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Business Growth Drives Demand

Conditions within Auckland's industrial property market have remained extremely tight over the last year as the development sector, despite ramping up activity, has failed to meet increasing demand. The region's powerfully performing economy has seen new business formation and expansion driving tenant demand holding vacancy rates at multi year lows. Upward pressure on rentals combined with yield compression, fuelled by high levels of competition for limited investment opportunities, has seen the industrial sector continuing to provide strong investment returns. With development land within most established precincts both scarce and expensive, future development will increasingly migrate to new precincts to the south, west and north of the city.

Auckland's industrial sector has been in expansion mode for a number of years as illustrated by business demography statistics published by Statistics New Zealand. The latest data, which covers the year to March 2016, shows the number of locations from which industrial businesses operate having reached new record levels. The employee count has, for the first time, surpassed levels reached prior to the Global Financial Crisis (GFC).

Employment growth has been particularly evident within the construction sector, unsurprising given the significant increase in residential, commercial and infrastructure projects evident over recent years. The sector's employee count has increased by approximately 34% since 2012. The number of locations from which Transport, Postal and Warehousing businesses operate from has increased by just over 17% over the same period.

Vacancy Rates Hold at Low Levels

The region's overall vacancy rate was all but unchanged between 2016 and 2017 according to the results of the *Bayleys Research* vacancy survey. The overall vacancy rate stands at 3.5% compared with 3.2% 12 months earlier. This is despite the fact that approximately 153,550m^2 of new space has been added to the survey area's inventory over the 12 month period. The survey covers property within the region's major industrial precincts, East Tamaki, Penrose, Wiri, Mount Wellington, Rosebank, The Airport Corridor and the Albany Basin.

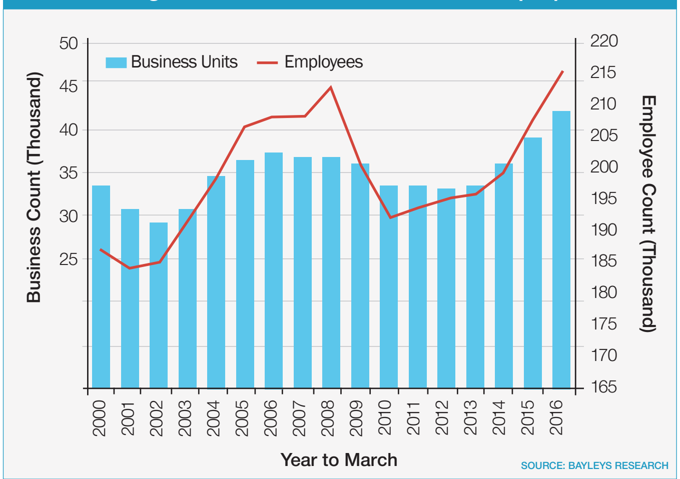
Vacancy is tight across the board ranging from just 1.1% within the Albany Basin to 7.1% in East Tamaki. Vacancy has fallen in four precincts and risen in three with the changes all but cancelling each other out. In total over 4.8 million square metres of space is surveyed across the precincts with just 167,350m^2 being vacant at date of survey.

Vacancies have increased in the region's two largest precincts. In East Tamaki the change has been caused, predominantly, by two companies vacating space while within the Airport corridor, high levels of development has led to a small rise in the vacancy rate.

The most significant increase was noted in East Tamaki a result of space becoming available within Springs Road as a result of changes in occupation by Fisher and Paykel and brewer Lion. Lion has vacated 11 Springs Road while Fisher and Paykel put on the market to lease space which it did not require within its Headquarters at 78 Springs Road. Subsequent to the survey date, both premises have been leased. Taking these lettings into account would put East Tamaki vacancy at approximately 3.5%.

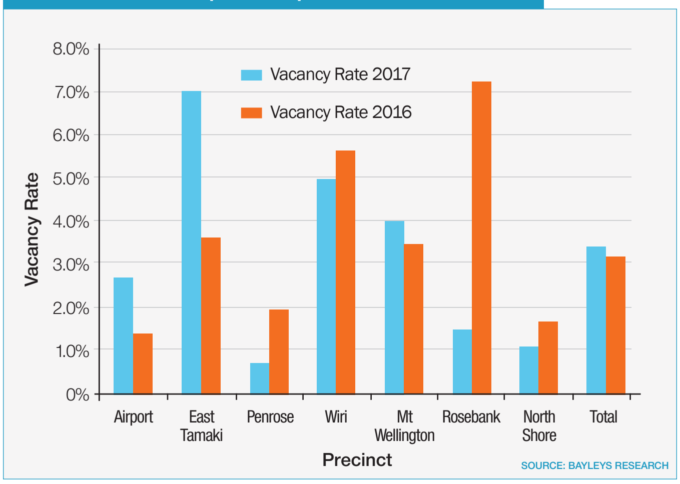
The Rosebank precinct has witnessed the sharpest reduction in vacancy with the rate falling from 7.3% to 1.5% between surveys. The uptake of space at 460 Rosebank Road by French Country Collection and Aeroqual as well as 41 Jomac Place by Methven being the most significant contributors to the fall.

Auckland Region Industrial Business Units v Employee Count



SOURCE: BAYLEYS RESEARCH

Industrial Vacancy Rate by Precinct 2017 v 2016

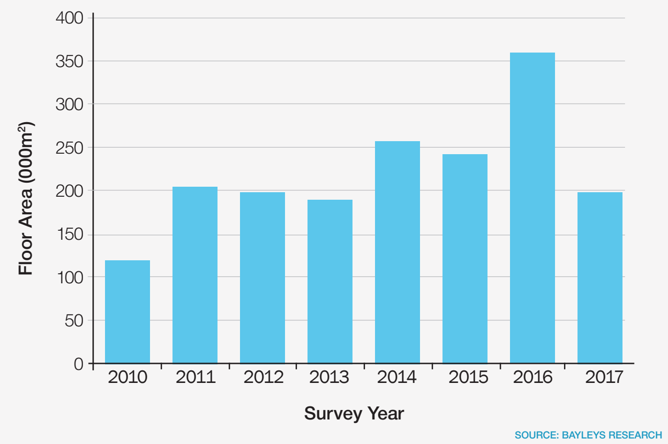


SOURCE: BAYLEYS RESEARCH

Development Activity Follows Land Supply

Vacancy rates have held at historically low levels over recent years despite the fact that development activity has ramped up post the Global Financial Crisis. Building consents data release by Statistics New Zealand shows that over 1,000,000m² of new industrial space has been consented across the Auckland region over the last four years.

Auckland Region Industrial Building Consents by Floor Area

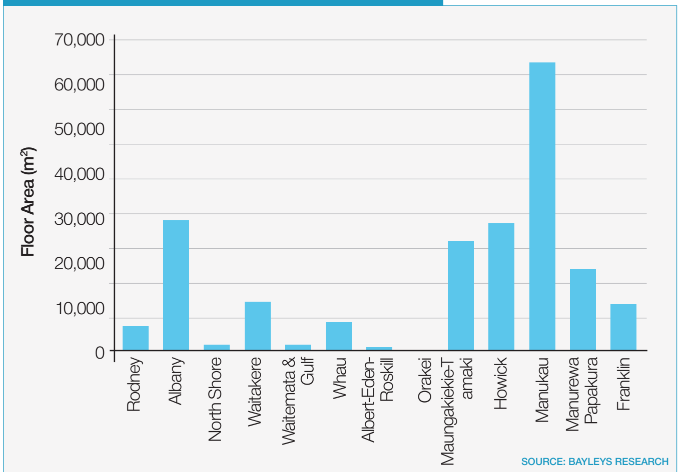


As the graph above illustrates, consents over the 12 month period to April 2017 have dipped following a particularly strong figure a year earlier. This in part reflects the fact that development is being hampered, within a majority of the established industrial precincts, by a shortage of land. In addition, that land which does exist has generally become too valuable for industrial development to be financially viable.

As a result development is predominantly occurring within areas where single land owners have held significant landholdings for some time, e.g. at Auckland International Airport, or within emerging precincts on the periphery of the City.

Confirmation of the above trends is provided by Stats NZ data building consents by Ward, as shown in the graph below.

Industrial Building Consents by Ward



In the 12 months to April 2017 the three wards which have witnessed the greatest development activity are Manukau, which incorporates the Airport corridor, Howick, which incorporates Highbrook, and Albany which incorporates the growth areas of Westgate to the west of Auckland and Silverdale to the north.

The North Shore which includes the traditional industrial precincts of Wairau and the Albany Basin, where lack of land and increases in land value are particularly acute, has seen practically no new industrial development activity over the last year.

Airport Development Continues

Bayleys Research's latest survey has found that the total industrial building inventory within its Airport Corridor survey area increased from 892,745m² in early 2016 to 1,025,290m² in early 2017. The area surveyed by Bayleys Research encompasses parts of Airport Oaks in Mangere, located west of George Bolt Drive and between Kirkbride Rd and Montgomerie Rd where property is predominantly in private ownership, as well as land to the south and east of this which is mostly owned by Auckland International Airport Ltd. The largest contributor to the increase in industrial premises over the last year is the massive 52,000m² Mangere manufacturing facility constructed for Sistema, the New Zealand-based manufacturer of plastic storage containers which exports to over 90 countries.

A further six hectares of former paddocks in front of this site on Oruarangi Road are also currently being developed or about to be developed, the first project being a new distribution centre at 576 Oruarangi Road for medical equipment distribution company Rem Systems Ltd Scheduled for completion late this year, the project encompasses 5,311m²of warehousing, with a stud height of 10.3m to 12.2m, and 660m² of office located on a 1.1ha site.

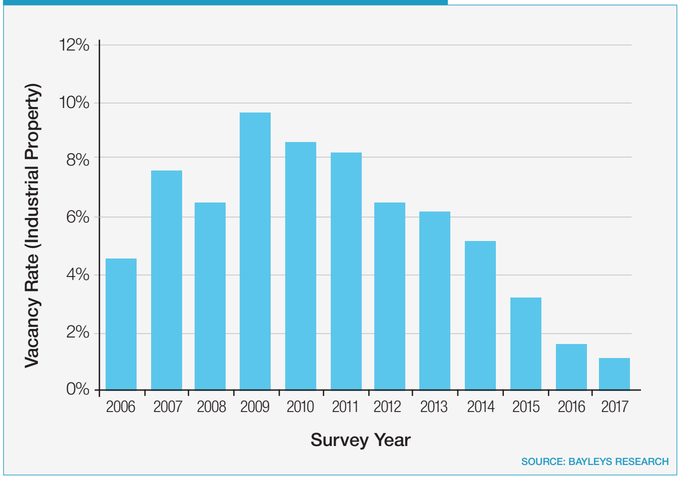
Despite the high level of development within the precinct the vacancy rate at time of survey still sat at under 3%. This reflects the fact that a majority of development continues to be on a design build basis.

Tight North Shore Conditions push Development North and West

Vacancy rates within the Albany Basin fell again as at the 2017 survey date falling to a new record low of just over 1%.

The latest total was achieved despite approximately 25,500m² of space being added to the inventory reflecting the ongoing demand for space within the area. Major additions include 93 Apollo Drive with a total floor area of approximately 3,850m² which has been leased to Anzor, 79 Apollo Drive, occupied by Shimano and 81 Apollo Drive leased to John Guest. The on going strength of leasing activity is well illustrated by the uptake of space by companies such as Nulook at Bush Road, Pauling Industries at Volkner Place and Pharmacy Direct at Paul Matthews Road.

Albany Basin Industrial Vacancy Rate



While, as stated above, development activity has taken place within the precinct over the last year, the ability of the development sector to meet the demand of both new and expanding businesses within the area is severely hampered by a shortage of affordable business land available for development within the North Shore's established industrial areas.

The lack of land is forcing a growing number of companies to look further north and west. The opening of the Waterview tunnel which completed the new western ring road, links to which are being further enhanced by the northern corridor roading improvements, has seen new west Auckland precincts such as Hobsonville and Westgate becoming popular choices for North Shore based companies looking for the ability to expand.

In Hobsonville the Neil Group's Workspace Sub-division has been fully sold down and development activity has been brisk. Jomac's site which neighbours Workspace has also seen high levels of tenant interest. Companies which have made the move to Hobsonville include Sherratt Ingredients which occupies approximately 3,000m^2 of space in Workspace Drive as an owner occupier. Makita has taken a lease at Westpoint Drive occupying approximately 3,500m^2 relocating from Albany. Black Steel Mobile is another North Shore Company which has chosen to purchase its new headquarters in Westpoint Drive. Construction is ongoing with Kea group, which developed the Makita Premises, now working on new premises at 39 Westpoint Drive.

The high levels of interest in the Hobsonville area has already resulted in upward pressure on both land and rental values. Fully serviced land is now commanding values of approximately \$500/m^2. The rents being achieved on new warehouse space fall within the range of \$120 - \$140/m^2 while office space can command rentals of up to \$250/m^2.

At Westgate, much of the new development activity is occurring on Northside Drive where Storesafe and G.J.Gardner have taken occupation of new premises. At 9 Northside Drive the sell down of phase one of the development is complete with phase two now having been released to market.

Silverdale is also being favourably viewed as an alternative base of operations north of the Harbour Bridge. Within the town's established industrial area centred on Foundry Road new development has taken place on Furnace Road with Linen and Things and Young and Robins amongst the new occupants.

On Foundry Road resource Consent has now been granted for the development of the Silverdale Trade Centre which will comprise 10 new office / showroom and warehouse units, including the option for Unit 10 to be a cafe' or showroom.

Highgate Business Park, the town's new hub for commercial and industrial developmen. Currently under construction is a new 10,500m^2 office / warehouse property, being developed by Argosy, for tenant Mighty Ape which will be relocating from its current Albany property due to a requirement for larger premises. Mighty Ape has agreed to sign a new ten year net lease commencing from the date of practical completion, with two yearly rent reviews to market.

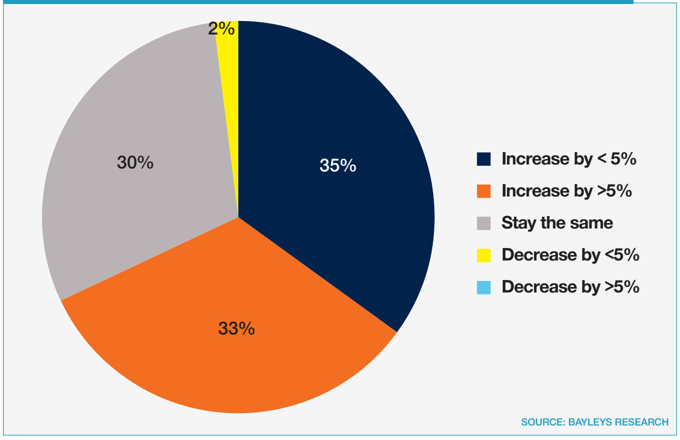
Sentiment Points to Rental & Value Gains

Industrial rental and capital values are set to rise over the next 12 months according to the results of *Bayleys Reasearch's* new commercial and industrial sentiment survey.

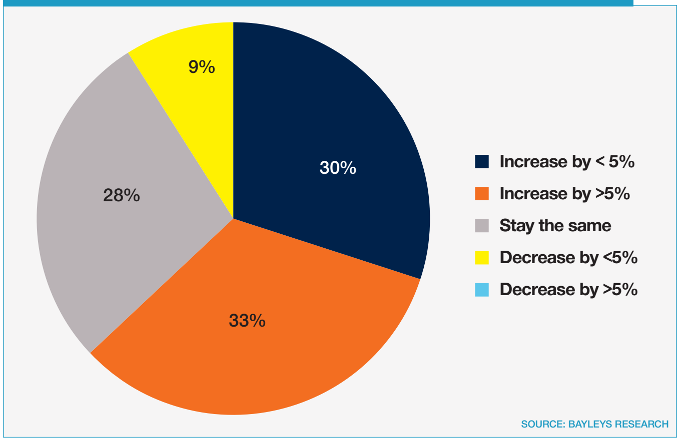
With reference to rents, 68% of respondents expect rents to rise. Of those expecting rents to rise almost 50% anticipate increases in excess of 5%.

The results are similar with regard to views for the prospects for capital growth. In this instance 62% of respondents advised that they expected rents to increase. Of those in the "growth camp" 52% believe that value gains will top 5% over the year ahead.

Auckland Industrial Rental Movement Over 12 Months Sentiment Survey Responses



Auckland Industrial Capital Value Movement Over 12 Months Sentiment Survey Responses



The survey sought responses on commercial and industrial markets in Auckland, Wellington, Christchurch, Whangarei, Hamilton Tauranga and Queenstown.

Sentiment surrounding the likelihood of rental increases over the next year was more positive in respect of the Auckland industrial sector than for all other sectors and regions with the exception of the more boutique Queenstown market. The sector also ranked highly in terms of expectations for capital value growth ranked fifth overall.

As noted later in this report Auckland located industrial property has generated double digit total returns over the last five years. Should rental and capital values move as the sentiment survey suggest, another year of strong returns will be generated by the sector.

Yields See Further Compression

Industrial property continues to be extremely attractive to commercial property investors given its reputation as a steady performer. Analysis of Core Logic data by *Bayleys Research* shows that approximately 56% of all Auckland's annual commercial property sale transactions in 2016 were in the industrial sector.

However, due to the lower dollar value of properties within the sector compared to the office and retail sectors, the aggregate value of industrial properties sold was much lower - just 43% of total commercial sales. Considering that 85% of all commercial property transactions in New Zealand sell for \$2 million or less, industrial property is attractive to purchasers, but bidding is competitive.

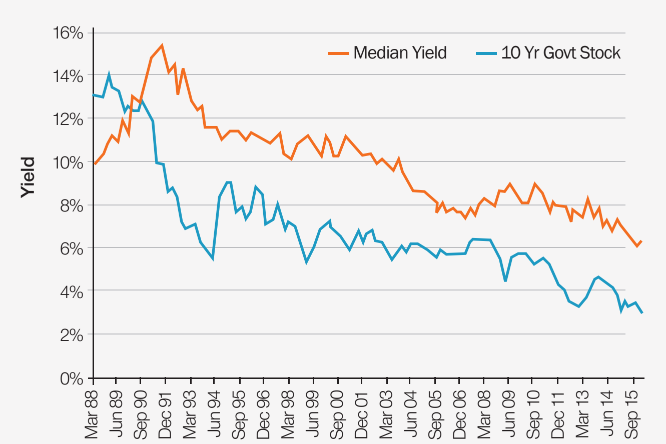
Auckland Industrial Trends 2017

		Rental Market ($/m²)			Leasing Market		Cap Rate (Yield)		Investment Market		
District	**Standard Lease Type**	**Ware-house**	**Office/ SRoom**	**Rental Trend**	**Demand**	**Supply**	**Yield**	**Fore-cast**	**Demand**	**Supply**	**Land Value $/m²**
Wairau Valley	Net	$90 - $145	$150 -$250	Rising	Strong	Scarce	4.5% - 6.0%	Steady	Strong	Scarce	$1000 - $1,300*
Albany / Nth Harbour	Net	$115 - $140	$200 - $265	Rising	Strong	Scarce	4.75% - 6.0%	Steady	Strong	Scarce	$500 - $650
Silverdale	Net	$100 - $120	$160 - $220	Rising	Strong	Scarce	5.0% - 7.0%	Steady	Steady	Sufficient	$400 - $500
Penrose	Net	$90 - $130	$140 - $240	Rising	Steady	Scarce	5.5% - 7.0%	Firming	Strong	Scarce	$500 - $700
Mt Wellington	Net	$90 - $130	$140 - $240	Rising	Steady	Scarce	5.5% - 7.0%	Firming	Strong	Scarce	$500 - $700
West Auckland	Net	$100 - $140	$175 - $250	Rising	Strong	Scarce	6.25% - 8.5%	Firming	Strong	Scarce	$400 - $550
Rosebank Road	Net	$100 - $130	$150 -$200	Rising	Strong	Scarce	6.0% - 8.0%	Firming	Strong	Scarce	$400 - $650
East Tamaki	Net	$100 - $125	$130 - $250	Rising	Strong	Scarce	5.75% - 7.0%	Firming	Strong	Scarce	$400 - $600
Airport Corridor	Net	$110-$125	$210 - $250	Rising	Strong	Scarce	5.25% - 6.25%	Firming	Strong	Scarce	$320 - $450
Manukau/Wiri	Net	$90 - $120	$140 - $225	Rising	Strong	Scarce	5.75% - 7.75%	Steady	Strong	Scarce	$400 - $550

ESTIMATED DUE TO SCARCITY OF TRANSACTIONS

SOURCE:BAYLEYS RESEARCH

Median Yield v 10 Year Government Stock



SOURCE: BAYLEYS RESEARCH

Investors have also had to compete with owner occupiers with the latter sector of the market taking advantage of low interest rates to secure their premises. The result has been a further tightening of yields over recent months.

Results from the latest *Bayleys Research* Auckland industrial yield index show the median yield to have fallen to 5.4% having sat at 6.3% as at the March quarter of 2016. The latest figure compares with the 10 year average of 7.6%.

The weight of competition for a relatively limited amount of stock being introduced to market has driven down yields. The latest figures also reflect the fact that interest rates remain at historically low levels. As the graph above illustrates despite the tightening of yields witnessed over recent years there is still a risk premium of just over two percent.

Industrial Returns Hold at High Levels

Latest data from MSCI shows industrial investment property to have performed strongly over the last year. Over the 12 months to March total returns stood at 13.7%, the capital return element stood at 6.6%. The continued rise in capital values reflects the upward pressure on rentals which has been driven by record low vacancy levels and the ongoing compression of yields.

Returns from industrial property, have again, outpaced those generated by the commercial office and retail sectors.

This variance in returns across the sectors has been ongoing for some time now as illustrated in the table below which shows annual average returns from the industrial sector to have outperformed the other major sectors over the last 15 years.

Total Returns All Sectors

ANNUAL AVERAGE	ALL PROPERTY	RETAIL	OFFICE	INDUSTRIAL
1 Year	10.4	8.2	10.0	13.7
3 Year	11.7	11.2	10.6	13.7
5 Year	11.3	10.9	10.6	12.4
10 Year	8.5	8.2	7.9	9.8
15 Year	11.3	11.4	10.9	11.9

YEAR TO MARCH

SOURCE: MSCI

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