

Market Overview

Wellington'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, over the same period, industrial land values have begun to decline.

The economic recession, both internationally and domestically, has had an impact on the Wellington 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 reversing its recent positive growth trend, falling 36% over the year to February 2009.

Table 1 presents a summary of indicative gross rents and land values for Wellington's main industrial submarkets as at March 2009.

Table 1: Market Summary by Sub-Market

Location	Prime Building Rents		Secondary Building Rents		Land Values (\$psm)*
	Office (\$psm)	Warehouse (\$psm)	Office (\$psm)	Warehouse (\$psm)	
Ngauranga	\$170 - \$210	\$130 - \$170	\$120 - \$150	\$110 - \$130	\$500 - \$700
Petone	\$160 - \$190	\$120 - \$140	\$110 - \$130	\$110 - \$120	\$500 - \$765
Seaview	\$130 - \$160	\$100 - \$130	\$90 - \$120	\$70 - \$90	\$300 - \$400
Porirua	\$120 - \$160	\$100 - \$130	\$90 - \$120	\$65 - \$80	\$150 - \$200

Source: Darroch Research

* For a typical 1,000 square metre to 4,000 square metre site.

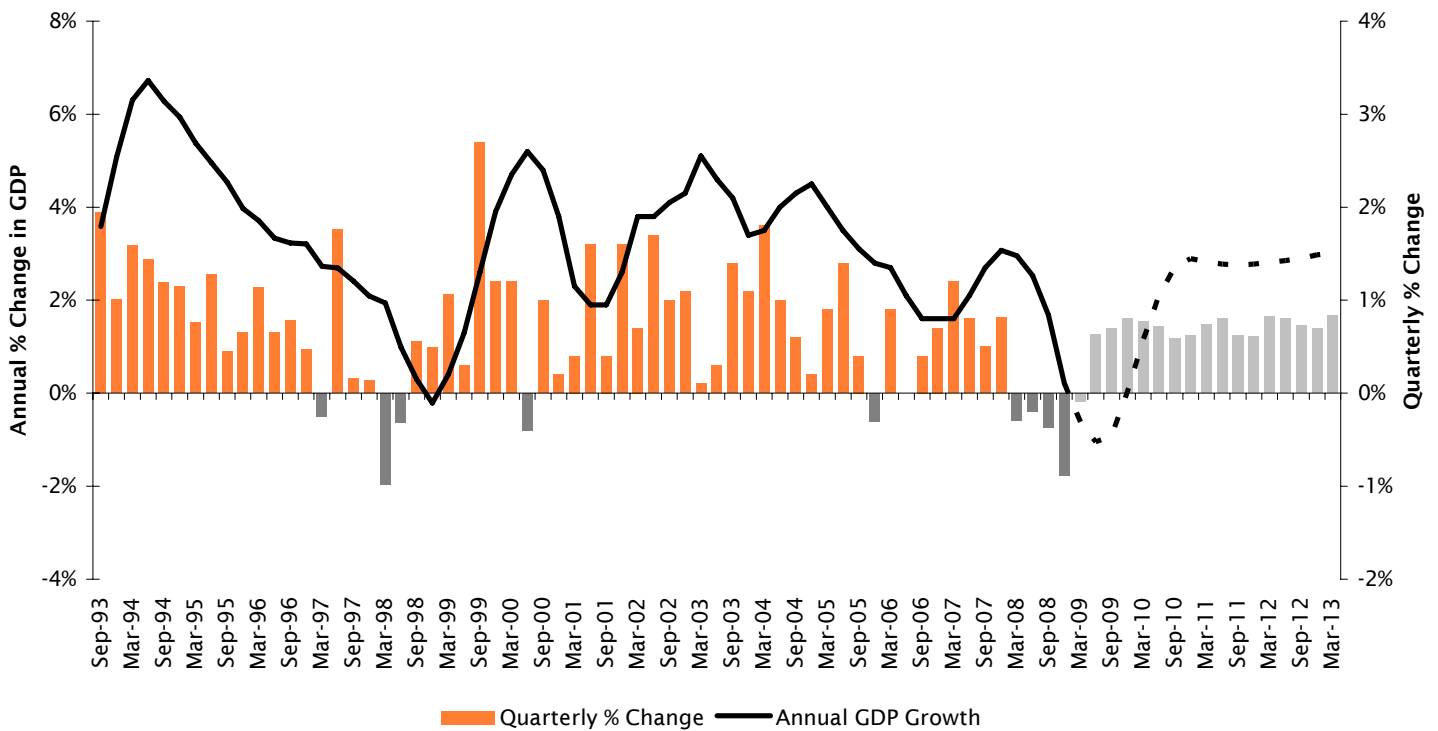
Prime and secondary rents for both the warehouse and office components of industrial property have remained relatively stable over the twelve months to March 2009. Over the same period, growth in land values has turned negative with land values across all key industrial locations experiencing a decline over the last twelve 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 of household's 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 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 Wellington. The upside for Wellington will be driven to a large extent by changes within the public sector. It is Important to note that although 40% of the Wellington market is public sector the 60% private business sector feeds off this public sector, and will be impacted by Government changes, for example potential outsourcing of public service contracts. This creates much more stable growth levels than would otherwise be expected.

Land Supply

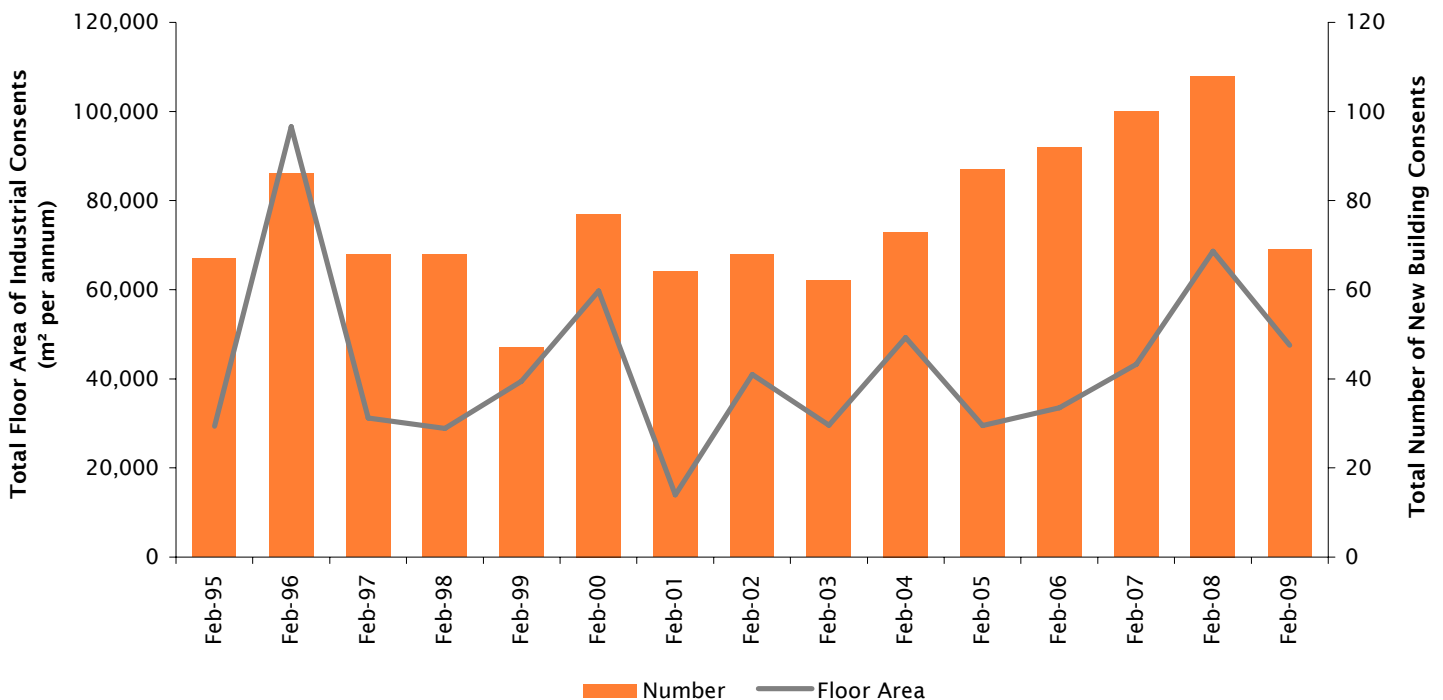
Land values in the region over the past twelve months have begun to ease, following several years of very strong appreciation. Examples of recent land sales include:

- A 7,650 square metre site at 13 - 15 Makaro Street, Porirua sold in January 2008 for approximately \$1.68 million or \$220 per square metre;
- An 8,337 square metre site on Montgomery Crescent, Upper Hutt sold in December 2007 for approximately \$1.1 million or \$132 per square metre. The site has been purchased with the intent to sub divide into four lots; and
- A 5,182 square metre site at 14 - 16 Makaro Street, Porirua, sold in October 2007 for \$1.1 million or \$212 per square metre.

Development Activity

Industrial development activity has been consistently strong in the Wellington region over recent years. Figure 2 presents the trend in the number, and total area, of consents issued for industrial buildings in the Wellington region since 1995.

Figure 2: Industrial Building Consents



Source: Statistics New Zealand

The total number of industrial building consents issued in Wellington has reversed its recent positive growth trend. In the year to February 2009, the number of industrial building consents decreased significantly, down 36% to 69, from the 108 consents issued over the previous corresponding period. At the same time the total floor area of consents issued decreased from 68,623 square metres in the year to February 2008 to 47,548 square metres in the year to February 2009, a decrease of 31%.

Development has focused primarily on the refurbishment of existing buildings, although some smaller new builds have been completed over the past twelve to eighteen months. Examples of recent new development activity include:

- North City Business Units, Maiti Close, Porirua. Seven units have been constructed for owner occupation and investment. Units range from 127 square metres to 137 square metres;
- The Birmingham Industrial Park, Te Roto Drive, Kapiti, has 11 unit titled units. Unit sizes range from 250 square metres to 330 square metres;
- The Alexander Business Park, Upper Hutt. Stage one has been put on the market. Units are approximately 160 square metres in size with seven metre stud heights;
- 12 owner occupier units on Gracefield Road, Seaview, ranging from 90 square metres to 255 square metres; and
- Seaview Business Park, 48 – 56 Seaview Road, Seaview, is marketing several units ranging from 500 square metres to 5,500 square metres. Bridgestone is the anchor tenant.

Grenada North is becoming an attractive location for industrial development as smaller businesses are forced out of sites in Newtown, Rongotai and Te Aro because of high land values and competing non-industrial uses. Although Seaview and Petone remain options for larger tenants, the very limited land supply and higher rents means some businesses are increasingly considering alternate locations further afield, such as Trentham, Levin and Palmerston North.

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. Table 2 presents significant recent leasing and lease renewal activity.

Table 2: Significant Leasing Activity

Tenant	Location	Area Leased (sqm)	Term (Yrs)	Start Date	Office (Net \$psm)	Warehouse (Net \$psm)
Cable Price Downer	Seaview	3,530	2	Feb-09	\$105 - \$115	\$80 - \$90
Right House	Petone	800	5	Nov-08	-	\$130 - \$140
Colgate Palmolive	Seaview	8,574	3	Nov-08	\$145 - \$155	\$95 - \$105
Fusion Interiors Limited	Ngauranga	1,820	6	Oct-08	\$145 - \$155	\$80 - \$90
Waiwhetu Distributors	Lower Hutt	1,666	6	Nov-08	\$145 - \$155	\$105 - \$115
Total Telecommunications	Lower Hutt	1,561	3	Sep-08	\$105 - \$115	\$80 - \$90
City Care Limited	Ngauranga	1,100	5	Jul-08	\$150 - \$160	\$140 - \$150

Source: Darroch Research

Comments include:

- Cable Price Downer has signed for a further two years on their lease of warehouse and office space on Port Road, Seaview. The recent review set the new rental at \$289,250 per annum;
- Right House has leased an industrial property located on Waione Street, Petone. The lease is for a term of 5 years at a rental of \$110,000 per annum;
- Colgate Palmolive has leased an industrial property located on Barnes Street, Seaview. The property comprises a high stud, column free distribution warehouse facility with substantial canopy and associated yards, with additional offices and amenities. The lease is for a term of 3 years at a rental of \$747,000 per annum;
- Fusin Interiors Limited has leased an industrial property located on Tyers Road, Ngauranga. The property comprises a substantial warehouse with associated office accommodation. The lease is for a term of 6 years at a rental of \$180,000 per annum;
- Waiwhetu Distributors has leased over 1,666 square metres of office, warehouse, showroom and carparks at 6 Gear Street, Petone, Lower Hutt. The site has an annual rental of approximately \$185,000 with a lease term of six years effective November 2008;
- Total Telecommunications has leased over 1,561 square metres of office, warehouse and yard at 22 Barnes Street, Seaview, Lower Hutt. The site has an annual rental of approximately \$120,000 with a lease term of three years effective September 2008; and
- City Care Limited has leased 1,100 square metres of office, warehouse, and carparks at 6 Hurring Place, Ngauranga. The site has an annual rental of approximately \$175,400 with a lease term of five years effective July 2008.

Investment Market

Yields across all grades of industrial property have increased over the last six months and in particular yields for secondary quality property.

Recent investment sales include:

- 228 Gracefield Road, Lower Hutt, was sold in December 2008 for \$760,000 on a yield of 8.7%. The property incorporates a high stud workshop / warehouse and office accommodation. The property is leased to Komatsu Australia with 5.5 years remaining on the lease;
- 22 Annie Huggan Grove, Petone, was sold in November 2008 for \$4.9 million on a market yield of 9.3%. The property comprises warehouse, showroom and storage facilities, together with associated office and amenities. The property is leased to Carter Holt with 7.5 years remaining on the lease;
- 3-9 Downer Street, Lower Hutt, was sold in October 2008 for \$1.03 million on a market yield of 7.8%. The property comprises a single storey warehouse building erected in the 1970s. The property is leased to Brake and Transmission NZ with 4 years remaining on the lease; and
- 13-15 Rutherford Street, Lower Hutt, was sold in October 2008 for \$1.25 million on a market yield of 8.8%. The property comprises two interconnected warehouse buildings with associated office and amenities. The property is leased to AA with approximately 1 year remaining on the lease.

Table 3 presents a summary of investment trends in the Wellington area.

Table 3: Wellington Industrial Investment Trends

Location	Market Rate		Investment Market	
	Yield	Market Expectations	Demand	Availability
Ngauranga	7.50% - 9.00%	Easing	Easing	Average
Petone	8.00% - 9.50%	Easing	Easing	Average
Seaview	8.50% - 9.50%	Easing	Easing	Average
Porirua	8.50% - 9.50%	Easing	Easing	Average

Source: Darroch Research

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	Wellington Office (CBD)
1 Year	8.7%	8.2%	11.4%
2 Years	16.0%	11.1%	18.7%
5 Years	16.3%	14.5%	19.6%
10 Years	13.9%	12.2%	13.4%

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 Wellington 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. The investor market too, will be constrained by the increased cost and reduced availability of credit while the occupier market will likely see weaker growth and a more cautious approach to relocation. Our expectation is that rental values will remain relatively flat and that yields across all classes of industrial properties will, to varying degrees, increase over the short term. Land values we would expect to continue to ease over the same period. The fact of minimal industrial vacancy coupled with limited greenfield land will, however, to some extent underpin the market going forward.

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