

Market Overview

Auckland’s industrial market has come under pressure over the last year as a result of a weak economy, a tightening in lending criteria, a reduction in the availability of credit and higher interest rates. Market conditions are unlikely to improve until the economy experiences a number of quarters of strong economic growth.

Tenant demand and enquiry has eased over the last year and yields have increased over the past year. Returns have declined dramatically and 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 by approximately 30.0% over the year to July 2009.

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

Table 1: Market Summary by Sub-Market – September 2009

Location	Prime Rents (net)		Land Values (\$ psm)
	Office (\$ psm)	Warehouse (\$ psm)	
North Shore / Albany	\$200 - \$250	\$105 - \$125	\$450 - \$575
Mt Wellington / Penrose	\$175 - \$210	\$95 - \$115	\$400 - \$500
Airport Oaks	\$180 - \$230	\$90 - \$110	\$200 - \$325
East Tamaki	\$175 - \$220	\$90 - \$110	\$325 - \$425
Wiri	\$170 - \$220	\$90 - \$105	\$200 - \$300

Source: Darroch Research

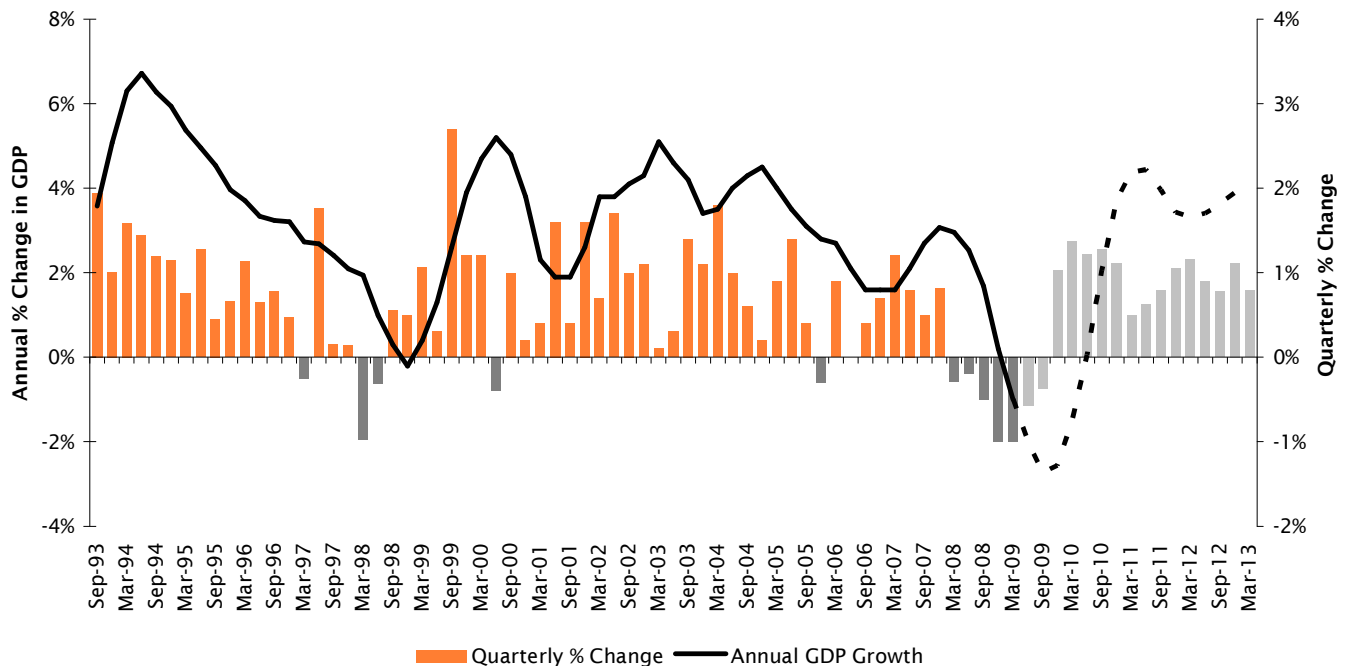
Over the last year, rent levels, in the face of weaker occupier demand and increased vacancy, have fallen across the market. At the same time, after five years of strong consistent growth, industrial land values too have declined at both the upper and lower end of the market throughout the whole Auckland region.

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 a further 0.9% in the December 2008 quarter. Growth has remained negative over the first quarter of 2009 (-1.0%) and is forecast to remain negative over the second and third quarters of 2009. The outlook is for growth to start to recover by late 2009, albeit at a slow rate, with GDP, on an annual basis, forecast to be positive by the third quarter in 2010.

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

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 12 months bank lending criteria has tightened, there has been a sharp reduction in credit availability and money has become more expensive. Expectations of future economic growth remain soft, with most commentators expecting negative growth to continue until late 2009.

The New Zealand economy is forecast to see positive growth return from late 2009 as a result of:

- Increased government expenditure;
- The stimulus provided by the October 2008 and April 2009 tax cuts;
- The fall in the relative value of the New Zealand dollar, from early 2008 to early 2009, will assist exporters’ profitability, offset the decline in some commodity prices and assist in reigning in our current account deficit. Unfortunately, approximately half of this foreign exchange gain has, since March 2009, been given up;
- The fall in transport costs driven by lower petrol and diesel prices;
- Lower residential mortgage interest rates may take some pressure off household’s budgets; and
- Stronger global economic growth and a forecast bottoming in the housing market.

However, some of these benefits will be offset by:

- A continuing softening in labour market conditions and rising unemployment. The extent of the softening in the labour market will be a critical indicator of the strength of the economic recovery and duration of this cycle;
- Interest rates for the non residential sector are likely to remain high with tighter lending criteria and restrictions on the availability of credit and residential interest rates are likely to rise;
- Net migration remains below New Zealand's long term average and tourist arrivals continue to decline;
- Weak dairy prices; 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 the 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, over the last year or so land values, particularly in fringe locations, have softened.

There have been few industrial land sales over the past 18 months compared with the number seen over previous years. Examples of recent land sales include:

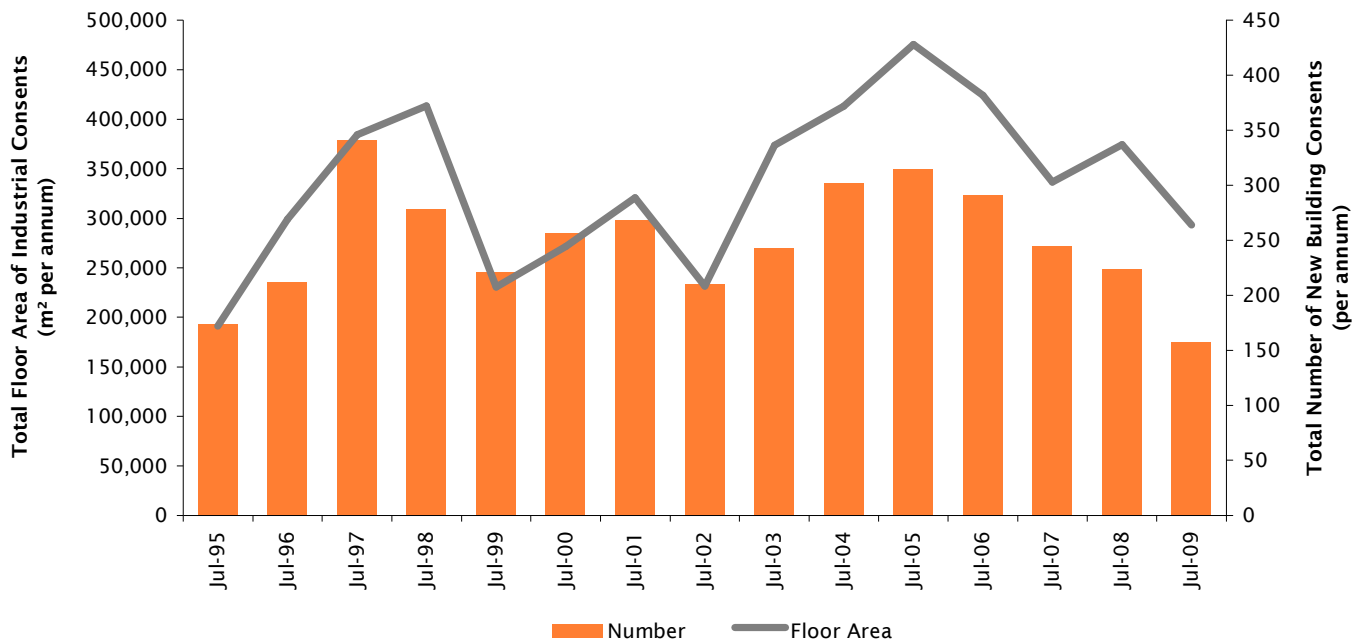
- Two adjoining sites totalling 12,366 square metres at 105-109 Apollo Drive, Albany, zoned Business 7C, sold for approximately \$3.56 million in July 2009, equating to a sale price of \$288 per square metre;
- Three adjoining sites totalling 12,878 square metres at 225-235 Rosedale Road, Albany, zoned Business 7A, sold for \$4 million in July 2009, equating to a sale price of \$311 per square metre;
- 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; and
- 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.

Development Activity

A large proportion of 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 functions. 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 of consents issued for industrial building in the Auckland region since 1995.

Figure 2: Industrial Building Consents



Source: Darroch Research

There has been a steady decline in the number of industrial consents issued over the past four years. Over the last 12 months the number of new industrial building consents in Auckland fell from 224 in the year to July 2008 to 157 in the year to July 2009, a decline of 29.9%. The floor area associated with industrial consents has also declined, from 374,261 square metres in the year to July 2008 to 293,074 square metres in the year to July 2009, a fall of 21.7%.

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. It is also a response to much weaker tenant demand generally and associated new build affordability issues. Whilst there is still tenant demand for high quality, purpose built industrial premises, albeit much weaker than 12 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 fallen over the last six months. Whilst face rents have shown little change, it is our understanding that incentives are being offered to secure tenants in the range of approximately two months for each year of the lease term, reflecting the significant easing in tenant demand.

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)
Packsys Limited	Mt Wellington	1,298	9	Mar 09	\$160 - \$170	\$90 - \$100
Hose Supplies	Penrose	1,039	3	Jan 09	\$155 - \$165	\$80 - \$90
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

Source: Darroch Research

Comments include:

- Packsys Limited has leased an industrial unit located on Carmont Place, Mt Wellington. The property is one of two units built. The warehouse provides clear span accommodation with a stud height of approximately six metres to the portal knee. The lease is for a term of nine years at a rental of \$135,000 per annum;
- Hose Supplies has leased an industrial property located on Fairfax Avenue, Penrose. The property comprises a refurbished clear span warehouse building which includes office/amenities at ground floor with a mezzanine staff room. The lease is for a term of three years at a rental of \$100,200 per annum;
- 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 six years at a rental of \$322,000 per annum; and
- 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 eight years at a rental of \$356,000 per annum.

Investment Market

Investor demand for industrial properties has been strong over recent years; however, demand has eased over the last 12 months. Good quality investment stock remains tightly held.

Recent investment sales include:

- 9 George Bourke Drive, Mt Wellington, was sold in May 2009 for \$4.05 million. The property has a 7.3 metre stud height and is located at the end of a cul-de-sac within a high quality industrial development;
- 17 Saleyards Road, Otahuhu, was sold in May 2009 for \$3.75 million on a yield of 9.60%. The property was sold with a sale and leaseback agreement with a lease term of eight years commencing 1 January 2008. The site is located fronting railway tracks;
- 12 Henderson Place, Onehunga, was sold in February 2009 for \$2.95 million on a yield of 8.8%. The property incorporates a six 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;
- 356 Church Street, Penrose, was sold in February 2009 for \$3.55 million on a yield of 9.35%. The property comprises a medium sized industrial building incorporating two levels of offices and amenities to the Church Street elevation with medium stud warehousing to the rear. The property had two leases in place at the time of sale to GEA and Kitchen Things with a weighted average lease term of 4.24 years;
- 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 three metre stud office accommodation. The property is leased to Universal Screen Supplies Ltd with over six 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; and
- 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 nine years remaining on the lease.

Yields have eased further over the past 12 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

Location	Market Rate		Investment Market	
	Yield	Market Outlook	Demand	Availability
Mt Wellington	8.25% - 9.50%	Easing	Selective*	Variable
East Tamaki	8.50% - 9.75%	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.

Table 4 presents the total return delivered by retail, industrial and CBD office property.

Table 4: Retail, office and industrial annual compound returns

To March 2009	NZ Retail	NZ Industrial	Auckland Office (CBD)
1 Year	-1.3%	2.6%	-2.0%
2 Years	10.6%	8.0%	9.3%
5 Years	14.1%	13.2%	13.8%
10 Years	13.1%	11.8%	8.9%

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 8% over the last 10 years.

Market Outlook

Table 5 presents the change in the Auckland industrial market since its peak in 2007 together with the market outlook over the short and medium term.

Table 5: Auckland Industrial Market Outlook

	Development Land Values	Development Activity	Rents	Yields	Returns
Change since June 2007	-20%	-75%	-20%	From 7.5% to 9.75%	From 16.2% to 2.6%
Short term outlook	Stable	Down	Down	Stable	Down
Medium term outlook	Stable	Up	Stable	Down	Up

Source: Darroch Research

A significant realignment of financial markets coupled with questions around the strength of the anticipated economic recovery, has resulted in an extremely uncertain operating environment for many businesses. Market conditions are unlikely to improve until the economy experiences a number of quarters of strong economic growth. As a consequence, we anticipate that development activity, despite recent increases in business confidence, will be constrained for some time to come. 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 continue to have a significant negative effect over the short term, the demand for vacant development sites is likely to strengthen over the medium to long 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, up until early 2008, has seen industrial rents increase as a result of increased development costs. The escalation in rents over the last five years, despite recent falls, 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 12 months, and while some further easing is possible we anticipate a degree of yield stability emerging over the next year.

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

Ian Mitchell
+64 (0)4 460 3857
ian.mitchell@darroch.co.nz

Sales and Investments

Kevin Richards
+64 (0)9 374 6621
kevin.richards@darroch.co.nz

Valuation

Sean Molloy
+64 (0)9 374 6611
sean.molloy@darroch.co.nz

Property Services

Andrew Potter
+64 (0)9 374 6659
andrew.potter@darroch.co.nz

Plant and Machinery Valuation

Peter Todd
+64 (0)9 374 6619
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

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