

4th Quarter 2009

Tougher Times Forecast for Major CBD Office Markets

➔ Vacancies set to Rise in Auckland & Wellington, Rents to Fall Further

Auckland and Wellington office markets are facing a tough three years ahead according to Darroch's latest forecasts. Rising vacancies and softer rents look set to put further pressure on a sector already feeling the effects of the downturn. General consumer confidence might be improving, but NZ's CBD office markets do not appear to be out of the woods yet.



CBD Office vacancy levels in Auckland & Wellington (above) are forecast to rise

In our latest *Property Times* report, Darroch is forecasting CBD vacancy rates to increase to between 16% and 18% in both Auckland and Wellington; putting vacancy rates at levels not seen since the mid 1990's. A combination of weak tenant demand, new office construction and vacated space remaining untenanted is expected to have significant impact. Darroch is forecasting prime CBD 'net effective' rents to ease by 15% to 20% from peak 2007/08 levels in both Auckland and Wellington. The situation is likely to further strengthen market dynamics in favour of the tenant.

At the moment the overall CBD office vacancy rate in Auckland is 11.7% (September 2009), up 2.7% from 9.0% in March 2009 and up from 6.7% from September 2008. Overall vacancies have risen 5.0% in the last 12 months and are unlikely to slow. New office space is beginning to surface which will create absorption issues. Major tenants such as BNZ, Deloitte, Westpac, Ernst and Young and Telecom have pre-committed to and are awaiting completion of new offices. We calculate over 75,000 square metres of new office space will be completed in the next two years. While the majority of this space is pre-let, relocating tenants will leave behind significant floors of vacant space which will often require refurbishment to attract new tenants. This is likely to lead to an excess supply of vacant lower-grade office space that will take some time to absorb. Overall, Darroch expects the total area of occupied space to contract by 30,000 to 35,000 square metres over the next two years.

In Wellington, we believe a similar pattern for the office market will unfold. The Wellington vacancy rate increased in the six months to June 2009 (7.4% to 8.8%), with an additional 21,400 square metres of space becoming vacant, mostly within premium and average quality buildings. Demand for space over the previous five years was driven primarily by an expanding government sector while business sector growth was not as strong. The recession has had a significant impact on Wellington's real economy. This along with the Government's goal to limit public sector growth is likely to see regional growth below trend over the short to medium term. New construction will also have an impact, as in Auckland. Over 90,000 square metres of space currently under construction will be completed in the next 2 years. While the majority of new developments are pre-let, many tenants shifting to new premises will leave significant vacancies behind.

Overall, CBD office markets are facing some headwinds over the next 2 years due to lag effects from the recession, increased inventory of new stock and falling net absorption.

For full details on Auckland and Wellington office property, visit www.Darroch.co.nz/research for Darroch's latest Property Times reports. The Darroch website contains a chronological record of all Darroch reports released over the past few years.