How LOW CAN THEY GO?

Yields on investment properties are at unprecedentedly low levels. Bayleys' national director commercial John Church looks at what's driving the downward pressure on income returns and whether this is likely to ease up any time soon.

Bayleys' *Total Property* portfolio auctions are a useful barometer of what is happening in the commercial and industrial property market, providing a good indication of market demand in this sector and where prices and yields are at.

Results can vary somewhat from auction to auction depending on the quality of offerings, but overall they provide a reasonably reliable overview of market trends. The first of what will be seven *Total Property* national auctions in 2016 took place in April and set the tone for the year.

Firstly they indicated that the huge appetite for commercial and industrial property that was evident in 2015 has rolled on through into 2016.

We had a bumper crowd at our Auckland auction on April 13 and a 100 percent clearance rate – with 11 out of 12 offerings selling at or before the auction, and one post.

The Bayleys Wellington office also had a good auction the next day, selling five out of six under the hammer.

This level of clearance, which is also being mirrored in our residential auction results, is a reflection of just how strong the demand for property is at present.

It is also a reflection of the relatively limited supply of commercial properties being presented for sale.

This is because the alternatives offered in an investment market characterised by low bank and bond rates and sharemarket volatility aren't that enticing. Therefore the supply/demand balance is seriously skewed to the demand side at present.

This imbalance, in combination with a continuing reduction in interest rates, has pushed commercial yields to levels that are lower than anyone could have reasonably forecast. Of the eight investment properties that sold under the hammer at the Auckland auction, four sold for under 5 percent and three between 5 percent and 6 percent.

The days of higher value properties commanding higher yields seem to have disappeared, for the moment at least. The lowest yielding property, a BNZ outlet in the Lincoln North Shopping in Henderson which sold at a 4.37 percent yield, also fetched the highest price of $3,020,000. It was declared on the market by auctioneer Richard Valintine at $2,450,000 and a long sequence of mostly $10,000 increases added a further $570,000 to the price before the hammer finally came down.

Provincial Bayleys' auctions in April also exhibited a similar firming yield trend, albeit at a higher level than in Auckland. A childcare centre in Tauranga sold at a 6.1 percent yield, an industrial building in Hamilton occupied by Hill Laboratories sold at a 6.55 percent yield while a commercial building at the entrance to Blenheim's CBD, anchored by Domino's Pizza, sold at a 6.6 percent yield. (Further details of these and other non-auction sales can be found in the Sales Snapshot section of this magazine.)

These transactions indicate that investors are prepared to pay a premium to secure a scarce supply of properties in good locations with well-established tenants. However, yields also tend to track interest rates down. Over the past year, the Reserve Bank has reduced the Official Cash Rate (OCR) from 3.5 percent to 2.25 percent so it is not altogether surprising that property yields have probably also moved by more than one percentage point on average over this time as well.

Whether they go any lower will be influenced by whether the Reserve Bank makes any further reductions in the OCR. However, yields must be close to plateauing, particularly in Auckland. Banks have also indicated they are facing increased costs for their offshore borrowings because of global economic uncertainty. Consequently, it is by no means certain that banks will necessarily pass on any further cuts in the OCR to customers.

Most future capital appreciation in commercial and industrial property values is therefore likely to come from the rental growth resulting from the very low vacancy rates that are evident across many sectors of the market. In this regard, it could be argued that rental increases have lagged behind spiralling land prices and construction costs and that now is the time for a catch up.

TOTAL property live REGIONAL EXPO

Planning is well advanced for our first regional commercial and industrial property expo to be held in Auckland on June 9th. The expo will showcase listings from outside Auckland featured in this issue of *Total Property*.

Exhibition stands will be manned by Bayleys' commercial representatives from around the country and there will also be presentations on regional economies and property markets by NZIER and Bayleys Research. The expo is the result of the current high level of interest being shown by Aucklanders in property opportunities elsewhere in the country.

The expo will be held on the ground level of Bayleys' central Auckland premises at 4 Viaduct Harbour Avenue from 4pm to 8pm on Thursday, June 9th. Investors wanting to attend can register their interest at bayleys.co.nz/regionalexpo.