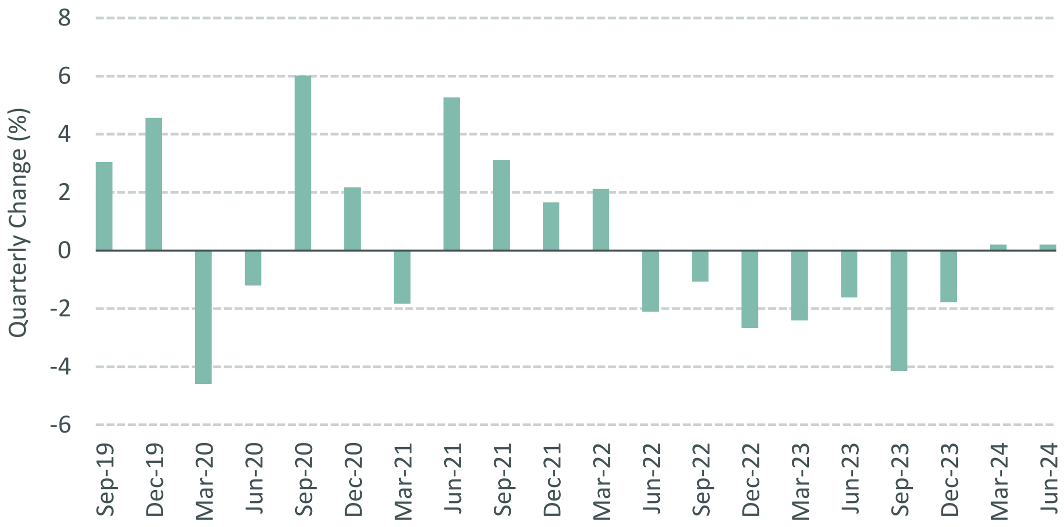
Wellington Property Market Overview

INSIGHTS

- The fundamental underlying stability, WALT, and covenant strength that the large public sector brings to the Wellington property market remains overshadowed by cyclical concerns around government cutbacks and soft economic conditions. Despite this, investor sentiment is becoming more positive as interest rates peak, although pricing remains relatively soft.
- 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.
- In Q2 2024, effective rents decreased in both the Prime and Secondary CBD office submarkets as landlords offered higher incentives to mitigate the vacancy gap.
- Supply-demand conditions are more favourable in the CBD retail and the industrial sector, and these are characterised by stable to increasing face rents. Market rent growth this year has been most evident in the lower to mid-range of the Prime industrial submarket as this catches up to benchmarks set earlier at the upper end of the range.

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	585 – 1,050	4 – 11	6.00 – 8.25
Secondary CBD Office	894,170	17.7	220 – 720	8 – 14	7.70 - 11.50
Prime Industrial	493,798	0.0	185 – 260	1 – 2	6.00 - 7.00
Secondary Industrial	1,729,053	3.2	120 – 180	3 – 4	6.50 - 8.50
Prime CBD Retail	23,335	1.1	2,000 - 2,800	10 – 11	6.75 – 7.60
Secondary CBD Retail	169,137	8.6	800 – 1,700	10 – 11	7.00 – 8.35

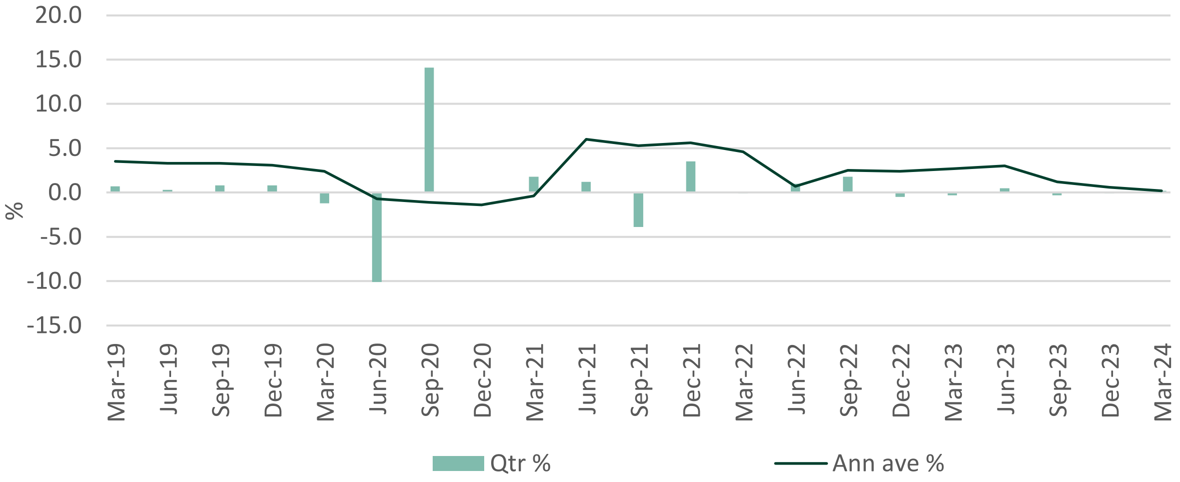
Economy

Major business surveys and activity indicators are at recessionary levels, indicating challenging economic conditions for the next few quarters. The Reserve Bank of New Zealand (RBNZ) revised its annual average GDP growth for 2024 to 0.4%.

However, there may be a silver lining, as the sluggish economy could lead to a quicker than previously anticipated dissipation of domestic inflation pressures and bring forward interest rate cuts. Although OCR cuts were expected to commence in Q2/Q3 2025 a couple of months ago, they have now been cut in response to inflation returning to within the 1-3% target band. The June 2024 quarter inflation rate was weaker than the RBNZ predicted in May (3.3% vs 3.6%). Even the domestic-generated (non-tradable) inflation during Q2 was almost on par with the figure that the RBNZ predicted (5.4% vs. 5.3%).

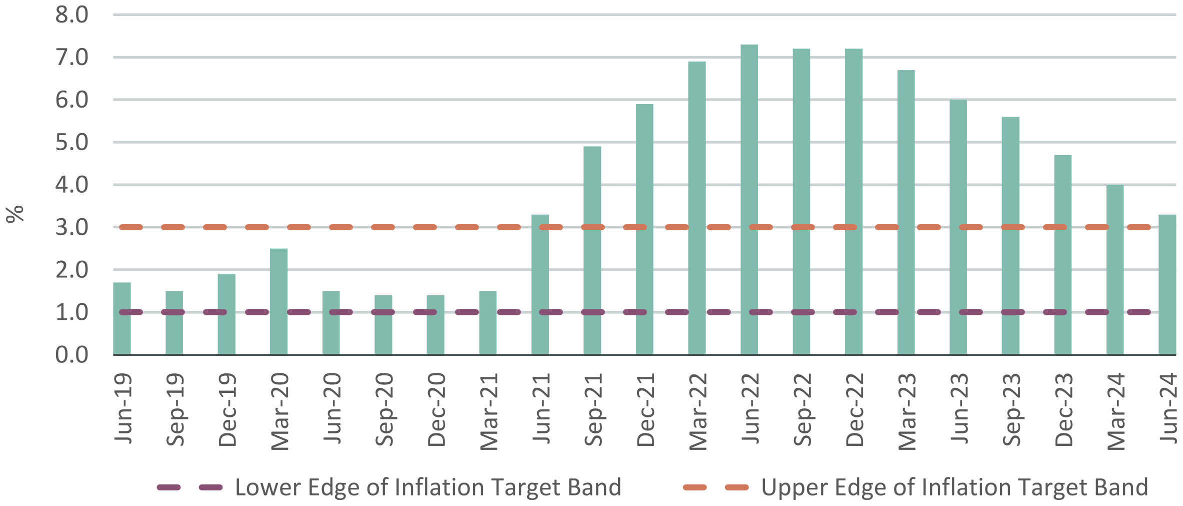
Some economists believe that a recession this year could potentially pave the way for a stronger economic rebound. Subdued or negative economic growth throughout the year and rising unemployment are the precursors of economic hardship. However, we can also expect a faster and more significant decrease in interest rates. As a result, there is a higher likelihood of a more dynamic economic recovery starting from mid-2025 onwards.

Gross Domestic Product (GDP)
Quarterly and annual average growth (%)



Source: : Statistics New Zealand

Consumer Price Index



Source: : Statistics New Zealand

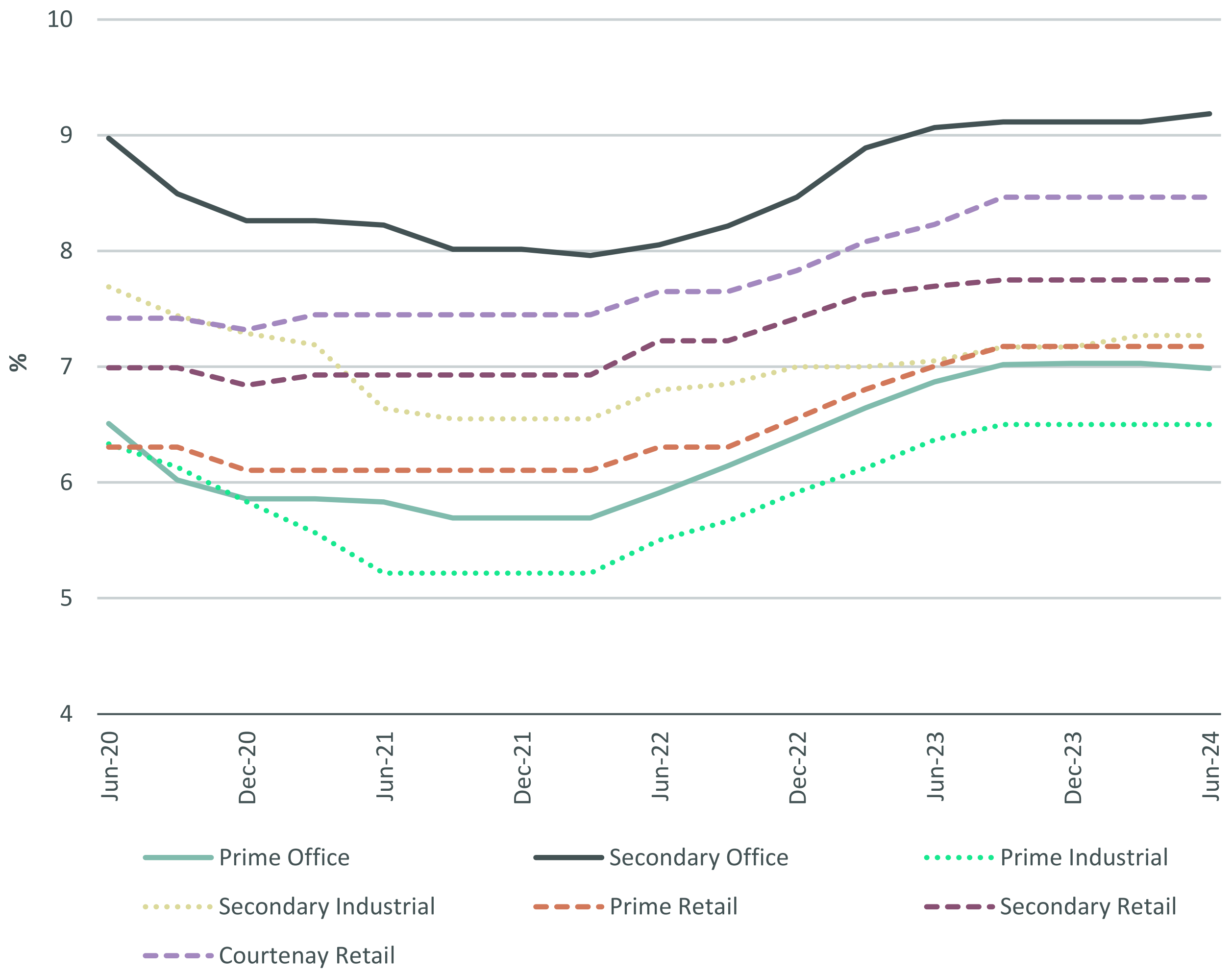
Investment market

The rate of yield increases in the last two quarters was the lowest since we commenced the easing cycle in early 2022. While interest rate pressures on cap rates are starting to dissipate, purchasers' pricing considerations are also moving beyond interest rates, with changes in supply-demand conditions and their vacancy and rental growth impacts increasingly influencing investor attitudes.

We anticipate that some vendors will face intensifying selling pressure in coming months. The subsequent transactions will offer insight into where the remaining difference between seller and buyer price expectations will eventually balance out.

CBRE's evaluation for Q2 showed a general pattern of stable market yields, with some softening in the Secondary office submarket. There is increasing upward pressure on Grade B office yields, more so than Grade C given that the latter is already approaching double digits.

Wellington Indicative Yields by Sector



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%.

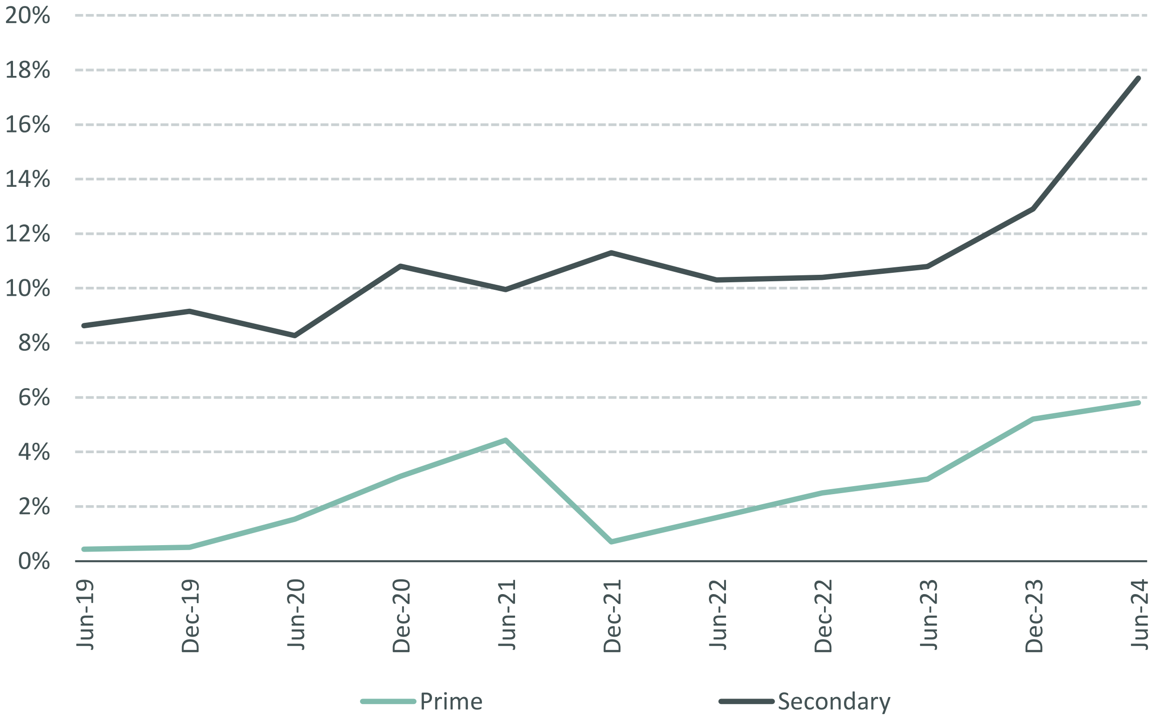
A mixture of downsizing and backfill vacancy triggered the increase in Grade B and Grade C office vacancy. Notable changes include the Parliamentary Services Commission vacating 5,060 sqm over nine levels in the TSB Building, a Grade B building located at 147 Lambton Quay although they still occupy five 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



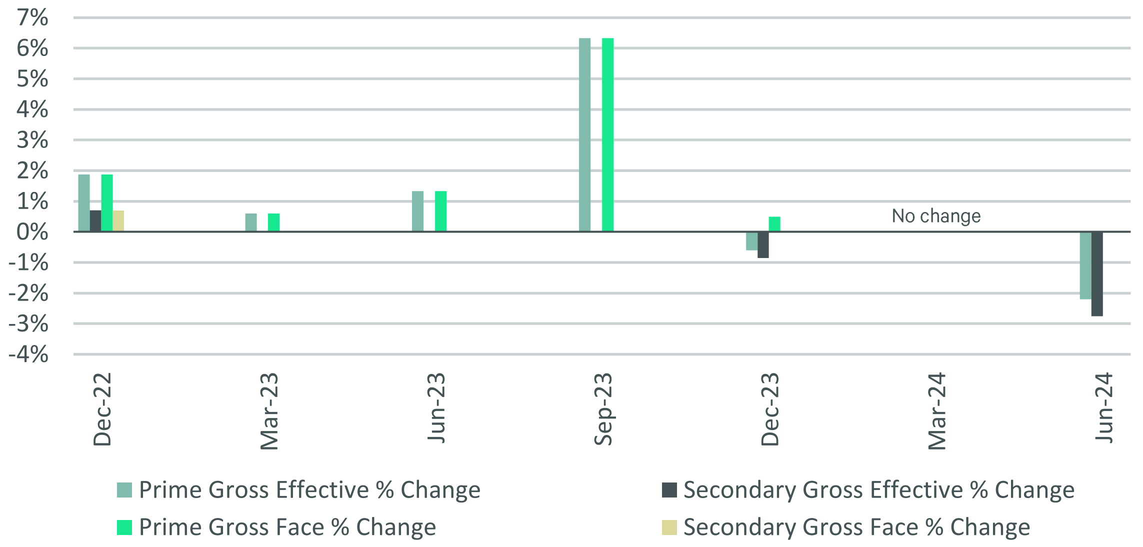
CBD Office Rents

In contrast to the preceding quarter, Q2 witnessed a drop in effective rents in both the Prime and Secondary office submarkets. Softening market conditions led to higher vacancy levels. This situation was further worsened by the Crown's hesitance to lease additional office space, compounding the supply side of both uncommitted new stock coming on the market and the creation of backfill vacancies as some of this new stock is taken up.

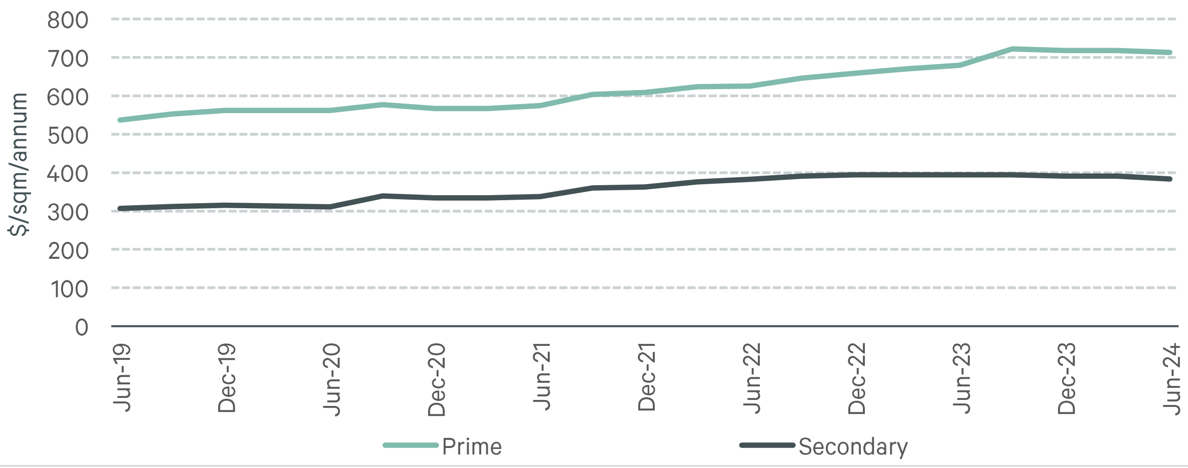
In response, landlords in both Prime and Secondary office buildings increased incentives to attract long-term tenants and fill the vacancy gap, dropping effective rents in both submarkets. Within the Secondary submarket, Grade B buildings had lesser incentive increases than Grade C, which have consistently struggled with higher vacancy levels.

According to CBRE's assessment, the Q2 indicative market incentives are at 6.3% of the face rents in the Prime office submarket, an increase from 4.8%. In the Secondary office submarket, they are at 11.6%, a rise from 8.1%.

Wellington Office Rents – Quarterly Change



Wellington Gross Effective Office Rents



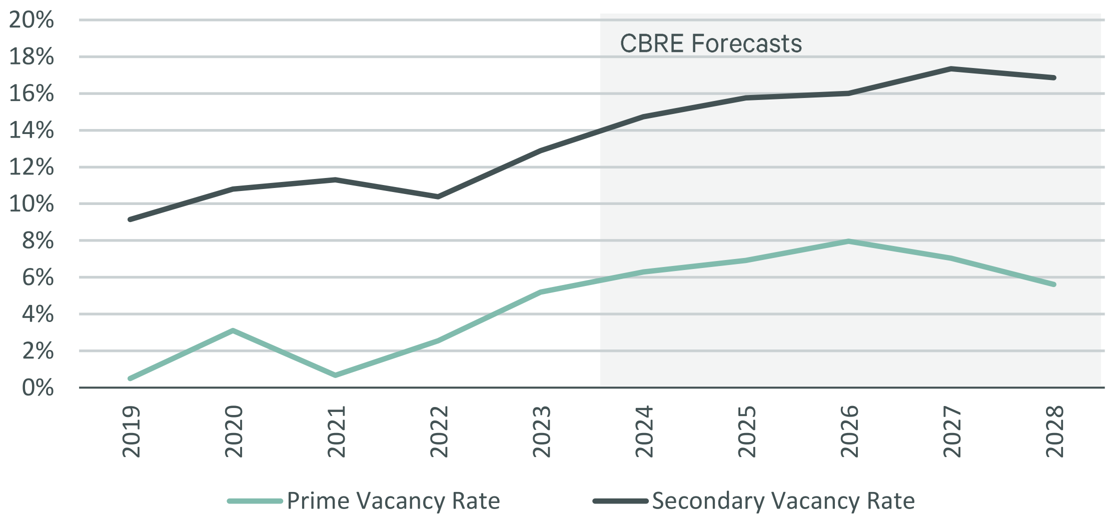
CBD Office Market Outlook

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 (Grade B, C, and D) and weaker demand across all CBD office submarkets. As economic conditions normalise, there is potential for demand to bounce back in 2027-2028.

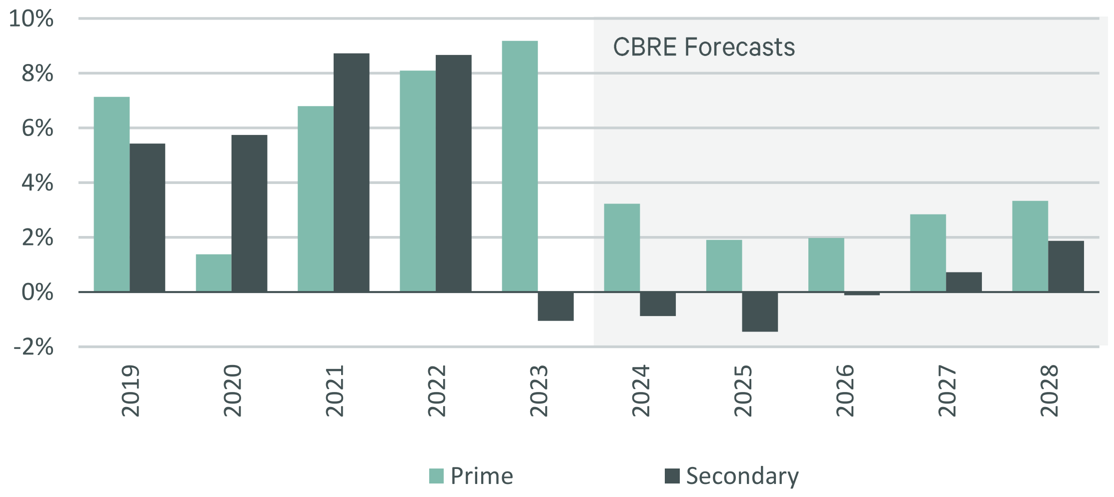
In 2024, four refurbished buildings are set to re-enter the Wellington CBD office market, adding approximately 28,000 sqm of space. These buildings include Bowen House (13,318 sqm), 126 Lambton Quay (6,120 sqm), 23 Kate Sheppard Place (5,400 sqm), and 126 Featherston Street (3,315 sqm). Unlike the negative supply trend in 2013-2023 (averaging around -12,000 sqm per year), the annual average supply of new stock during 2024-2028 will be about 11,200 sqm. Overall, total stock is expected to increase by approximately 56,000 sqm over the next five years, with withdrawals offsetting the gross supply pipeline.

This will result in higher vacancy rates, which are expected to remain in double digits throughout our forecast period. The primary reason for the rise in vacant space is the increasing backfill vacancy in Secondary buildings (mainly Grade B assets), driven by tenant relocations to higher quality buildings (especially to Grade A buildings) and less overall demand for office space due to economic headwinds and government policy. The combination of the demand and supply cycles suggests vacancy peaking in 2027. However, Prime vacancy is expected to peak in 2026. We expect modest increases in Prime gross rents, but Secondary rents are forecast to decrease during 2024-2026.

CBD Office Actual and Forecast Vacancy



CBD Office Actual and Forecast Annual Gross Effective Rental Change

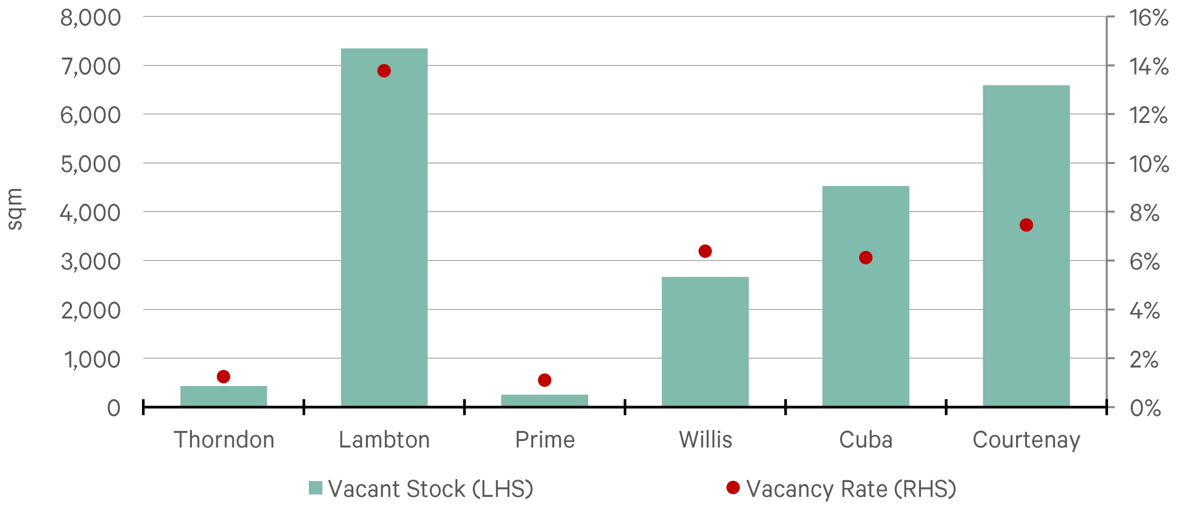


Retail Vacancy

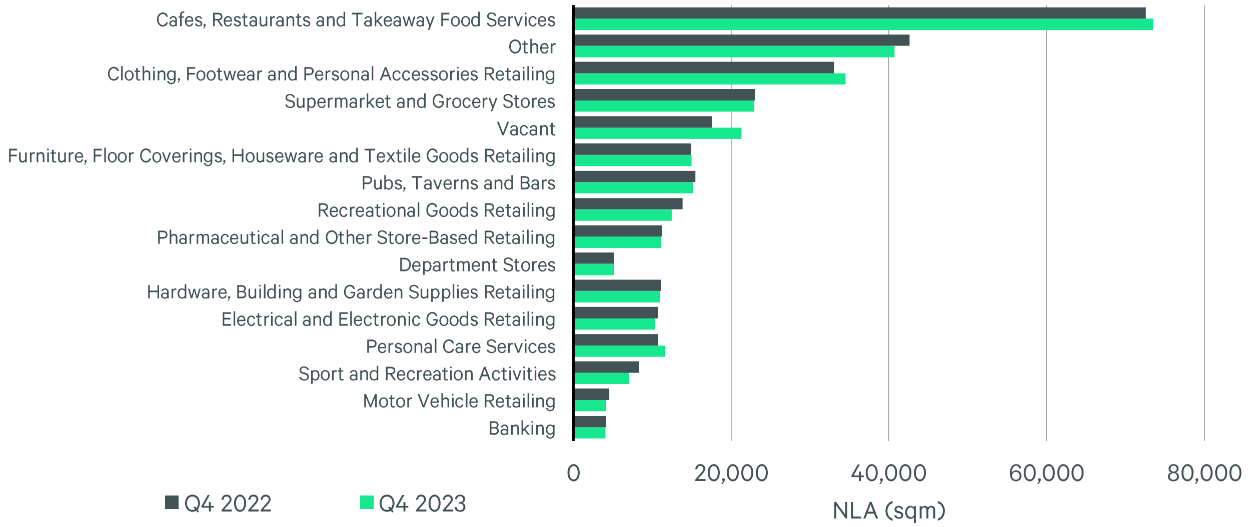
In 2023, the Wellington CBD retail submarket was exposed to higher vacancy levels. The vacancy rate increased from 5.7% to 6.9% compared to December 2022. This was mainly due to a considerable jump in vacancy in Courtenay, which witnessed its vacancy rate increase from 3.3% to 7.5%. The vacant retail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

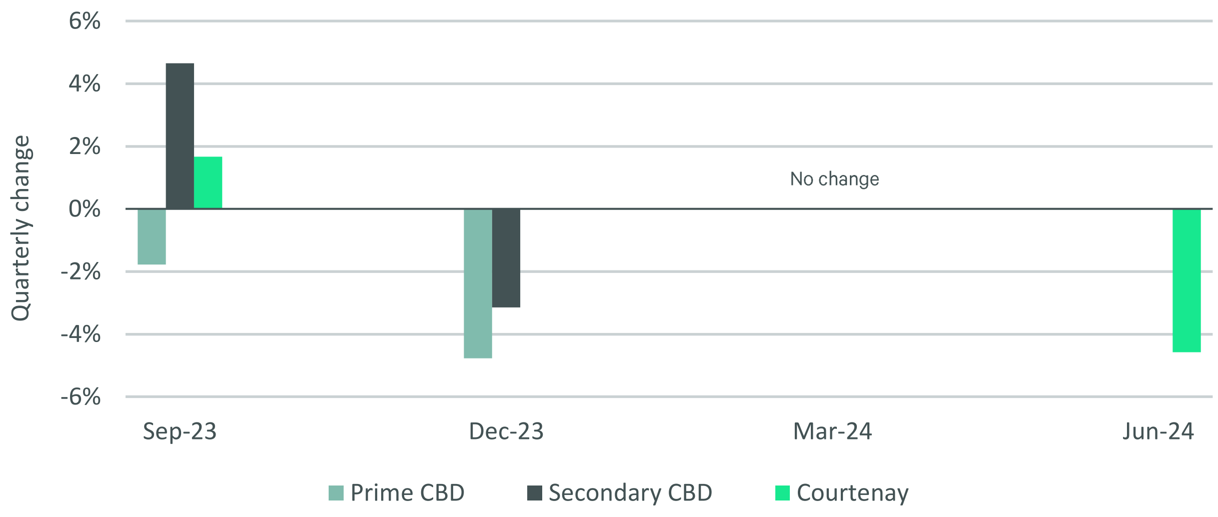


Retail Rents

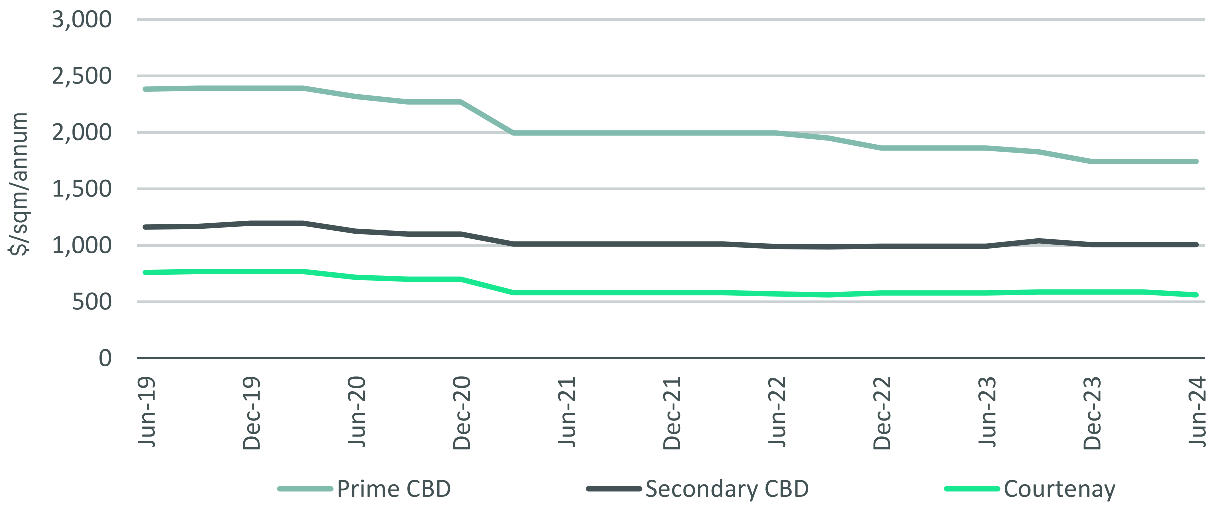
Despite the burgeoning interest in prime retail locations on Lambton Quay, Willis Street, and Cuba Street, market rents in both Prime and Secondary CBD retail submarkets remained steady throughout Q2, supported by positive occupier interest in available spaces, even if these tend to take their time to convert into actual leases. On the other hand, Courtenay is dealing with greater softness in demand, high vacancy rates, and changes in licensing regulations affecting certain hospitality sectors.

Indicative market incentives in both Prime and Secondary CBD retail submarkets remained unchanged at 11.1% of face rents in Q2. However, in the past 12 months, effective rents in the Prime CBD retail submarket were affected by a rise in incentives. As a result, gross effective rents fell by 4.1% in Prime CBD retail locations over the last year, driven by landlords' efforts to attract good long-term tenants. However, the weak demand for space in Courtenay led to an increase in incentives in Q2, pushing them to 12.5% of face rents and causing a 4.6% reduction in effective rents compared to Q1.

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.

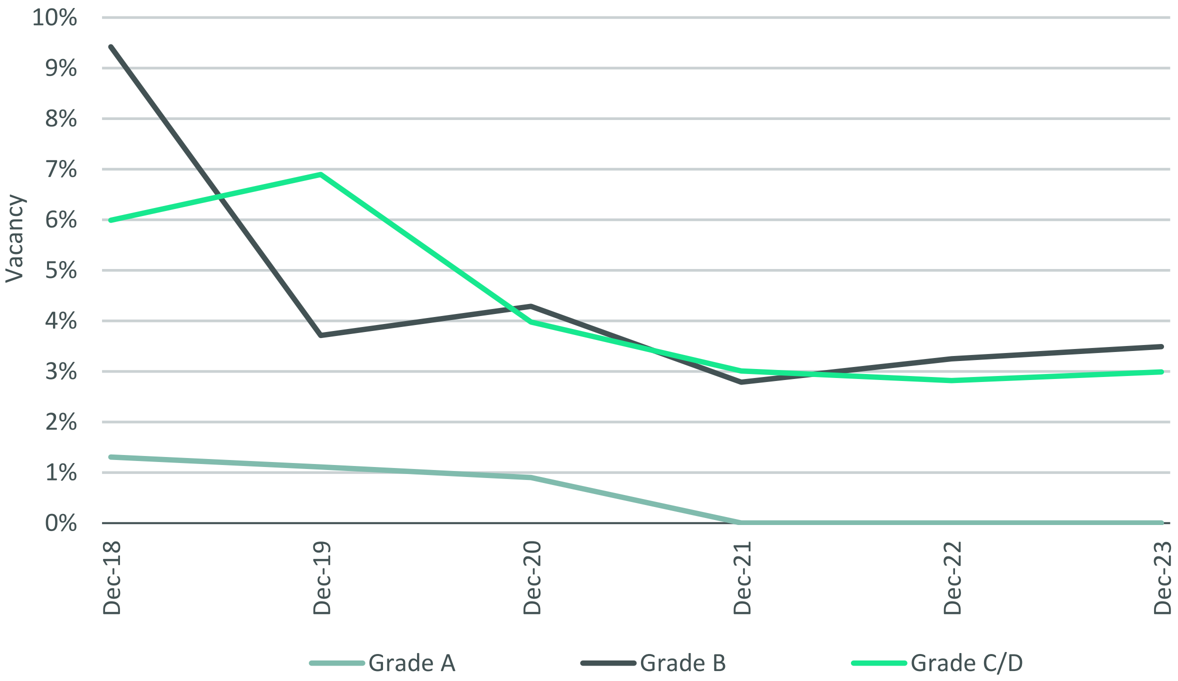
Around 20,150 sqm of new stock hit the market during 2023. In terms of stock withdrawals, some buildings were torn down in Melling on Marsden Street and Pharazyn Street (totalling 5,175 sqm) as part of the Riverlink project, which requires the demolition of several industrial buildings along the Hutt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



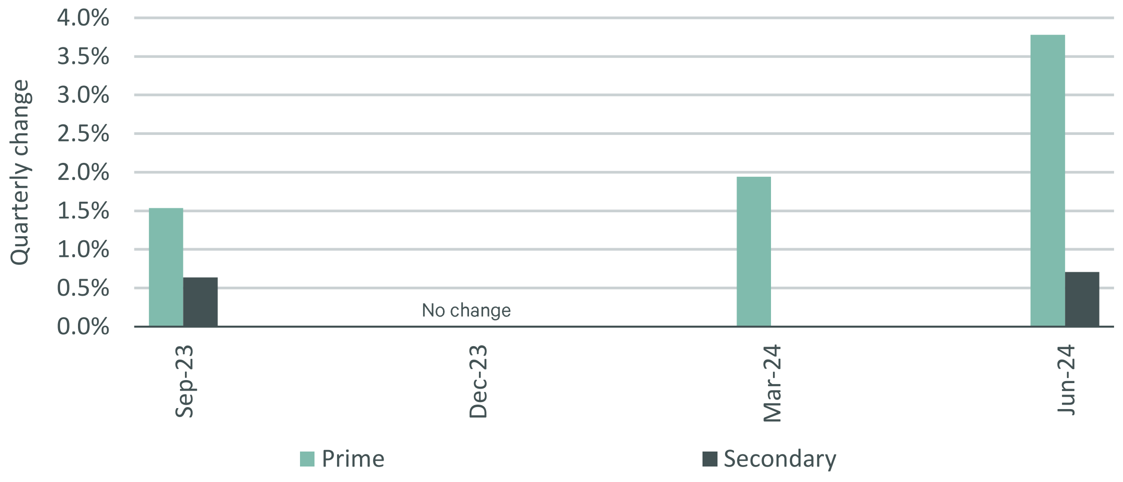
Industrial Rents

The industrial market was the only commercial property sector to see positive rental growth in Q2. Contrary to previous periods, both Prime and Secondary industrial submarkets witnessed rents going up, driven by a stable demand. Rental growth was particularly robust in Prime buildings, mainly due to a constrained supply, a characteristic of the Wellington industrial market in the last years.

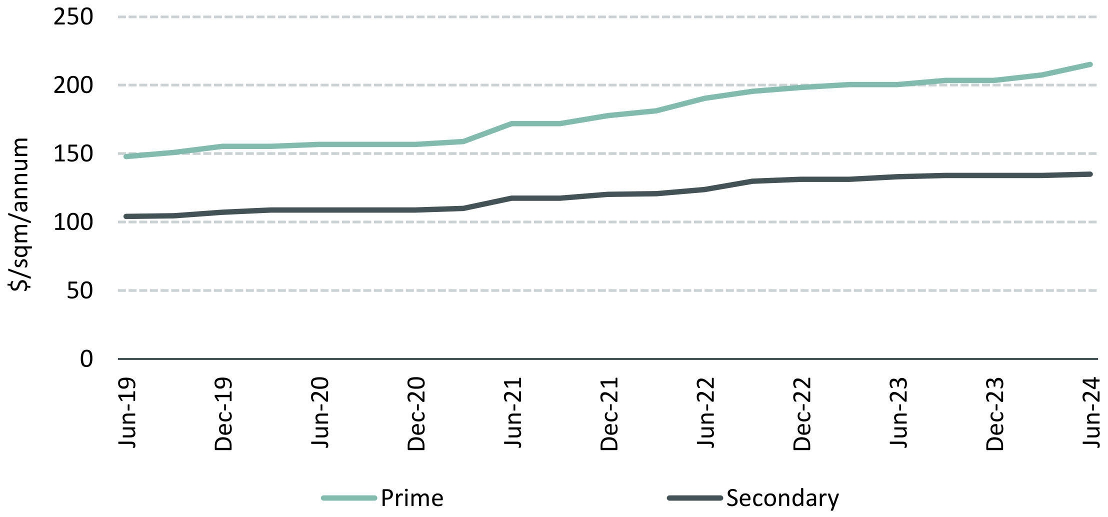
Industrial Prime gross effective rents sat at $215 per sqm, up by 3.8% compared to Q1 of the previous year, mainly affecting assets in the medium and lower end of the Prime rental range. Industrial buildings in the Secondary submarket also noted a growth in effective rents, though it was comparatively modest at 0.7%.

Based on CBRE's assessment, indicative market incentives remained unchanged in Q2 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. The prime incentives are at 1.9% of the face rents, while the secondary ones stand at 4.2% of the face rents.

Industrial Gross Effective Rents Quarterly Change



Wellington Industrial Gross Effective Rents

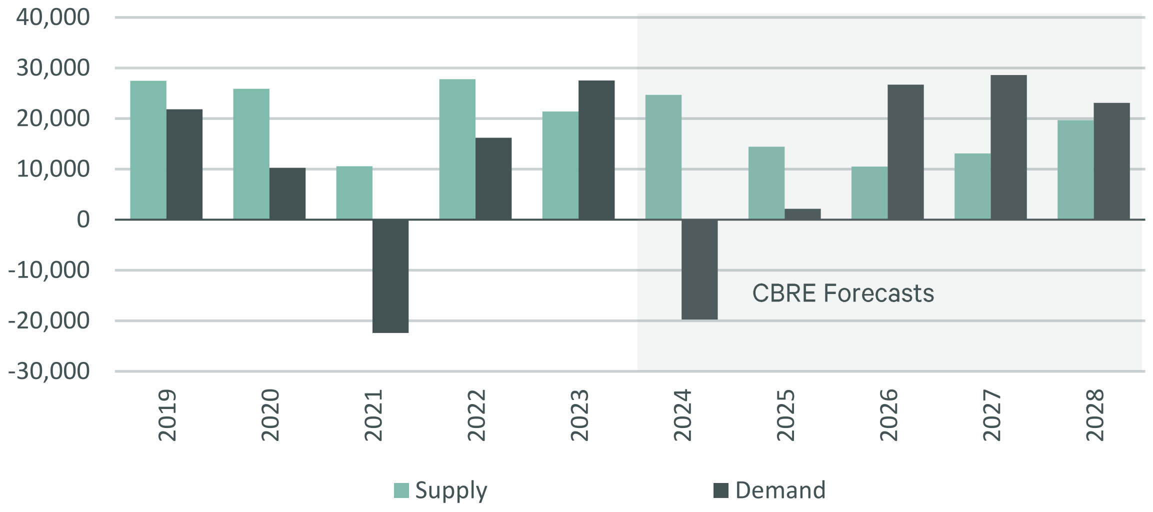


Industrial Market Outlook

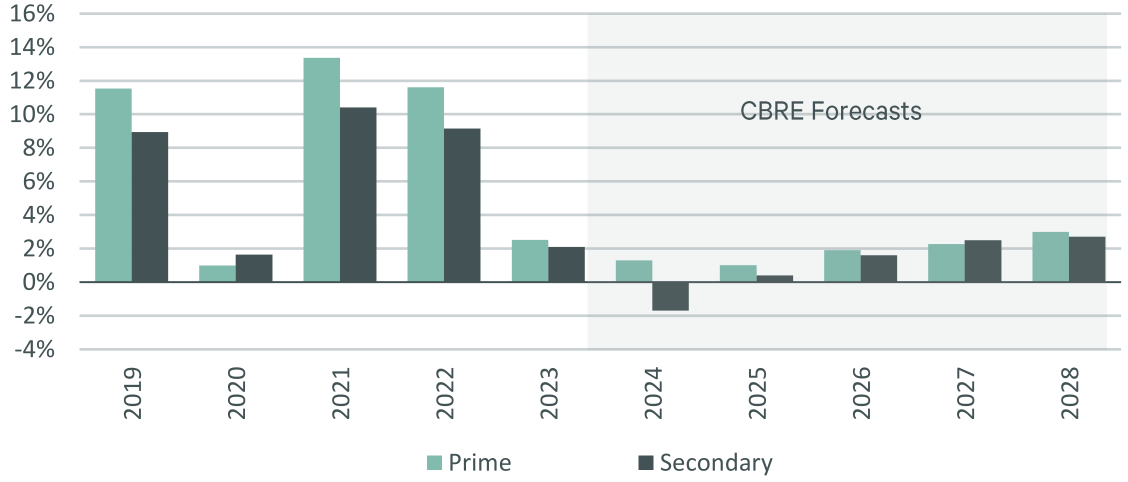
Despite the current economic headwinds, industrial new supply remains active. Five industrial buildings are scheduled to be completed this year, with the largest being the new Tesla showroom and warehouse in Ngauranga. This comes after the completion of three buildings totalling nearly 18,000 sqm, led 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



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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