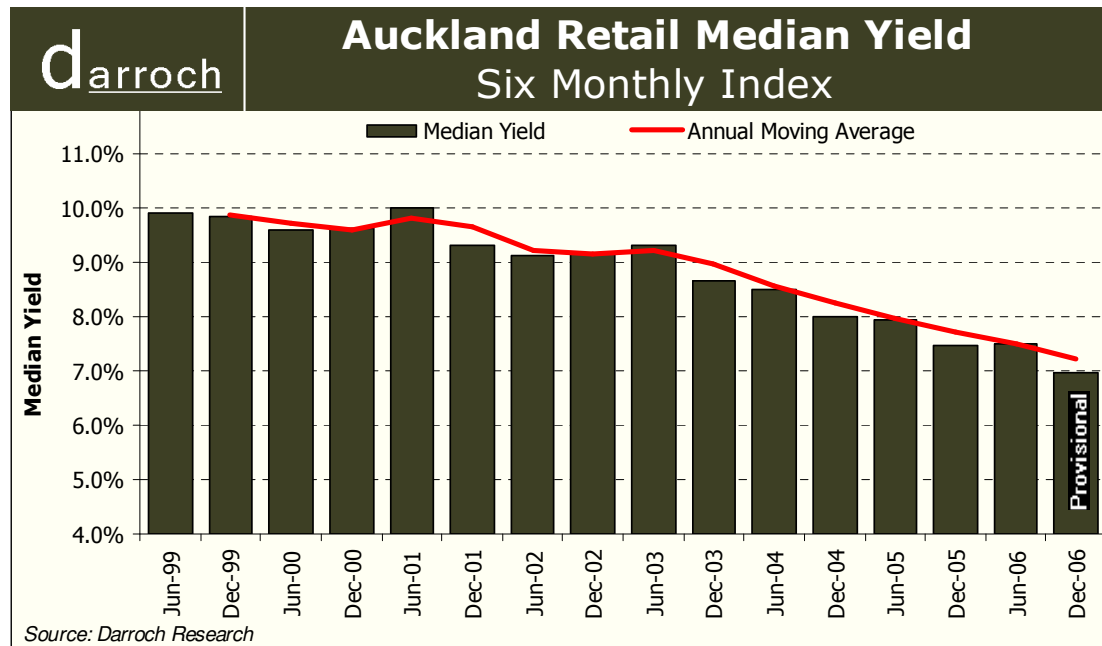


Auckland Median Retail Yield 7.5% and Firming

December 2006

The median yield for retail property in Auckland hit 7.5% in the six months ending June 2006, according to the latest figures by Darroch Research. The result shows that demand for retail property is still very strong with returns firming/reducing nearly half a percent in the last 12 months alone. Back in June 2005 the median yield for retail was closer to 8.0%, and further back in 1999, the yield was a dizzy 9.9%. The lower returns of late come despite a period of higher inflation and generally higher interest rates, indicating that real returns are being marginalised. The buying behaviour of investors is further interesting in that many are viewing commercial/retail property as near "risk-free". Provisional 6-monthly results for December 2006 reiterate this with Darroch noting that retail yields have firmed again - to around 7.0%.

Darroch tracks sales of commercial retail property across Auckland on a six monthly basis. Only properties that are fully tenanted or have a "pure retail" function are considered. The analysis excludes any sales of retail property with an office or residential component. The overall trend line shows a notable downward decline in the median yield since June 2003.



At face value retail property has been a fairly sound investment over the last few years and has been assisted by low vacancy rates and reasonable rental growth. Auckland Metropolitan vacancy rates have consistently been under 5% in the last three years, with some locations experiencing almost no vacancy. The competition to occupy/lease premises has resulted in upward pressure on rents - particularly in prime locations. For example, in Takapuna Darroch calculate rental growth for prime retail premises has averaged compound returns of 5% per annum since 2000. Many investors have enjoyed both rental and capital growth.

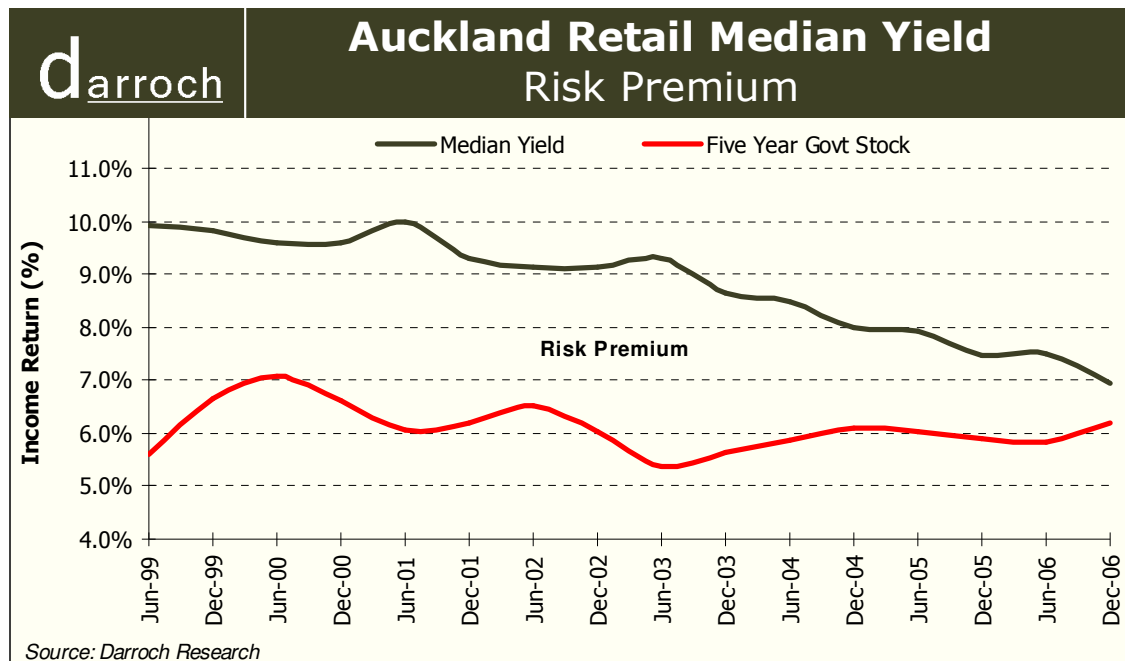
When the economy is strong retail tenants have been prepared to negotiate longer leases and pay a rent premium to secure premises. To a large degree the performance of the retail sector (and by inference retail property) is mirrored in economic performance. This is evident after 2002 when stronger GDP growth, lower interest rates and greater demand for goods and services had a positive impact on the retail sector. Consumer retail spend across Auckland increased 30% from \$13 billion in 2002 to nearly \$17 billion in 2006.

Greater retail spend helps to keep vacancy levels down and in the process provides financial security to both tenant and landlord. However it should be noted that in the last 12 months the NZ economy has slowed and GDP growth is forecast to bottom out at 1.1% in mid 2007 before recovery in 2008. With this in mind many economists are anticipating a slowdown in consumer spending as inflation and higher interest rates impact on disposable income. In due course it will be interesting to see what impact this will have on the retail property sector.

Investor Behaviour

For many investors at present "capital gain" appears to be the key performance measure for property. Investors will accept a lower return now for the prospect of future capital growth. This means that current rents would need to lift and yields will have to firm (i.e. reduce) further. The prospects of this will largely depend on demand/supply factors, the future performance of the NZ economy and the continued involvement of foreign investors. To date the capital gain theory has worked well with vendors achieving price levels well in excess of that expected five years ago. But with weaker economic conditions coming into play, more caution may be exercised by new investors than previously.

In the meantime, demand for commercial property remains strong and the risk premium associated with retail property continues to dwindle. The risk premium is the additional rate of return "over and above" the risk free rate that an investment is expected to yield. In NZ, five-year government bonds are usually referred to as the risk free benchmark. Back in 1999 the risk premium or return gap between five year government bonds and retail property was just over 4%. This narrowed to around 3% by mid 2003. Since then the risk free margin has squeezed to between 1.5% and 2%. In other words investors are regarding retail property as almost "risk free".



Undoubtedly this approach has been exacerbated by a wave of demand from listed property companies and overseas investor groups most notably from Australia. The majority of investment companies are purchasing for medium/long term hold, resulting in further scarcity of investment stock and increased competition among buyers.

Still, on paper it would be a surprise to see yields drop too much further, from a New Zealand perspective at least. Major overseas investors such as superannuation-funded investors are cash rich and are purely seeking a higher rate of return than attainable at home. Moreover if borrowings are required, these can be drawn overseas - often at a lower cost (i.e. lower repayments) than otherwise available in NZ. This comparative advantage translates to a wider risk premium over and above what the Kiwi investors is shackled with. This cushion could put further downward pressure on yields. From a New Zealand perspective, the outlook is now more challenging. Domestic inflation and interest rates are at comparatively higher levels than two to three years ago, and the ability of the kiwi investor to fund their investment in a positive cashflow manner will be tested.