Market Overview

Auckland's industrial market has enjoyed several years of strong growth driven by robust economic and investment fundamentals. Over the last twelve months however, these fundamentals have come under pressure as a result of a weaker economy, growing credit constraints and, until recently, higher interest rates. Industrial rentals, after a number of years of continuous growth, have stabilised over the last twelve months and growth in industrial land values has ceased, with industrial land values in many areas declining over the past six months.

The economic recession, both internationally and domestically, has had a clear impact on the Auckland industrial market, resulting in a significant slow down in development, leasing activity and investment sales. Tenant demand and enquiry has eased over the last twelve months. Over the same period yields have continued to increase and investor demand has eased in the face of the broader financial market volatility. Investors have become more discerning in terms of not only building quality and location, but also price and tenant quality. The level of development activity has also eased, with the number of industrial building consents issued continuing its recent downward trend, falling 8.8% over the year to February 2009.

Table 1 presents a summary of indicative net effective rents and land values for Auckland's main industrial sub-markets as at March 2009.

Table 1: Market Summary by Sub-Market

	Prime Building Rents		Secondary Building Rents		
Location	Office ($psm)	Warehouse ($psm)	Office ($psm)	Warehouse ($psm)	Land Values ($psm)
North Shore / Albany	$220 - $260	$105 - $125	$180 - $200	$90 - $110	$425 - $575
Mt Wellington / Penrose	$190 - $225	$100 - $125	$165 - $200	$85 - $110	$400 - $500
Airport Oaks	$185 - $235	$95 - $110	$145 - $185	$80 - $95	$250 - $350
East Tamaki	$180 - $220	$95 - $110	$145 - $185	$85 - $100	$325 - $425
Wiri	$175 - $210	$90 - $105	$135 - $185	$75 - $95	$220 - $320

Source: Darroch Research

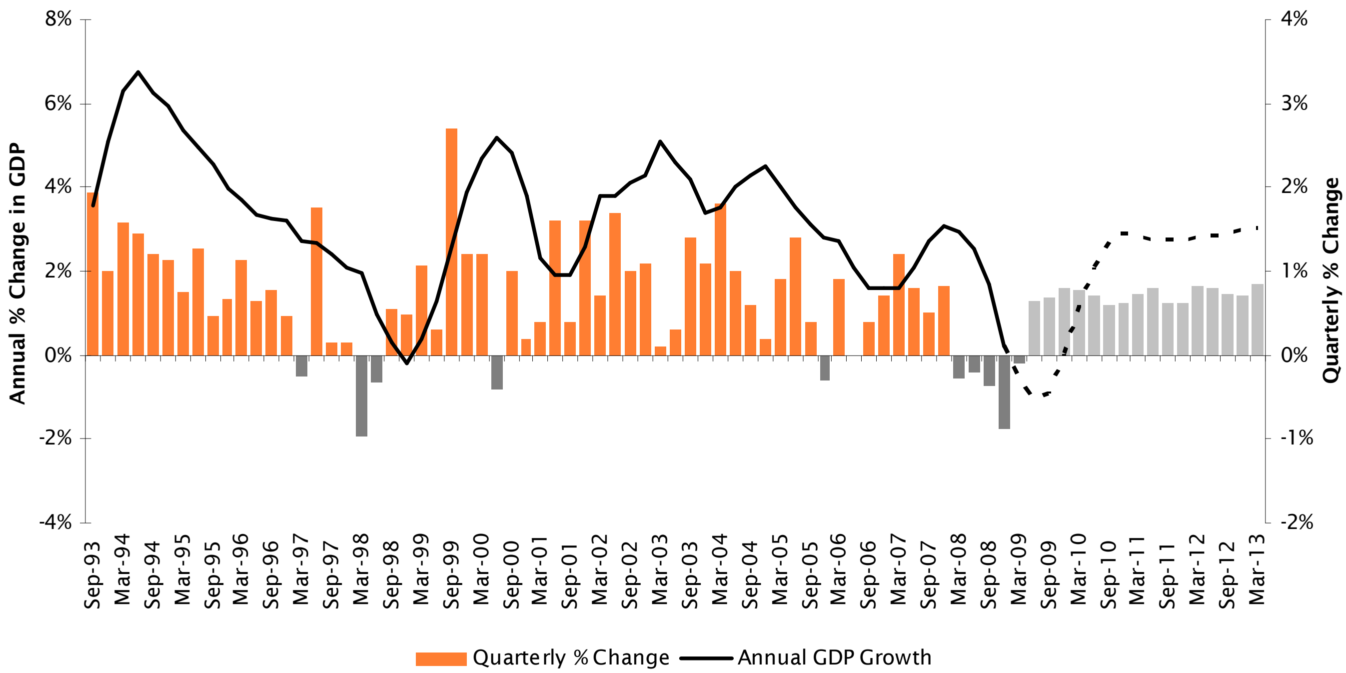
Prime and secondary rents for both the warehouse and office components of industrial property have remained relatively stable over the twelve months to March 2009. However, whilst most industrial areas have seen strong and consistent land value growth over the past five years, it would appear we have reached the peak in the current cycle and have started to see industrial land values decline at both the upper and lower end of the market over the last six months.

The Economy

New Zealand's economy experienced a consumer led slowdown over 2008. The economy contracted by 0.9% in the nine months to September 2008 and contracted a further 0.9% in the December 2008 quarter. The outlook for 2009 is for growth to start to recover, albeit at a slow rate, with GDP forecast to be 0.0% in the December 2009 year.

Figure 1 demonstrates the trend in annual and quarterly economic growth (GDP) since 1993 and in addition presents the growth forecast up to, and including, March 2013.

Figure 1: National Economic Growth



Source: NZIER

Expectations of future economic growth remain soft, with most commentators expecting negative growth to continue in the first half of 2009. There are significant downside risks associated with these forecasts and we suspect current growth expectations may overstate what is likely to occur. Other recent economic releases suggest that these forecasts are optimistic, and indicate that the economy may continue to contract in the March 2009 quarter at a similar level to the December 2008 quarter.

The economy remains vulnerable to the downstream financial and economic impact of the 'sub-prime' mortgage crisis and the associated 'credit crunch.' Over the last twelve months bank lending criteria has tightened, there has been a sharp reduction in credit availability and money has become more expensive.

The New Zealand economy is forecast to move into positive growth again in late 2009 as a result of:
- Increased government expenditure;
- Tax cuts, although consumers may initially pay off debt rather than spend any increase in net income;
- Fall in the relative value of the New Zealand dollar will assist exporters profitability, offset the decline in some commodity prices and assist in reigning in our current account deficit, we note, however, the recent rebound in the New Zealand dollar;
- Fall in transport costs driven by lower petrol and diesel prices; and
- Falling interest rates may take some pressure off household budgets.

However, some of these benefits will be offset by:
- A softening in labour market conditions and rising unemployment. The extent of the softening in the labour market will be a critical indicator of the depth and duration of this cycle;
- Interest rates for the non residential sector may remain high with tighter lending criteria and restrictions on the availability of credit;
- Net migration, although forecast to increase, remains at below New Zealand's long term average and tourist arrivals continue to decline;
- Further softening in housing market conditions, notwithstanding recent talk of a bottoming, and a subsequent fall in values; and
- Continued volatility in overseas and domestic capital markets.

The forecast recovery is expected to be export led. The growth that does occur is unlikely to be evenly distributed around the country. Regions with an export oriented economy are likely to do better than those with a domestic consumption focus, for example Auckland. The upside for Auckland will be driven to a large extent by how quickly net migration numbers recover and the relative flow of tourists into the country. The 2011 Rugby World Cup may be a catalyst that assists to boost growth to levels at, or above, the long term average.

Land Supply

Over the past five years, strong economic growth has seen a rapid uptake of industrial land and a significant increase in the amount of development activity in Auckland's industrial market and, over this time, most industrial areas have seen land values at least double, if not triple. However, it would appear we have passed the peak in the current land value cycle and have seen industrial land values soften over the last twelve months, particularly in fringe locations.

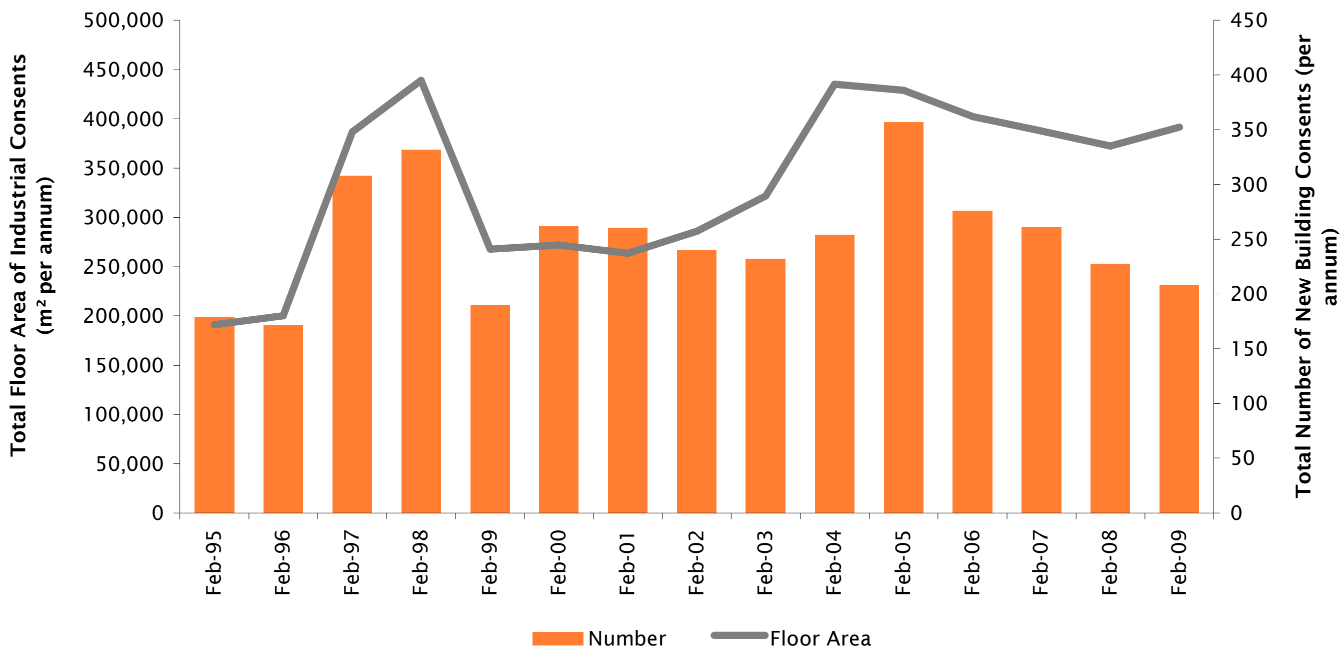
There have been very few industrial land sales over the past twelve months compared with the number seen over recent years. Examples of recent land sales include:
- A 2,153 square metre site at 84 Lady Ruby Drive, East Tamaki, zoned Business 6, sold for $900,000 in August 2008, equating to a sale price of $418 per square metre;
- A 2,470 square metre site at 12 Hannigan Drive, Mt Wellington, zoned Business 4, sold for $1,030,000 in August 2008, equating to a sale price of $417 per square metre;
- A 2,154 square metre site at 88 Lady Ruby Drive, East Tamaki, zoned Business 6, sold for $976,480 in April 2008, equating to a sale price of $453 per square metre;
- A 8,695 square metre site comprising part of lot 7 at 46 Crooks Road, East Tamaki, zoned Business 6, sold in April 2008 for $3,130,000, equating to a sale price of $360 per square metre; and
- A 5,001 square metre site at 4 Amelia Earhart Avenue, Airport Oaks, zoned Business 5, sold for $1,715,000 in April 2008, equating to a sale price of $343 per square metre.

Development Activity

A large proportion of the recent development activity has been concentrated in and around Manukau City and has been driven by freight forwarding / logistics operations seeking greater integration of their distribution / storage and transport networks. These developments have focused on the construction of modern, high stud distribution facilities close to major transport nodes. This trend is expected to continue, however, the limited availability of industrial zoned land in and around South Auckland is resulting in a north and south development drift.

The amount of development activity in Auckland's industrial market has eased over recent years. Figure 2 presents the trend in the number and floor area of consents issued for industrial building in the Auckland region since 1995.

Figure 2: Industrial Building Consents



Source: Statistics New Zealand

There has been a steady decline in the number of industrial consents issued over the past four years. Over the last twelve months the number of new industrial building consents issued fell from 228 in the year to February 2008 to 208 in year to February 2009, a decline of 8.8%. However, over the year ending February 2009 the floor area associated with industrial consents issued increased, from 372,490 square metres to 391,506 square metres, or by 5.1%.

The reduction in the number of consents is in part a response to a much weaker economy and the reduction in credit availability and its increased cost, but it would also seem that escalating land values, together with increased construction costs, notwithstanding recent rental growth, is making it difficult for developers in Auckland to make industrial projects financially feasible. Whilst tenant demand for high quality, purpose built industrial premises is still evident, albeit weaker than twelve months ago, many are increasingly unwilling to pay the much higher rents associated with such premises. Going forward the occupier market will likely see weaker growth and a more cautious approach to relocation.

Leasing Activity

Prime and secondary rents for both the warehouse and office components of industrial property have remained relatively stable over the twelve months to March 2009. Examples of recent leasing activity are presented in Table 2.

Table 2: Leasing Activity

Tenant	Location	Area Leased (sqm)	Term (Yrs)	Start Date	Office (Net $psm)	Warehouse (Net $psm)
Ecodiesel Limited	Onehunga	4,980	10	Jan-09	$135 - $145	$80 - $90
TCL Marketing	Mt Wellington	2,682	6	Dec-08	$175 - $185	$115 - $125
MGLogistics Limited	Airport Oaks	3,334	8	Dec-08	$170 - $180	$100 - $110
Carters	Mt Wellington	7,676	8	Oct-08	$150 - $160	$90 - $100
Eagle Bergman	Albany	1,912	10	Sep-08	$195 - $205	$140 - $150
Mayo Hardware	Albany	1,904	3	Aug-08	$175 - $185	$105 - $115

Source: Darroch Research

Comments include:

- Ecodiesel Limited has leased an industrial property located on Captain Springs Road, Onehunga. The property comprises conventional medium stud warehouses with associated offices and amenities. The lease is for a term of 10 years at a rental of $519,000 per annum;
- TCL Marketing has leased a standalone distribution warehouse and associated office accommodation located on Fisher Crescent, Mt Wellington. The lease is for a term of 6 years at a rental of $322,000 per annum;
- MGLogistics Limited has leased a contemporary style distribution warehouse building with associated offices and amenities, on Richard Pearse Drive, Airport Oaks. The lease is for a term of 8 years at a rental of $356,000 per annum;
- Carters have leased a predominately high stud warehouse property with a small office and amenity component, on Harris Road, East Tamaki. The lease is for a term of 8 years at a rental of $731,000 per annum;
- Eagle Bergman has leased an industrial property located on William Pickering Drive, Albany. The property comprises a modern single level industrial building constructed in 1997. The warehouse provides approximately 6 metre stud height and has associated office accommodation. The lease is for a term of 10 years at a rental of $280,000 per annum; and
- Mayo Hardware has leased a good quality road front industrial development located on William Pickering Drive, Albany. The property comprises the 2 levels of office accommodation to the front with an associated 5.5 metre stud warehouse space. The lease is for a term of 3 years at a rental of $210,000 per annum.

Investment Market

Investor demand for industrial properties has been strong over recent years; however, demand has eased over the last twelve months. Good quality investment stock remains tightly held.

Recent investment sales include:

- 12 Henderson Place, Onehunga, was sold in February 2009 for $2.95 million on a yield of 8.8%. The property incorporates a 6 metre stud heavy duty factory warehouse, two levels of offices and amenities. The property is leased to Mulford Plastics with 4.8 years remaining on the lease;
- 7 Basalt Place, East Tamaki, was sold in January 2009 for $3.3 million on a yield of 8.0%. The property comprises a modern industrial building featuring high stud, column free warehouse space, along with a single level of attractively presented, 3 metre stud, office accommodation. The property is leased to Universal Screen Supplies Ltd with over 6 years remaining on the lease;
- 41 Nesdale Avenue, Wiri, was sold in January 2009 for $12.5 million on a yield of 9.0%. The property comprises a substantial distribution warehouse complex with ancillary offices and amenities originally developed for Nestles New Zealand Limited in 1991 with extensions completed in 1997. The property is leased to Five Star Distribution with 10 years remaining on the lease;
- 6 - 8 Airpark Drive, Airport Oaks, was sold in January 2009 for $19.1 million on a yield of 8.6%. The property comprises a head office constructed in 2004 along with a distribution centre completed early 2006. The internal finishes of the offices are of a high specification. The property is leased to Bendon with over 9 years remaining on the lease; and
- 587 Great South Road, Otahuhu, was sold in October 2008 for $15.6 million on a yield of 8.3%. The property comprises a substantial industrial building of older construction, occupying a large site in a rear position in close proximity to the Manukau City Centre. The building provides a relatively basic standard of offices and amenities, typical of industrial facilities built in the 1970s, together with low, medium and high stud warehousing. The property is leased to APN Print NZ Ltd with 9 years remaining on the lease.

Yields have eased further over the past six months, and we expect this upward trend to continue over the short term for industrial property.

Table 3 presents a summary of investment trends in the Auckland region.

Table 3: Auckland Industrial Investment Trends

	Market Rate		Investment Market	
Location	Yield	Market Expectations	Demand	Availability
Mt Wellington	8.25% - 9.50%	Easing	Selective *	Variable
East Tamaki	8.25% - 9.50%	Easing	Selective *	Variable
Airport Oaks	8.50% - 9.75%	Easing	Selective *	Variable
Albany	8.00% - 9.50%	Easing	Selective *	Variable

Source: Darroch Research

* Demand still exists for high quality, well leased properties; however, investors are being a lot more selective than over the recent years.

There is limited quality data available on the past return performance of the different sectors of the New Zealand property market. Table 4 presents the total return delivered by retail, industrial and CBD office property over the last year, two years, five years and ten years.

Table 4: Annual Average Compound Returns

To September 2008	NZ Retail	NZ Industrial	Auckland Office (CBD)
1 Year	8.7%	8.2%	12.4%
2 Years	16.0%	11.1%	18.2%
5 Years	16.3%	14.5%	17.4%
10 Years	13.9%	12.2%	10.4%

Source: Darroch Research and The New Zealand Property Council

N.B. Return series are based on the New Zealand Property Council's Index up to March 2006, and since then Darroch's return series.

Returns across all New Zealand property sectors have been relatively strong over the last five years, however, the past 12 months has seen a significant decrease in returns across all property sectors. With the exception of the past year, industrial property investments have provided annual average returns (rental income and capital gains) in excess of 11% over the last ten years.

Market Outlook

The significant realignment of financial markets that is currently occurring around the world is adding to the uncertainty associated with future growth in demand as many businesses face a turbulent future. The realignment of capital markets combined with increased borrowing cost and a tightening of lending conditions, and increased uncertainty of the future direction of the economy is likely to continue to constrain future development activity over the short to medium term. The decrease in the affordability of new developments and subsequent softening in tenant demand has also resulted in a lower rate of development activity. This too is expected to continue over the short term. We would therefore expect industrial development activity, over the next year, in the Auckland region to be well below its five year average.

Whilst the recession will have some negative effect over the short term, the demand for vacant development sites is likely to strengthen over the medium to longer term. Over the short term, the investor market will also be constrained by the increased cost and reduced availability of credit, however, over the longer term, developers and investors envisage a shortage of sites to develop in preferred locations and consequently, where able, are likely to land bank sites as they become available.

The past few years has seen industrial rents increase as a result of increased development costs. However, significant land value appreciation and rising construction costs is having an effect on the affordability of new premises, and as a result rent levels have stabilised over the past twelve months. The escalation in rents has decreased the affordability of new space for tenants and consequently, going forward, we are likely to see tenants increasingly weigh up the advantages and efficiencies associated with new space compared to their existing premises, against the additional cost. Yields have continued to increase over the past twelve months, and we expect this upward trend to continue over the short term for industrial property.

For more information, please contact:

Darroch
Level 16
Auckland Club Tower
34 Shortland Street
Auckland NZ
Tel: +64 (0)9 309 3040

www.darroch.co.nz

Contacts

Key Auckland Contacts

Consulting and Research	Sales and Investments	Valuation
Ian Mitchell	Kevin Richards	Sean Molloy
+64 (0)4 460 3857	+64 (0)9 374 6621	+64 (0)9 374 6611
ian.mitchell@darroch.co.nz	kevin.richards@darroch.co.nz	sean.molloy@darroch.co.nz

Property Services	Plant and Machinery Valuation
Andrew Potter	Peter Todd
+64 (0)9 374 6659	+64 (0)9 374 6619
andrew.potter@darroch.co.nz	peter.todd@darroch.co.nz

New Zealand Office Contacts

Auckland
Alan Roskruge +64 (0)9 374 6652 alan.roskruge@darroch.co.nz

Wellington
Milton Bevin +64 (0)4 460 3853 milton.bevin@darroch.co.nz

Christchurch
Lance Collings +64 (0)3 363 5044 lance.collings@darroch.co.nz

Disclaimer and confidentiality clause

Every effort has been made to ensure the soundness and accuracy of the opinions, information, and forecasts expressed in this report. Information, opinions and forecasts contained in this report should be regarded solely as a general guide. While we consider statements in the report are correct, no liability is accepted for any incorrect statement, information or forecast. Darroch disclaim any liability that may arise from any person acting on the material within. Readers should take professional advice from a member of Darroch prior to acting on any matter contained in this report.