HEADLINES:
- Vacancy falls to new lows
- Development response escalates
- Investment sector performs strongly

Bayleys Research

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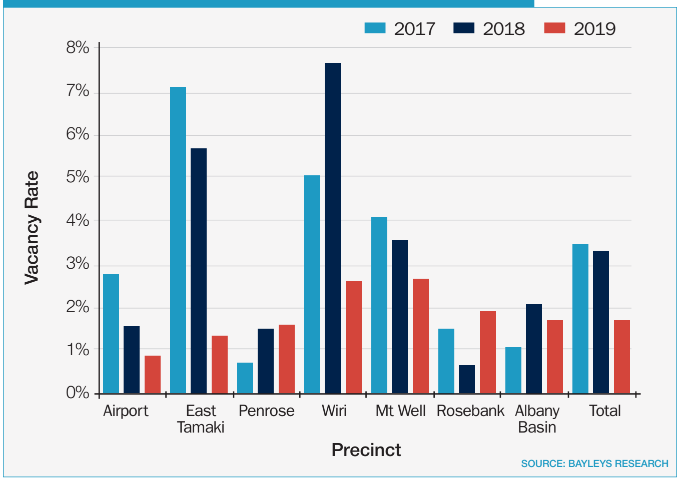
Auckland Industrial Market

Industrial Property Remains in Demand

Conditions within Auckland's industrial property sector tightened further over 2018 with vacancy rates reaching a new low of just 1.7%. The region's strongly performing economy, driven by booming population growth, has seen business expansion and job creation generating increased demand for industrial workspace. This demand has, to date, run ahead of new supply which has elicited a significant response from the development sector.

The industrial property investment sector continues to perform strongly with competition for assets, as and when they are brought to market, remaining at high levels as investors seek higher yielding assets in a low interest rate environment which looks set to remain in play for an extended period of time yet.

Auckland Industrial Vacancy Rate by Precinct



Vacancy Rates Reach New Lows

Average vacancy rates across Auckland's largest industrial precincts plunged to a new low in early 2019 according to the results of the latest Bayleys Research industrial vacancy survey.

The overall vacancy rate fell to 1.7% from the already historically low rate of 3.3% recorded in 2018.

While overall vacancy has sat at below 4% since 2014 this is the first occasion on which none of the precincts surveyed have recorded vacancy of over 5%. As at the date of the 2018 survey the vacancy rate in Wiri was recorded as 7.6% while in East Tamaki the figure stood at 5.7%. In the 2019 survey however, the highest vacancy rate recorded across the precincts was just 2.6% (Wiri and Mount Wellington).

The North Shore's largest industrial precinct, the Albany Basin, has again seen vacancy rates tighten with the overall figure falling from 2.1% at the time of the 2018 survey to 1.7% this year. Demand from both tenants and owner occupiers has held vacancy rates in the precinct at below 5% since 2014.

Further north at Silverdale pressure on supply has been maintained with new space within the precinct's established industrial area and at Highgate proving popular with occupiers. By way of example the Trade Centre on Foundry Road now has just two units vacant with the others leased to a mix of occupiers including TWL.

At Highgate a multi Unit project on Emirali Road developed by Kea has also seen rapid take up by both tenants and owner occupiers.

Case Studies

Brigade Road, Airport Corridor

Sale Date April 2019 | Sale price: $13,200,000

Method: Deadline Private Treaty | Yield: 6.08%

Bowden Road Mount Wellington

Sales Date: Jan 2019 | Sale Price: $5,100,000

Sale Method: Negotiation | Yield: 5.6%

Rents and Lease Terms Increasing

The long term pressure that the industrial leasing market has been under for an extended period of time has obviously been reflected in a significant upward bias in rental rates.

In 2014 warehouse rents in East Tamaki topped out at approximately $125m² this upper limit is now at or over $150/m² an increase of approximately 20%. A similar uplift has been witnessed in the Airport corridor.

Tight market conditions have resulted in rent, increasingly, being charged for car park spaces and yards. Within East Tamaki, yard space is commanding rental rates of between $15/m² to $20/m². Car parks are generating a rent of between $5 and $12 per space per week. With overall rents comprising a wide range of different elements, a blended rate is increasingly being adopted for comparison purposes.

Lease terms are also extending with initial terms of between 10 and 12 years now becoming common for larger scale manufacturing or distribution properties. This, in part, reflects the fact that landlords have the upper hand in lease negotiations. However, other factors are also in play, such as the trend towards greater automation within Warehouses.

As a result, warehouse fit outs have transitioned from comprising low cost systems based upon a simple requirement to store goods to far more sophisticated systems to meet the requirements of Just in time delivery techniques and the impact of being a link within global supply chains, a situation becoming increasingly common as the influence of international E traders increases.

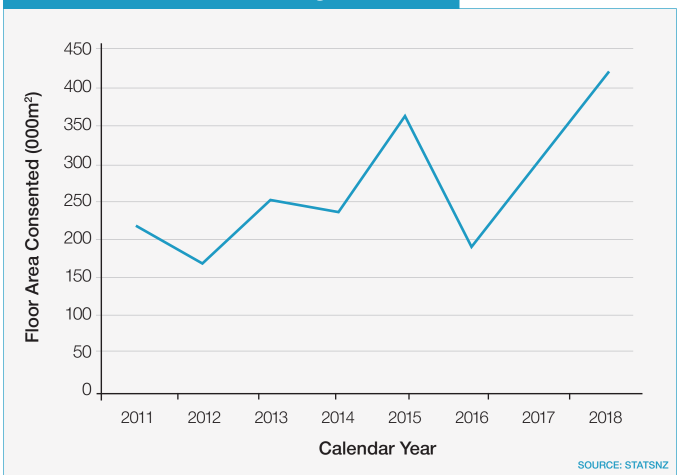
Businesses operating from warehouses are therefore evolving rapidly, increasingly utilising artificial intelligence and automation.

The integration of automation in warehouses significantly increases fit out costs meaning that longer lease terms are required in order to ensure that the greater costs are offset by rental income, in cases where Landlords meet the initial cost, or, through certainty of occupation in cases where tenants meet the cost.

Development Response Gathers Pace

The development sector's response to ultra tight market conditions continues to gain momentum with 2018 seeing over 415,000m² of new industrial buildings consented, the highest figure recorded since Auckland's unitary authority came into being.

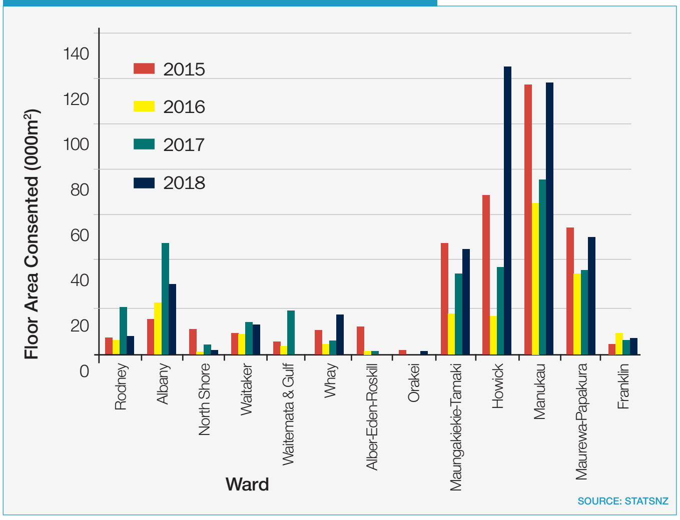
Auckland Industrial Building Consents



If this momentum is to be maintained however, it is essential that council ensures that there is a sufficient supply of industrially zoned land. Within the region's established industrial precincts vacant land is rare and even where such land is available its cost often makes industrial development financially unfeasible.

In the 2018 calendar year building just over 415,000m² of new industrial development was consented, surpassing the previous high of 362,000m² recorded in 2015. Over the last four years over 1.25 million square metres of new industrial space has been consented comprising just short of 1 million square metres of storage buildings with the balance being factories and industrial buildings according to Stats NZ figures.

Industrial Building Consents by Ward



The consents data shows that the region's southern wards continue to dominate the development pipeline. The Howick and Manukau wards alone account for 59% of 2018 consents with Maungakiekie-Tamaki making up a further 11% of the total.

The results are not surprising given that located within the Howick and Manakau Wards are two of the few areas within the region which have had significant tracts of vacant land zoned for industrial development. The Highbrook Business Park is located within Howick while Auckland Airport's landbank is located within the Manukau Ward.

In both of the above locations development activity was strong in 2018. As well as pre committed development of 7,300m² for existing customer Plytech at Highbrook, the park's manager Goodman also progressed speculative development projects including the construction of 14 new warehouses at The Gateway and Parade. The Gateway, consists of seven warehouses between 1,485m² and 6,115m². The parade comprises a further seven premises ranging in size between 691m² and 958m² with early leasing success having been reported.

At Auckland Airport the most significant new project launched in 2018 was a new 65,000m² distribution centre and a support centre for Foodstuffs North Island Ltd. The facility will be developed within Stage 4 of The Landing Business Park and will be constructed over a three year period, with completion scheduled to occur in late-2020. The development will comprise a world-class distribution centre plus a 5-star green-rated support centre.

Constraints to Growth Persist

The development sector however, faces a number of constraints in meeting the high levels of demand evident in the market, primarily:

- **Availability and cost of land**
- **Access to Finance**
- **Construction cost inflation**

Shortage of Land Options sees Values Escalating

Vacant development land within a majority of the region's established industrial precincts is an increasingly rare commodity. Even at Highbrook Business park it is likely that industrial development will have reached its full capacity by 2021.

The shortage of land options has driven upward pressure on values. As land values have increased the financial viability of new industrial development has been called into question.

Expansion options are rare, however limited opportunities do exist. In Wiri, for example a 67 hectares of un-serviced land has been introduced to the market. The land is located on Puhinui Road adjacent to the precinct's main industrial area. Master planning, for the development of a business park is in place, albeit that it is subject to roading improvements being completed. This significant addition to the precinct's industrial land inventory will ease pressure on the local market, pressure which has seen the value of serviced lots reaching \$625/m^2 compared with an upper limit of approx. \$325/m^2 in 2014. .

While the Airport company still has access to a significant landbank, opportunities for groups which prefer owner occupation have become increasingly rare within the Airport Corridor precinct. The opening up of Oruarangi Road has therefore attracted significant interest with companies such as REM systems, First Global Logistics and Lim Brothers having opened facilities there over recent years.

The sale of land at 586 Oruarangi Road paves the way for further development with design build options being offered by the new owners. Recent land sales on Oruarangi land have commanded values of approximately \$550/m^2.

Elsewhere however conditions within established industrial areas are tighter. In East Tamaki, for example, industrial development land has become an extremely rare commodity and this has seen land which commanded a value of between \$350 and \$450/m^2 in 2014, now valued at between \$600 and \$900/m^2.

On the North Shore it is a similar story. Scarcity of land within the Albany Basin has seen values continuing to escalate with the recent sale of a 2,950m^2 lot on Arrenway Drive achieving a sales value equating to just over \$710/m^2.

As established precincts approach full capacity development activity has begun to migrate to new industrial zones. Even within these however, land value appreciation has become apparent. To the North of the region land in Silverdale has recently sold for over \$540/m^2 with a lot on Emirali Drive selling at a price equating to approximately \$680/m^2 albeit for a bulk retail end user.

To the west of the city at Westgate land on Northside Drive has recently changed hands for values equating to \$550/m^2 while at Westpoint Drive in Hobsonville sales of between \$620/m^2 and \$650/m^2 have been achieved.

Credit Harder To Come by

Banks have become increasingly risk averse in respect of lending practices, a situation compounded by the Recent Royal Commission inquiry into the Australian Banking sector. One of the outcomes being that banks have been instructed to hold higher levels of capital on their books, thereby reducing funds available for lending.

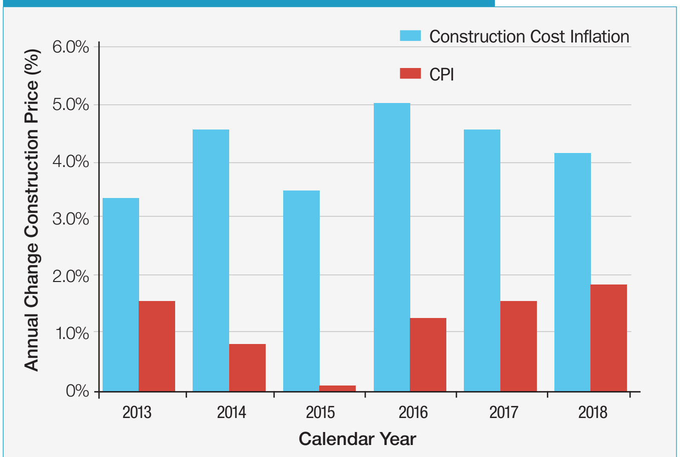
In New Zealand, the Reserve Bank has proposed changes to bank capital requirements which, if implemented, would exacerbate the impacts of the Australian Inquiry.

The response from the banks is likely to be the biasing of lending to low risk borrowers with those that carry more risk finding access to funding increasingly hard to obtain. One of the riskier sectors is property development. Speculative development, in particular, will face additional constraints. Even with clear demand for new industrial space therefore a further increase in levels of development activity will be hard to achieve.

Construction Costs Still Rising

The latest release from Statistics New Zealand shows that construction costs are still on the rise. In the year to December 2018 construction costs increased by a further 4.2% nationally. The latest annual rise was in line with those over recent years as illustrated in the adjacent graph. At 4.2% annual growth is running at more than twice the rate of inflation (1.9% year to Dec 2018).

National Constuction Cost Inflation v CPI



SOURCE: STATSNZ, PRODUCER PRICE INDEX, RBNZ

The rate of increase in construction costs within Auckland are generally accepted to be running well ahead of national averages. In mid 2018 Rider Levett Bucknell reported that over the course of 2017 Auckland experienced cost inflation of 8 percent and forecast 6 percent growth over the course of 2018.

It appears however that the rate of cost inflation may have peaked with both Rider Levett Bucknell and Stats NZ forecasting an easing in rates of increase to approximately 3.5% over 2019 and 2020.

Auckland Industrial Trends 2019

District	Standard Type	Rental Market ($/m²) Ware-house	Rental Market ($/m²) Office/Show	Rental Trend	Leasing Market Demand	Leasing Market Supply	Cap Rate (Yield) Yield	Cap Rate (Yield) Forecast	Investment Market Demand	Investment Market Supply	Land Values $/m²
Wairau Valley	Net	$115 - $180	$170 - $275	Rising	Strong	Scarce	4.5% - 6.0%	Steady	Strong	Scarce	$1,000 - $2,000
Albany / North Harbour	Net	$120 - $150	$200 - $280	Rising	Steady	Scarce	4.5% - 5.5%	Steady	Strong	Scarce	$700 - $850
Silverdale	Net	$105 - $140	$180 - $260	Rising	Strong	Scarce	5.0% - 6.0%	Steady	Strong	Scarce	$550 - $600
Penrose	Net	$120 - $135	$170 - $250	Rising	Steady	Scarce	4.75%-6.5%	Firming	Strong	Scarce	$650 - $1,000
Mt Wellington	Net	$120 - $135	$170 - $250	Rising	Steady	Scarce	4.75% - 6.5%	Firming	Strong	Scarce	$650 - $1,000
West Auckland	Net	$110 - $140	$195 - $250	Rising	Strong	Scarce	6.25% - 7.75%	Firming	Strong	Scarce	$550 - $800
Rosebank Road	Net	$110 - $130	$165 -$210	Rising	Strong	Scarce	6.0% - 8.0%	Firming	Strong	Scarce	$550 - $900
East Tamaki	Net	$120 - $150	$240 - $255	Rising	Strong	Scarce	4.75% - 6.25%	Firmiing	Strong	Scarce	$600 - $900
Airport Corridor	Net	$120 - $135	$230 - $260	Rising	Strong	Scarce	5.00% - 6.00%	Firming	Strong	Scarce	$550 -$650
Manukau/Wiri	Net	$110 - $135	$160 - $235	Rising	Strong	Scarce	5.0% - 7.25%	Steady	Strong	Scarce	$550- $625
Drury	Net	$110 - $120	$220 - $230	Rising	Steady	Scarce	5.2% - 7.25%	Steady	Steady	Scarce	$320 - $375

Industrial Sector Investment Returns Stronger for Longer

The low interest rate environment which New Zealand, along with most western economies, has had since the Global Financial Crisis (GFC) has seen investors searching for higher yielding assets. Commercial and industrial property has been one of the favoured investment vehicles with there being high levels of competition for the limited number of premises brought to market.

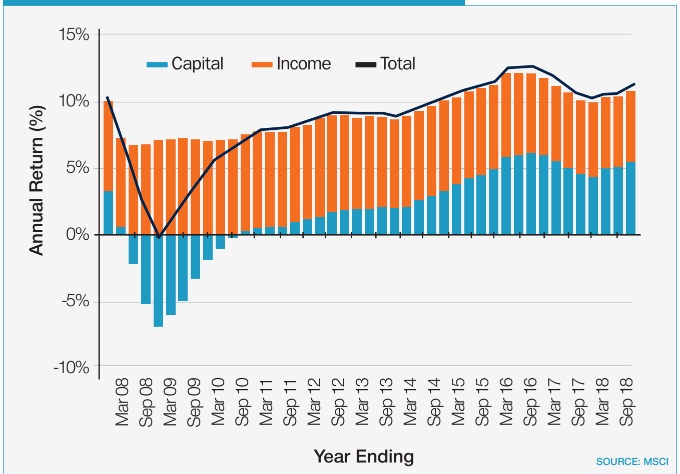
This competition has resulted in significant compression of yields over recent years which has seen capital values rise. In tandem with the upward pressure on rentals which ultra tight market conditions have driven the result on total property returns has been positive.

While most commercial property sectors have performed well it is the industrial sector which has provided the highest returns over an extended period of time according to statistics released by MSCI.

In the year to September 2018 industrial property, nationally, returned 13.2% continuing a run of double digit returns which began in March of 2012. The latest figures include a capital return of just over 6.5% reflecting ongoing yield compression.

Further analysis conducted by MSCI shows property located within Manukau and the airport corridor to have outperformed the wider market generating total returns of 15.6% in 2018 including a capital return of 9%.

Investment Returns Industrial Property



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