HEADLINES:
- Vacancy rates hold at historic lows
- Yields reach cyclical low
- Sentiment remains positive

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# Bayleys Research

## Auckland Industrial Report

Auckland's economic expansion has continued apace over recent months, with the regional GDP having topped $100 billion according to Statistics New Zealand figures (Stats NZ). New business formation and expansion has continued to ramp up demand for business space with this demand, in the industrial sector, outpacing new development. As a result, vacancy rates have continued to decline whilst rents have faced further upward pressure.

Increasing development activity is hindered by a shortage of, and the increased cost of, land, particularly within established precincts. This has increasingly seen a migration of construction activity to new precincts on the periphery of the city.

Continued demand for a limited supply of industrial investment assets has seen yields holding at historically low levels, a situation likely to remain in play over the short to medium term future given the relatively benign outlook for interest rates.

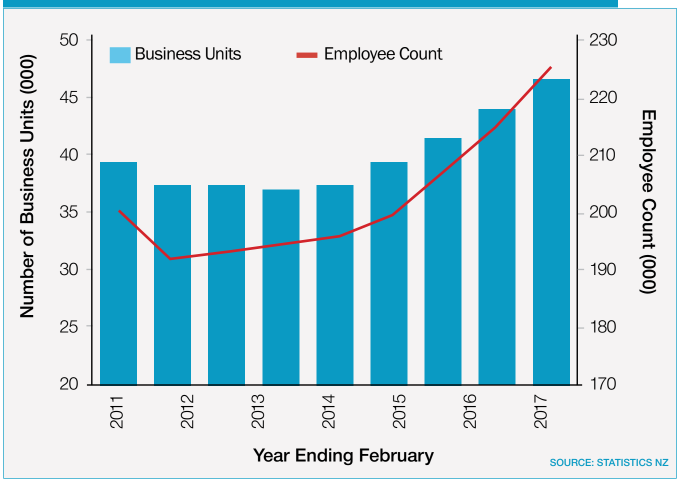
Whilst sentiment, amongst both property owners and occupiers, has softened slightly since the 2017 election it remains positive with further increases in both rental and capital values anticipated by a majority of respondents to the latest  Bayleys Research sentiment survey.

## Vacancy Holds at Historically Low Levels

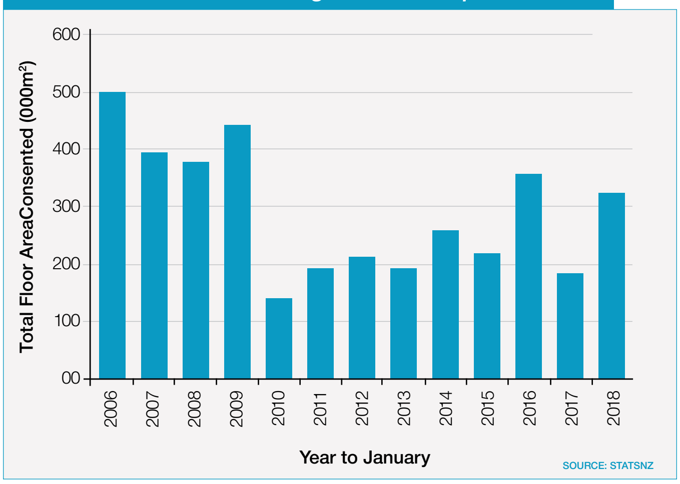
Vacancy rates across Auckland's leading industrial precincts have held at historically low levels as demand for space has outpaced new development, despite an acceleration in construction activity. Demand has been driven by a local economy which has continued its rapid expansion. Auckland's GDP surpassed $100 billion for the first time in then year to March 2017 and continues to perform strongly with GDP growth of 2.9% over the 2017 calendar year (Infometrics / Auckland Council).

Unsurprisingly there has been a significant response from the development sector with the total floor area of new building consents issued for industrial premises topping 320,000m2 for the second time in there years. While development activity still lags that apparent prior to the Global Financial Crisis, high demand for space and the opening of new industrial precincts, supported by new roading infrastructure, is likely to see construction activity holding at elevated levels over the course of 2018.

### Auckland Region Business Units and Employee Count




### Auckland Industrial Building Consents (by Floor Area)




Results of the latest vacancy survey conducted by Bayleys Research show the overall vacancy rate, across the region's largest industrial precincts, to be sitting at 2.8%. The latest figure is all but unchanged from that recorded in 2017 and 2016 reflecting the high levels of business growth and expansion within the region.

With tight market conditions persisting we would expect industrial rents to face further upward pressure strongly underpinning capital values.

Compared with the 2017 survey results vacancy fell across the Airport corridor, East Tamaki and Mount Wellington precincts. The rate was unchanged within the Rosebank Road industrial area while there were small upward movements in Penrose, from a low of less than 1% last year, Wiri and the North Shore.

East Tamaki, the region's largest industrial precinct saw the vacancy rate falling by approximately half from 7.1% to 3.4%. The decline was, in part, due to the temporary removal from the survey of the ex Lion Breweries site in Springs Road. Owners Stride have plans to redevelop the site with works to include the demolition of the existing site structures to make way for a purpose built 8,285m$^2$ industrial facility for Waste Management. Occupying the entire site, the development will provide comprehensive logistics and operational buildings.

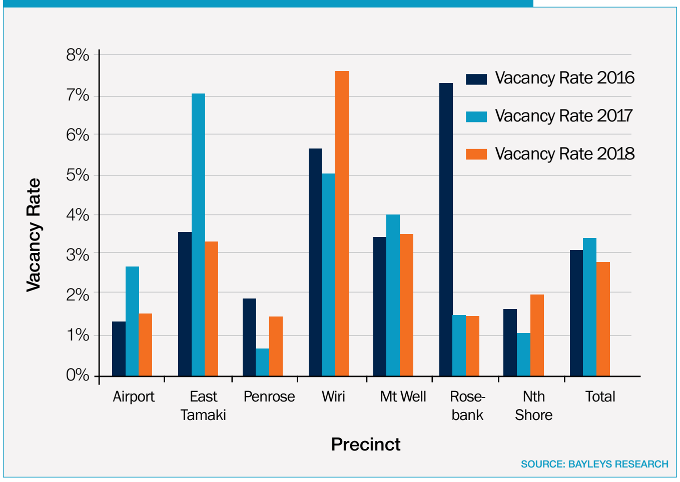
Following the completion of the redevelopment (targeted for the quarter ending September 2019), Waste Management will commit to a lease with Stride for an initial 25 year term, with initial net rental of $3.89 million per annum and structured rental growth.

Few large scale vacancies remain within the East Tamaki precinct with a majority of units available to lease being less than 400m$^2$.

The airport Corridor has also seen vacancy rates fall with the rate sitting at just 1.5%, as at the date of the latest survey. The precinct's vacancy rate has halved since 2015 when it stood at 3.1%. This reduction has been achieved despite the fact that the precinct has experienced significant growth in recent years. Since 2015 the total floor area surveyed within the area has increased by over 29%.

Much of the development in the precinct has been driven by the Airport company itself. Over recent months it has completed a new 6,000m$^2$ building to accommodate the Ministry for Primary Industries and a new 7,000m$^2$ warehouse and office facility for international freight forwarding specialist Röhlig Logistics. In addition construction of a new 20,000m$^2$ distribution centre, to be occupied by Bunnings has also been progressed.

## Auckland Industrial Vacancy Rate by Precinct



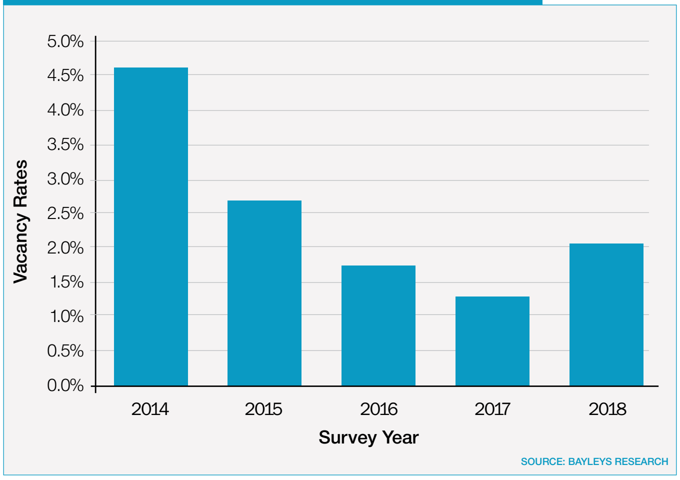

Penrose continues to boast the tightest conditions within the major Auckland precincts, with vacancy sitting at just 1.4%. The latest figure is up marginally on 2017's figure of 0.7% due to the relocation of National Signs and Impressions International. These movements impacted the figures slightly more than the re-introduction of 57 Walls Road to the survey, following its refurbishment and occupation by Flint Group.

The precinct with the region's highest vacancy rate is Wiri where the latest figure is 7.6%, up from 5.1% a year earlier. The upward movement in the figures is, predominantly, the result of the departure of tenants from 70 Kerrs Road and Honda NZ's move from 105 Wiri Station Road which has left two large scale vacancies.

## North Shore Conditions Remain Tight

Mirroring the trends evident across the wider region, conditions within the North Shore industrial market remain extremely tight. Vacancy within the Albany Basin as at the date of Bayleys Research' latest survey was 2.1% up only marginally from the 1.3% recorded in 2017.

## Albany Basin Industrial Property Vacancy Rate




Across the area's three precincts, Mairangi Bay boasted the lowest rate at just 1.3% albeit this was up from 0.6% in 2017. The other two precincts saw little change in their rates with North Harbour registering 2.0% and Rosedale 2.5%.

The stability within the vacancy rates reflects the fact that the strong demand for property from both tenants and owner occupiers means that premises which become vacant are quickly reoccupied. The appetite for space is well illustrated by strong leasing activity which followed the release of newly developed units within Corinthian Drive.

Unsurprisingly, given current market conditions, rental levels are experiencing upward pressure with new product setting new benchmark levels and, as a consequence, dragging general levels higher.

The upward movement in rentals combined with the yield compression evident within the Auckland market over recent years has seen values rise which, in a low interest rate environment has helped make new industrial development viable despite the sharp rise in land values.

The North Shore's other established industrial precinct, Wairau Valley, is experiencing similar trends. Agency reports advise that vacancy is at negligible levels with strong tenant and owner occupier demand, particularly for smaller properties in the 300m$^2$ to 600m$^2$ size range.

Recent sales have illustrated the yield compression which has resulted from intense competition for property from both investors and occupiers. 17 Ashfield Road for example sold in April 2018 for $1,700,000 reflecting a yield of 4.5%.

Investors however are facing competition from owner occupiers, benefitting from low interest rates, looking to secure property for their business purposes and to protect themselves from increasing rental levels. This has resulted in a number of instances in which vacant premises have sold for higher prices than comparable tenanted investments.

The lack of development land and competition for space within the Albany Basin and Wairau Valley has seen local companies, seeking to expand, increasingly, migrating to the north and northwest of the city.

A recent example being OneOne Health which has vacated its previous Interplex headquarters for newly developed premises at Westpoint Drive in Hobsonville.

Notable new entrants to the local tenant pool is Kiwi Storage which has taken occupation of the first of the buildings at 110 Hobsonville Road, further construction on site is currently progressing.

Westgate another of the region's emerging industrial precincts has also witnessed expansion over the last 12 months including completion of the multi unit Founders Lane development.

At Silverdale, evidence of the region's strong leasing market is again apparent, with vacancy within the towns most established industrial precinct surrounding Foundry Road at negligibly low levels.

Although a lack of land has limited new development, at 30 Foundry Road a new 10 unit office / showroom and warehouse complex is under construction and due for completion in October of this year. The project has attracted strong leasing success with local and national companies agreeing terms.

A majority of future growth, within the precinct, however, will take place immediately to the north at Highgate Business Park. Over the last 12 months, e retailer, Mighty Ape has taken occupation of its new headquarter and and distribution property on Highgate Parkway. On an adjacent site, 22 Highgate Parkway a proposed development of 12 units being marketed "off the plan" has met with sales success with 60% of the units having sold at values of over $3,100/m$^2$.

Kea Property have successfully developed new industrial premises on a speculative basis with units selling, off the plan for between $3,700/m$^2$ and $4,000/m$^2$. Further additions to the local industrial inventory are to be developed in Emriali Road. The proposed development illustrates the importance being placed upon a property's configuration, in order to maximise its appeal to target markets. In this case the buildings are to feature a 10+ metre Stud height, minimal office content and a large canopy.

Increased development activity has seen land values surge in the area moving from $385/m$^2$ in late 2016 to in excess of $500/m$^2$. Agency comments suggest that sites benefitting from high visibility to State Highway 1 could command a sale price of up to $600/m$^2$.

## Sentiment Remains Positive

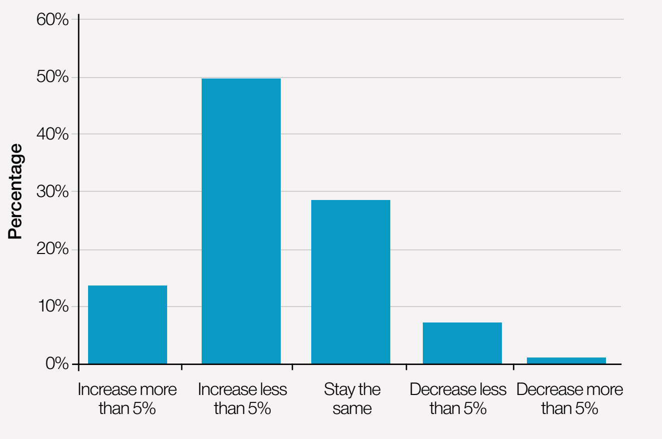
Results of the latest Bayleys Research commercial and industrial sentiment survey shows that respondents remain positive about prospects for further rental and capital growth over the next 12 months.

In respect of rents, approximately 69% expect an increase versus just 7% anticipating a decline. 50% of respondents expect the increase over the year will be up to 5% with a further 14% tipping increases of in excess of 5%.

When questioned about views on capital values, sentiment was similar with 59% expecting values to rise, with just over 18% anticipating the increase to top 5%, while only approximately 10% foresee a fall.

The slightly lower reading for those expecting capital gains versus rental rises is based on the view that yields have reached their cyclical low. A number of respondents commented that over the next 12-24 months they expect interest rates to rise with a consequent easing of cap rates.

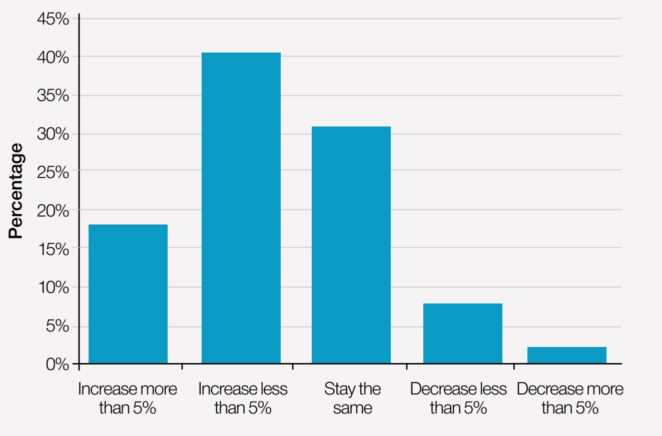
## Expectation of Changes in Industrial Rents




SOURCE: BAYLEYS RESEARCH

Results from the latest survey show confidence to have stabilised having dipped in the final quarter of 2017, post election. In mid 2017, the number of respondents expecting both rental and capital values to rise by over 5%, over 12 months, was elevated, at 35% and 29% respectively. Survey responses still highlight concerns following the change of government, including the impact on the ability of occupiers to manage costs following increases in the minimum wage and a change in approach in regard to spending on transport infrastructure. Other responses continued to cite a lack of clarity in some policy positions as a hindrance to business planning. It appears however, given the fact that overall sentiment remains positive, that both property owners and occupiers are adjusting to the new regulatory backdrop.

## Expectation of Changes in Industrial Values



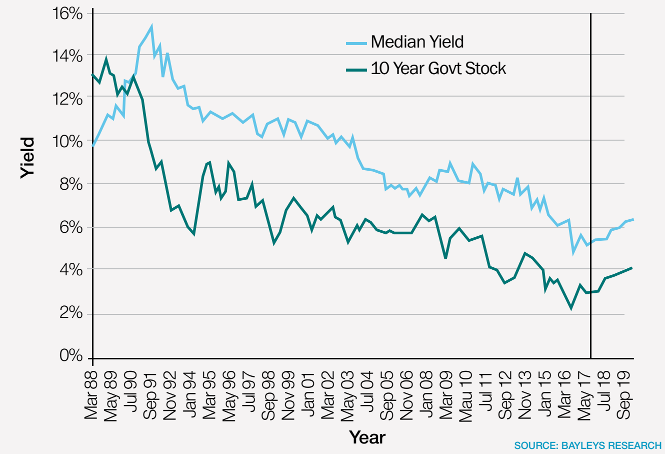

SOURCE: BAYLEYS RESEARCH

## Yields Holding at Low Levels

The median yield achieved from Auckland located industrial property investment sales in the final quarter of 2017 was 5.4% according to the latest Bayleys Research Auckland industrial yield index.

The median yield has remained at sub 6% since the final quarter of 2016 reflecting the ongoing demand for property assets in a low interest rate environment. Interest rates across the western world, have been held at stimulatory levels since the Global Financial Crisis (GFC). Against this backdrop, investors, ranging from individuals, through syndicated offerings, to international superannuation funds have sought out higher

## Median Auckland Industrial Property Yield v 10 Year Government Stock




SOURCE: BAYLEYS RESEARCH

yielding assets, which has included property. Whilst competition for, a limited supply of investment product, has driven yields to historic lows, returns have continued to provide a premium over risk free alternatives. As the graph below illustrates, the risk premium over the returns generated by New Zealand 10 year government bonds has been holding at approximately 2.0% - 2.5%.

Looking ahead it is likely that yields have reached their cyclical low. That having been said, a sharp increase in yields remains unlikely as increases in interest rates increases are almost certain to be limited and spread over an extended time frame. Central Banks, whilst wishing to "normalise rates" do not want to risk stalling economic growth through a premature increase in borrowing costs.

In New Zealand, the Reserve Bank (RBNZ), has repeatedly confirmed that interest rates will remain accommodative for a considerable period. A majority of economic commentators take this to mean that the OCR will remain on hold until late 2019. If this is the case then investment property yields will hold at close to current levels over the short to medium term.

## Auckland Industrial Trends 2018

| District | Lease Type | Rental Market | | Rental Trend | Leasing Market | | Cap Rate (Yield) | | Investment Market | | Land Value $/m² |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Warehouse | Office/Show | | Demand | Suppluy | Yield | Forecastr | Demand | Supply | |
| Wairau Valley | Net | $115 - $170 | $150 - $250 | Rising | Strong | Scarce | 4.5% - 6.0% | Steady | Strong | Scarce | $800 - $2,000 |
| Albany /Nth Harbour | Net | $115 - $150 | $200 - $280 | Rising | Strong | Scarce | 4.75% - 6.0% | Steady | Strong | Scarce | $550 - $650 |
| Silverdale | Net | $105 - $150 | $180 - $250 | Rising | Strong | Scarce | 5.0% - 6.0% | Steady | Strong | Scarce | $500 - $600 |
| Penrose | Net | $115 - $125 | $150 - $245 | Rising | Steady | Scarce | 5.00% - 7.0% | Firming | Strong | Scarce | $550 - $950 |
| Mt Wellington | Net | $115 - $125 | $150 - $245 | Rising | Steady | Scarce | 5.00% - 7.0% | Firming | Strong | Scarce | $550 - $950 |
| West Auckland | Net | $100 - $140 | $175 - $250 | Rising | Strong | Scarce | 6.25% - 7.75% | 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 | $115 - $145 | $240 - $255 | Rising | Strong | Scarce | 5.00% - 6.25% | Firmiing | Strong | Scarce | $525 - $700 |
| Airport Corridor | Net | $115 - $130 | $225 - $260 | Rising | Strong | Scarce | 5.00% - 6.25% | Firming | Strong | Scarce | $425 - $550 |
| Manukau/Wiri | Net | $100 - $125 | $140 - $225 | Rising | Strong | Scarce | 5.0% - 7.75% | Steady | Strong | Scarce | $450 - $600 |
| Drury | Net | $110 - $120 | $220 - 230 | Rising | Steady | Scarce | 5.2% - 7.5% | Steady | Steady | Scarce | $300 - $350 |

SOURCE: BAYLEYS RESEARCH

**RYLOCK PLACE, PAKURANGA**

• Sold May 2018 •Sale Price $2,425,000
•Yield 5.19% • Deadline Private Treaty

**VESTY DRIVE, MT WELLINGTON**

• Sold December 2017 • Sale Price $5,550,000
• Yield 5.5% • Sales Method – Tender

**VESTY DRIVE, MT WELLINGTON**

• Sold March 2018 • Sale Price $8,000,000
• Yield 5.0% • Sales Method – Private Treaty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