoings did not significantly raise gross rents. Secondary assets saw a 0.3% decline in gross effective rents in Q3 due to higher incentives. However, the 0.8% increase in secondary gross face rents during this period was driven by the adoption of a small portion of net lease structures, as higher outgoings were not counterbalanced by market adjustments to face rents and incentives.

Based on CBRE's assessment, the Q3 indicative market incentives are at 6.8% of the face rents in the Prime office submarket, a rise from 6.3%. In the Secondary office submarket, they are at 12.3%, an increase from 11.6%.





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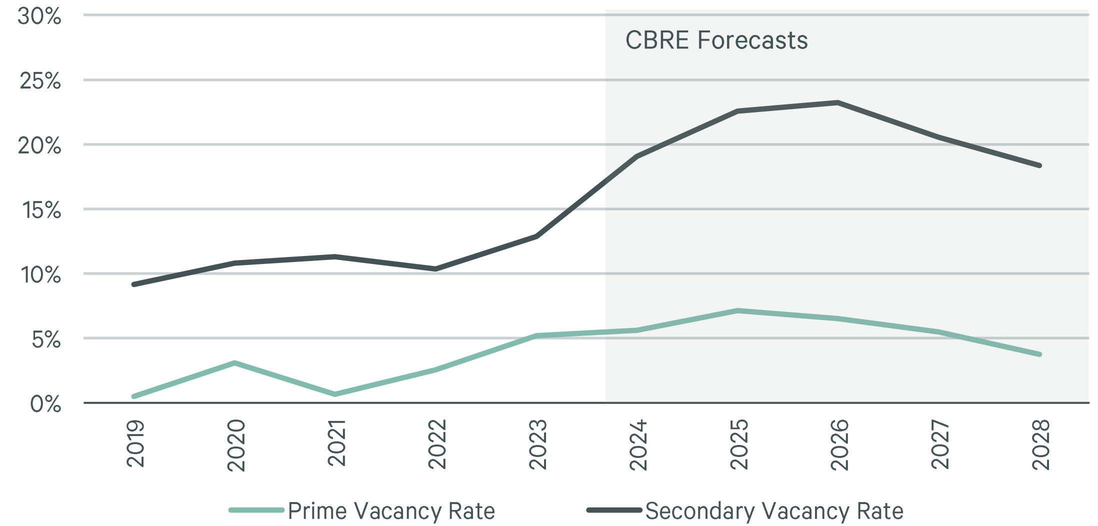
CBD Office Market Outlook

Last year, Wellington's CBD office market saw robust net absorption (nearly 30,000 sqm) due to strong commitments from new and refurbished buildings. However, CBRE's forecast predicts negative net absorption in 2024 and 2025. This is driven by absorption losses tied to backfill vacancies in Secondary buildings and weaker demand across all CBD office submarkets. As economic conditions normalise, there is potential for demand to bounce back in the subsequent years.

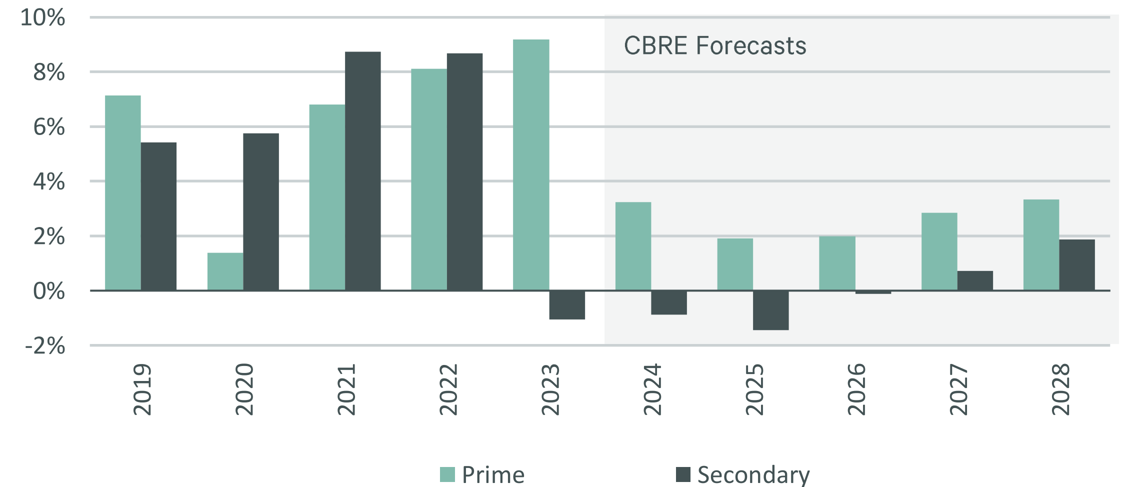
In 2024, three refurbished buildings are set to re-enter the Wellington CBD office market, adding approximately 25,000 sqm of space. These buildings include Bowen House (13,318 sqm), 126 Lambton Quay (6,120 sqm), and 23 Kate Sheppard Place (5,400 sqm). The annual average supply of new stock during 2024-2028 will be about 24,000 sqm. Overall, the total office stock is expected to increase from circa 1.38 million sqm in 2023 to around 1.43 million sqm in 2028.

The 2024-2025 supply cycle will be strong enough to push Prime vacancies higher, but we expect a mild increase from 5.2% in December 2023 to 7.1% in December 2025. The dissipating supply pipeline, circa 20,000 sqm in 2026 compared to 46,000 sqm in 2025, will facilitate a Prime vacancy improvement considering the forecast net absorption benefits of occupier flight to quality, improving economic conditions and stabilising public sector demand. After 2026, a further decline in the supply pipeline is forecast to result in an accelerating improvement of occupancies. Secondary offices will be subject to much higher vacancy pressures and will be slower to improve, with vacancies forecast to continue increasing in 2026. However, we forecast quite a rapid turnaround in 2027 and 2028 due to a pick-up in conversions.

CBD Office Actual and Forecast Vacancy



CBD Office Actual and Forecast Annual Gross Effective Rental Change



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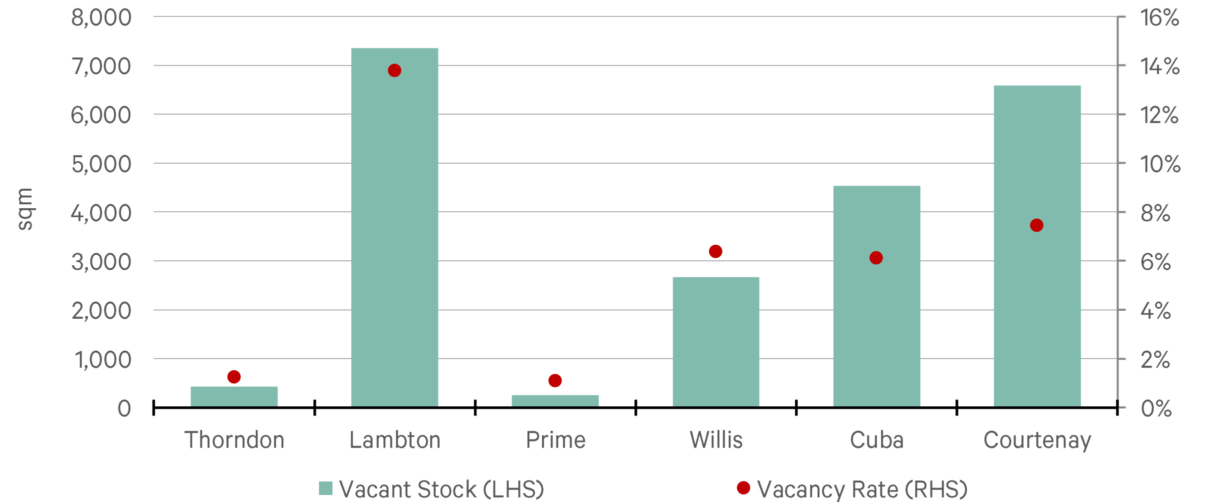
Retail Vacancy

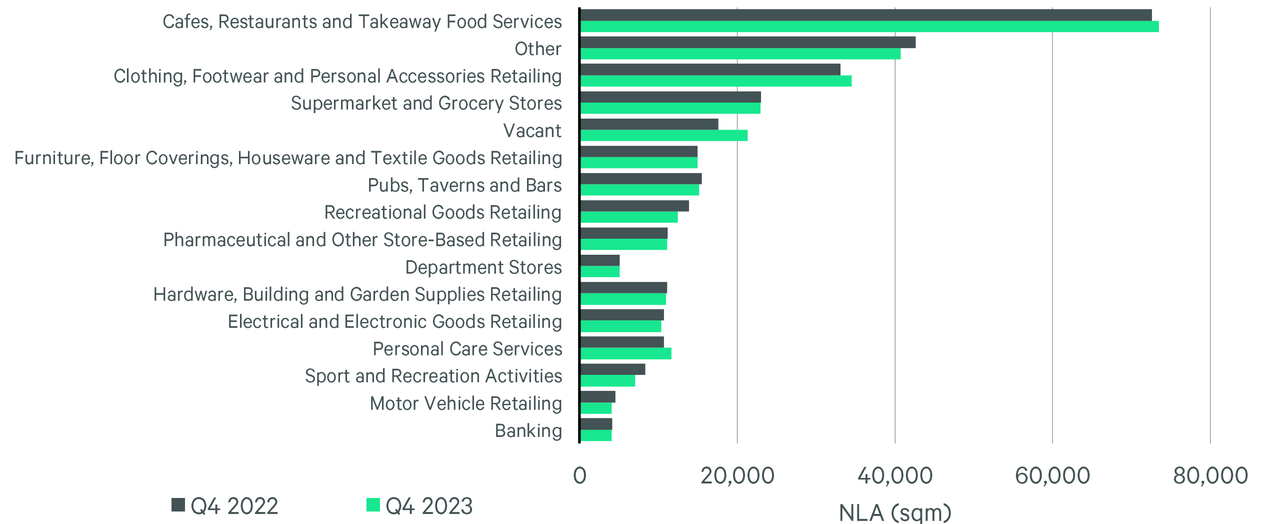
In 2023, the Wellington CBD retail submarket was exposed to higher vacancy levels. The vacancy rate increased from 5.7% to 6.9% compared to December 2022. This was mainly due to a considerable jump in vacancy in Courtenay, which witnessed its vacancy rate increase from 3.3% to 7.5%. The vacant retail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



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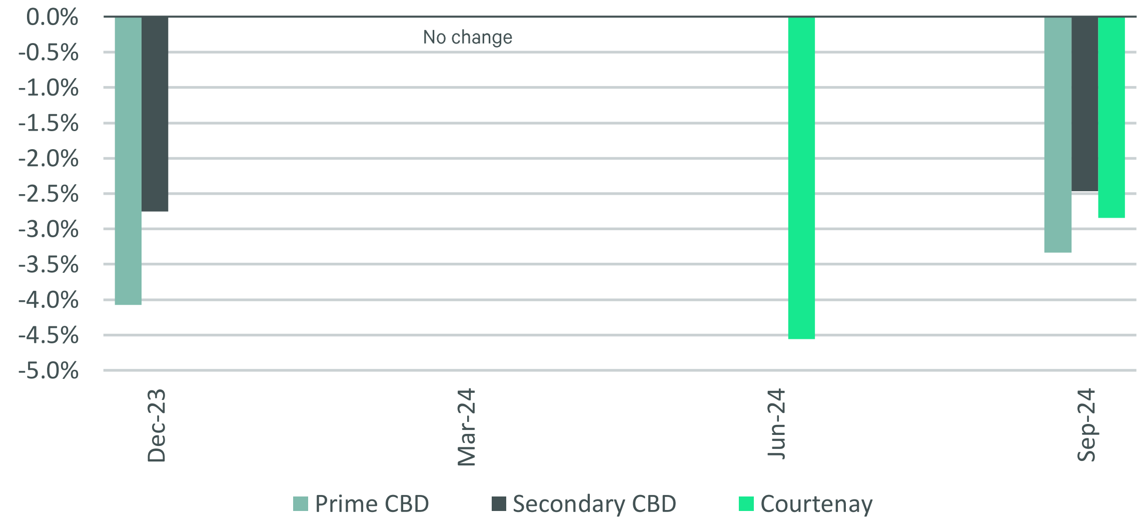
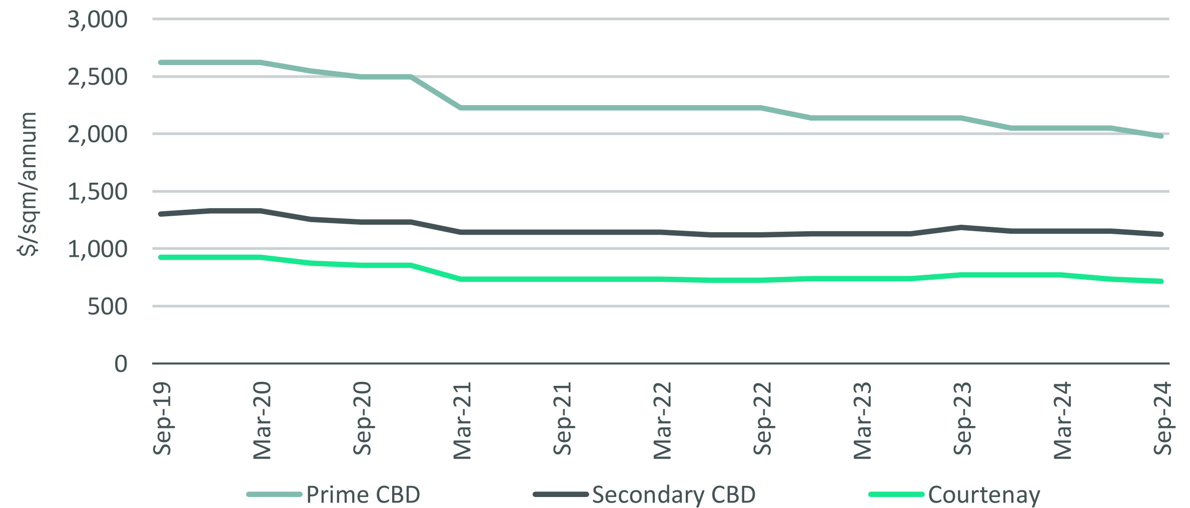
Retail Rents

Demand for CBD retail space softened during Q3, with some locations experiencing higher vacancy levels. Also, in contrast to previous periods, demand for retail locations on Lambton Quay and Willis Street was subdued in Q3. Gross rents across all retail submarkets experienced a decline in Q3: Prime CBD rents declined by 3.3%, Secondary CBD rents by 2.5%, and Courtenay rents by 2.8%. This was mainly driven by face rents decreasing due to weakening demand in contrast to previous periods in which incentives went up.

Indicative market incentives in both Prime and Secondary CBD retail submarkets remained unchanged at 11.1% of face rents during Q3. However, in the past 12 months, an increase in incentives impacted effective rents in both the Prime and Secondary CBD retail submarkets. As a result, gross effective rents fell by 7.3% in Prime CBD retail locations over the last year, driven by landlords' efforts to attract good long-term tenants, whilst gross effective rents declined by 5.2% in the Secondary CBD submarket. In addition, the constant weak demand for space and higher incentives in Courtenay caused gross effective rents to decline by circa 32% in the last 12-month period.





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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.

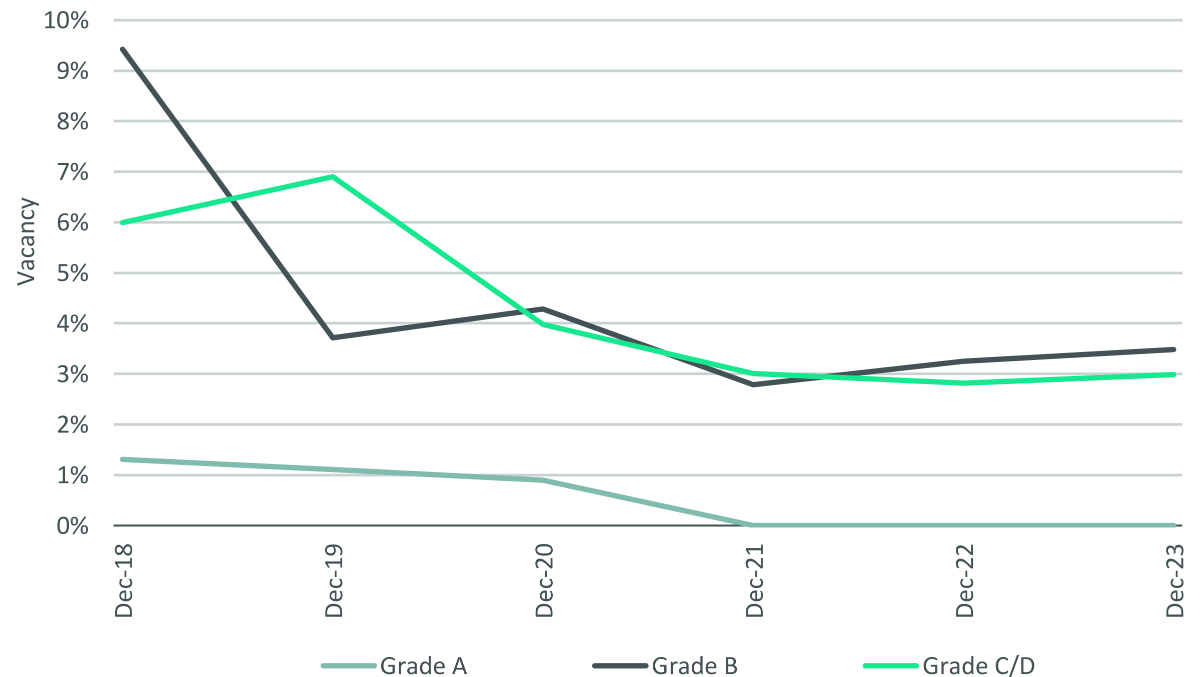
Around 20,150 sqm of new stock hit the market during 2023. In terms of stock withdrawals, some buildings were torn down in Melling on Marsden Street and Pharazyn Street (totalling 5,175 sqm) as part of the Riverlink project, which requires the demolition of several industrial buildings along the Hutt 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 - December 2023	%	0.0%	3.5%	3.0%	2.5%
	sqm	0	20,198	34,354	54,552
Vacancy - December 2022	%	0.0%	3.2%	2.8%	2.4%
	sqm	0	18,796	32,585	51,381

Wellington Industrial Vacancy



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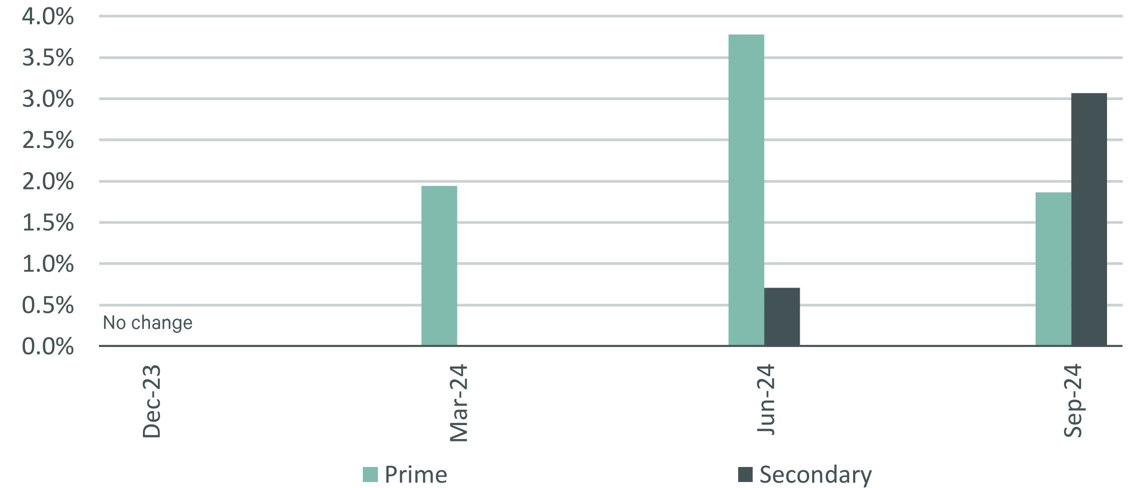
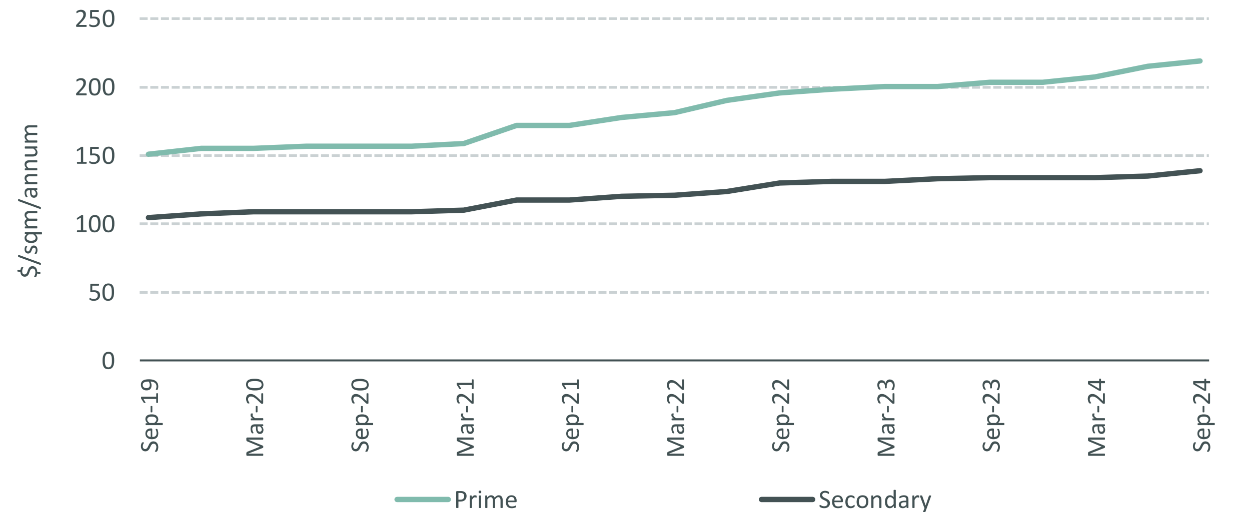
Industrial Rents

Demand from industrial occupiers during Q3 was resilient. The combination of low vacancies for good quality premises led to increasing market rents in Q3. The Prime industrial submarket saw a rise in rents by 1.9%, mainly impacting buildings in the medium and lower end of the rental range. Industrial buildings in the Secondary submarket registered robust rental growth, increasing by 3.1%, driven by an uplift in face rents across all Secondary submarkets. Additionally, the increase in outgoings had a material impact on industrial gross rents.

According to CBRE's assessment, indicative market incentives remained unchanged in Q3 2024. The industrial segment still stands as an anomaly in the Wellington commercial property market, with no alteration in incentives observed for over four years. Prime incentives are at 1.9% of face rents, while secondary incentives stand at 4.2% of face rents.





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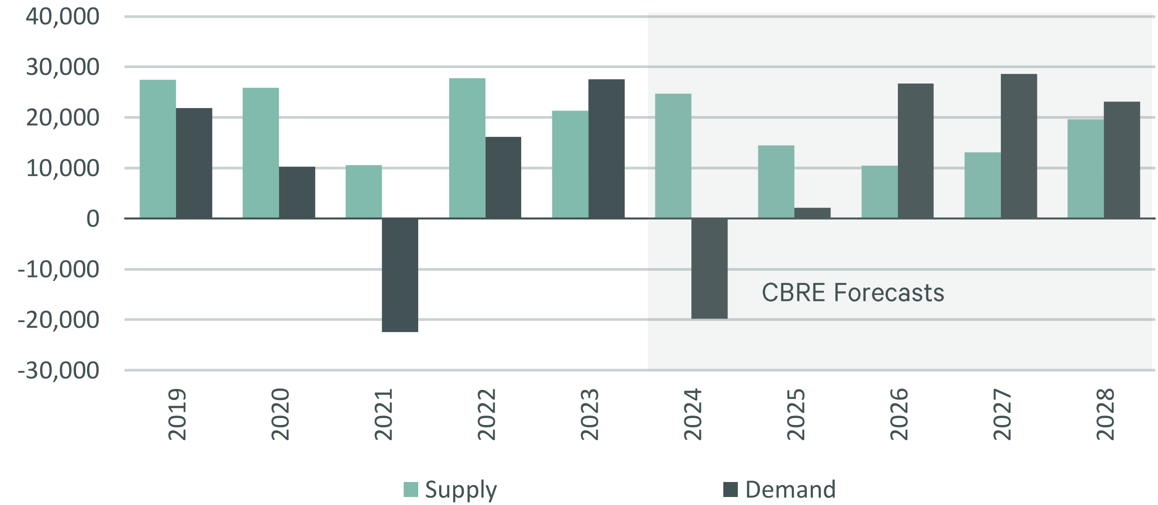
Industrial Market Outlook

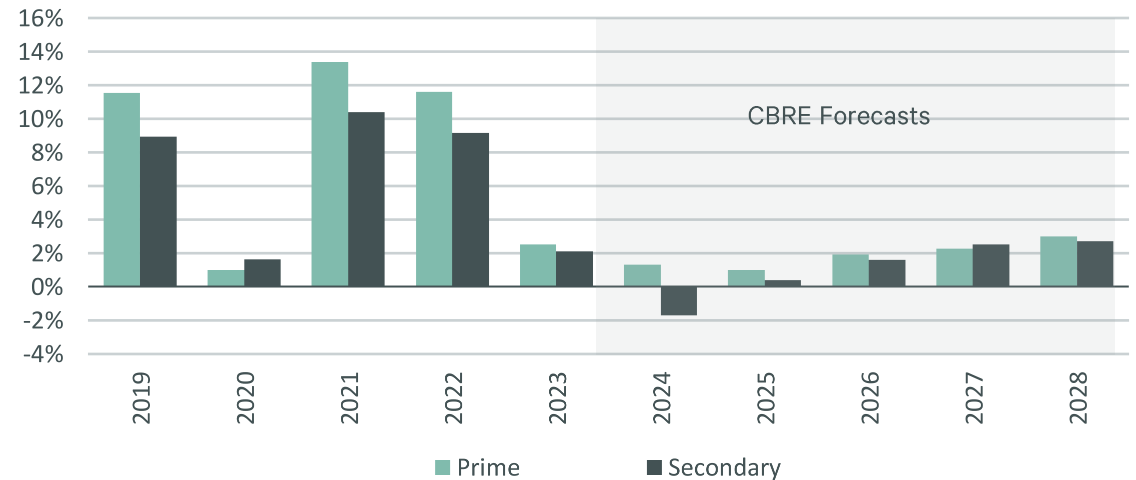
Despite the current economic headwinds, industrial new supply remains active. Five industrial buildings are scheduled to be completed this year, with the largest being the new Tesla showroom and warehouse in Ngauranga. This comes after the completion of three buildings totalling nearly 18,000 sqm, led by The Works Elsdon multi-unit development. The pipeline remains operational, with four projects slated for completion in 2025. The largest of these is Bidfood's new distribution centre in Grenada North, estimated to be around 6,000 sqm. Additionally, we predict a gradual increase in supply volumes from 2026 to 2028 due to improved economic conditions.

CBRE predicts that the detrimental effects of high Opex increases will persist until 2025. Earlier this year, we observed strong Prime rental growth, but with the adjustments to our Opex in Q3 to reflect new rate regimes, net rentals are likely to remain more stable. In the Secondary submarket, where gross rental growth is already losing momentum, increasing Opex will likely result in falling net rents. Combined with more challenging economic conditions, it may not be until 2027 that more significant rent growth returns.

Wellington Industrial Supply and Demand Forecasts



Wellington Industrial Gross Effective Rents Outlook



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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.

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