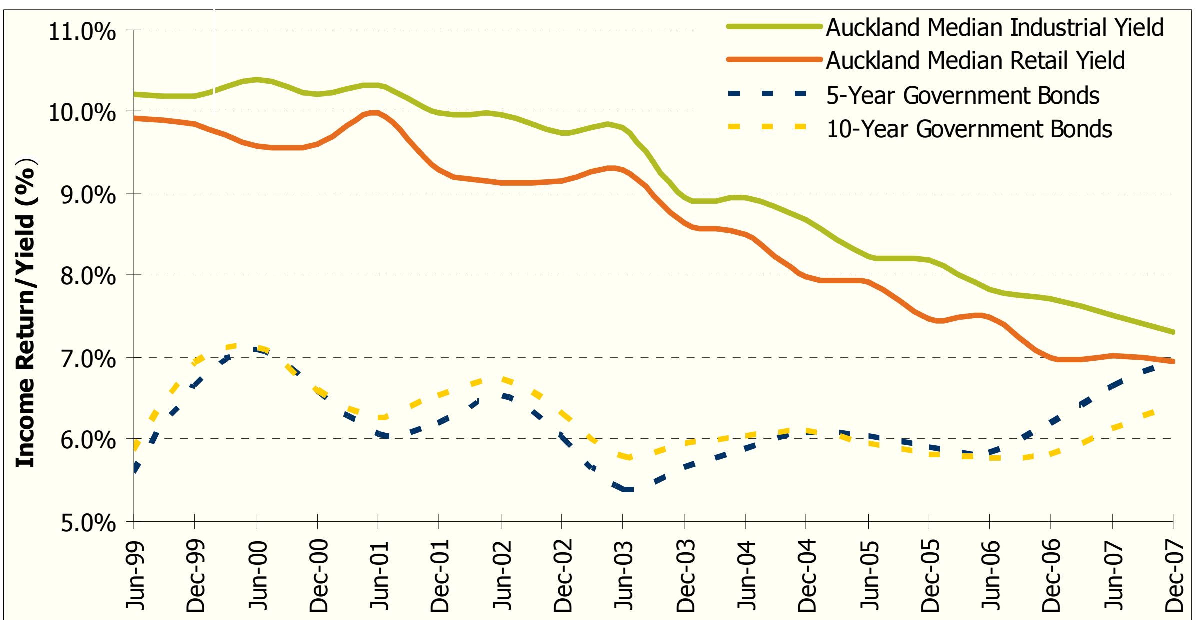
Retail Yields Show Signs of Softening

➲ But Not Mirrored in Industrial Sector, Yet

Coming into 2008, rental returns for Auckland commercial property remain at very competitive levels but latest analysis suggests that the downward movement in yields experienced over the past five years has slowed.

Downward pressure on retail yields softened in early 2008.

According to Darroch Research, the median yield for Auckland retail property for the six months ending 31 December 2007 was 6.95%. This is virtually identical to the preceding June 2007 and December 2006 half year results and suggests that investment demand for retail property is starting to plateau. Demand for prime retail property remains very positive but buyers are more discerning about secondary stock, especially in light of the current shake out in the sub-prime lending sector and its potential repercussions on wider business markets.



Source: Darroch Research, Reserve Bank of New Zealand

Interestingly, the cautionary mood in retail was not mirrored across the Auckland industrial market. Investment sales in this sector have remained very competitive. For the last six months of 2007, Darroch calculates the median yield for Auckland industrial property to be just under 7.3% - the lowest result on record. Further analysis shows *prime* industrial yields are now down to 7.1% with *secondary* yields fractionally over the 7.3% average. For the moment the results appear to defy any suggestions that this market is starting to level out.

Darroch's Research Manager, Peter Sluyter, believes investors still see growth prospects with industrial property. "The dynamics of New Zealand business is rapidly changing. New Zealand is manufacturing less and importing more, particularly from Asia where production costs are lower. Distribution is still a growth industry and looking forward, investors visualise a growing tenant base, low vacancy and upside in rental growth" says Sluyter. However he says "property markets invariably move in tandem and we could see a softening in secondary industrial yields at a later stage during the year".

The levelling off in retail yields suggests the retail sector is perhaps more responsive to economic trends. Discretionary spending suffers when cost of living factors like mortgage interest rates and petrol prices rise, with retail businesses usually the first to feel this. While it is anticipated that investor interest in prime retail property will remain strong over 2008, more caution will be exercised with secondary property, particularly where tenant covenants are less favourable. Tighter lending rules are also likely to impact. The shakeout in lending markets has meant a tightening in access to funding - on balance requiring investors to have a greater equity ratio - as lenders look to reduce their risk exposure. Reduced borrowing levels will effectively limit the amount an investor can pay for an investment property, therefore testing the resolve of vendors in the negotiation process.

Overall, the confidence shown in investment property in recent years is clearly evident in the attached chart. Buyer behaviour suggests that many investors view property as near "risk free" and are purchasing at yields marginally above long term government bonds, a situation unseen in New Zealand in the past two decades.