

## Market Overview

The occupier and developer sectors of Wellington’s industrial market have remained under pressure over the last year as a result of a still weak economy. Market conditions are unlikely to significantly improve until the economy experiences a number of consecutive quarters of strong economic growth. Yields stabilised during 2009, especially for better quality properties, however, those properties with vacancy, weak tenant covenant or term, poor location and of poorer quality continue to face yield pressure. Investors have become much more discerning in terms of not only building quality and location, but also price and tenant quality. The level of development activity has also reduced significantly, with the number of industrial building consents falling 17.4% over the year to February 2010.

Table 1 presents a summary of indicative prime gross building rents and land values for Wellington’s key industrial sub-markets as at March 2010.

**Table 1: Market Summary by Sub-Market – March 2010**

Location	Prime Building Rents (gross)		Land Values (\$psm)
	Office (\$psm)	Warehouse (\$psm)	
Ngauranga	\$170 - \$210	\$130 - \$170	\$600 - \$700
Petone	\$150 - \$180	\$120 - \$140	\$600 - \$700
Seaview	\$120 - \$150	\$90 - \$120	\$300 - \$400
Porirua	\$120 - \$160	\$90 - \$130	\$150 - \$200

Source: Darroch Research

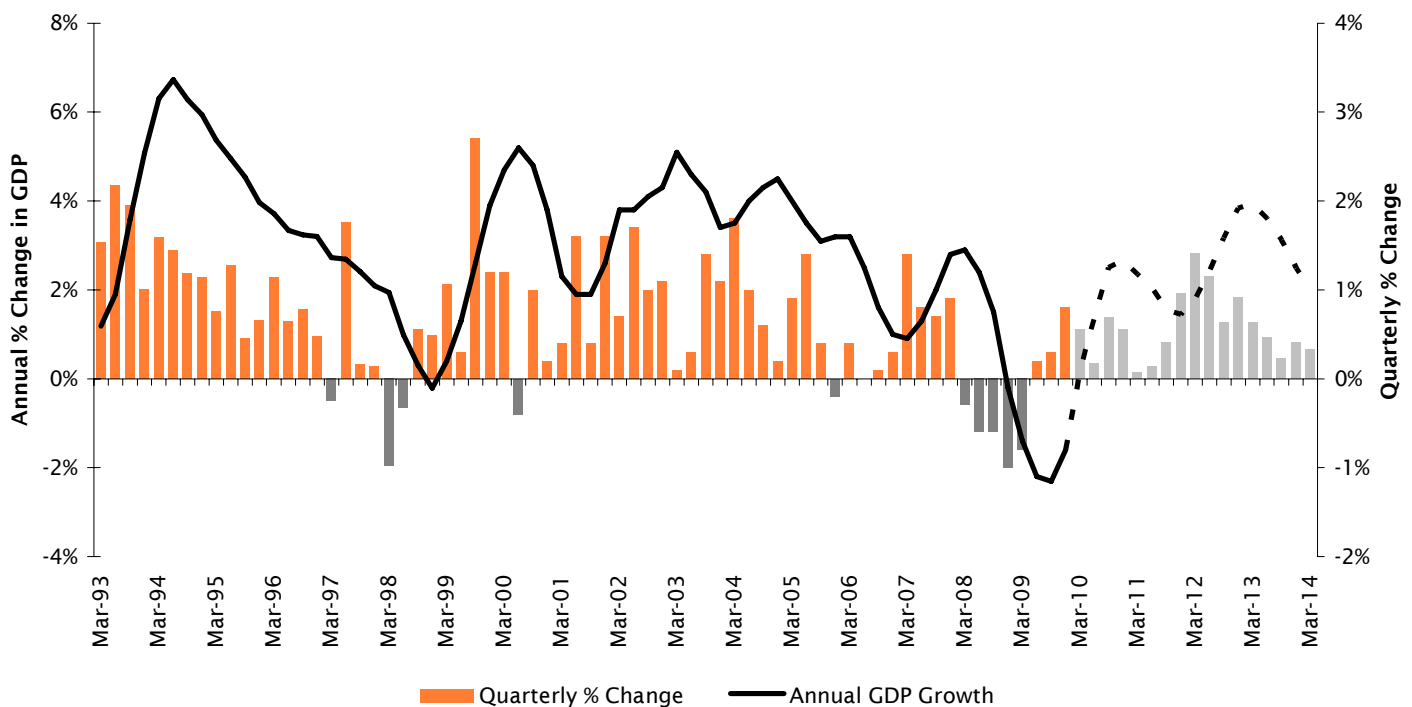
Industrial rents, after a number of years of continuous growth have, with the exception of the Ngauranga precinct, eased since 2008. Over the last 2 years land value growth has turned negative with land values across most key industrial locations, with the exception of Ngauranga, experiencing a decline.

# The Economy

New Zealand's economy experienced a consumer led slowdown over the early and middle part of 2008 which was then compounded by the global credit crisis and subsequent global economic recession. The economy contracted for five consecutive quarters, up to, and including, the first quarter of 2009, however, since then this negative trend has reversed and the last three quarters have seen positive growth of 0.2%, 0.3% and 0.8% recorded respectively. The outlook is for growth to continue to recover, albeit at a slow rate, with GDP, on an annual basis, forecast to be positive by the first 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 2014.

**Figure 1: National Economic Growth**



Source: NZIER

The economic recovery, however, remains vulnerable to a range of global and domestic influences.

In terms of positives a number of factors can be cited:

- Stronger global economic growth;
- Continued strength in the Australian economy, New Zealand's key trading partner, combined with a relatively low NZD / AUD cross rate;
- A strong rebound in commodity prices during 2009;
- A significant increase in late 2009, in Fonterra's payout for the 2009 / 2010 season;
- A stronger manufacturing sector;
- A recovery in residential building, albeit off a low base;
- Above trend overseas migration gains;
- Increased government infrastructure expenditure; and
- Lower interest rates, albeit the bottom in the current cycle has now passed, may take some pressure off household's budgets.

However, some of these factors will be offset by:

- Ongoing labour market weakness and potentially still rising unemployment;
- Short term regulatory uncertainty prior to the 2010 budget;
- A forecast easing in net overseas migration gains;
- Interest rates for the non residential sector are likely to remain high with tighter lending criteria and restrictions on the availability of credit; and
- Continued, albeit declining, volatility in overseas and domestic capital markets.

There are still some downside risks associated with current economic forecasts, both global and New Zealand growth remains fragile, and current growth expectations may overstate what is likely to occur.

## Land Supply

Land values in most parts of the region over the past 2 years have fallen, following several years of very strong growth. There have been limited sales of vacant industrial land over the last six months. Examples of recent land sales are presented in Table 2.

**Table 2: Land Sales Activity**

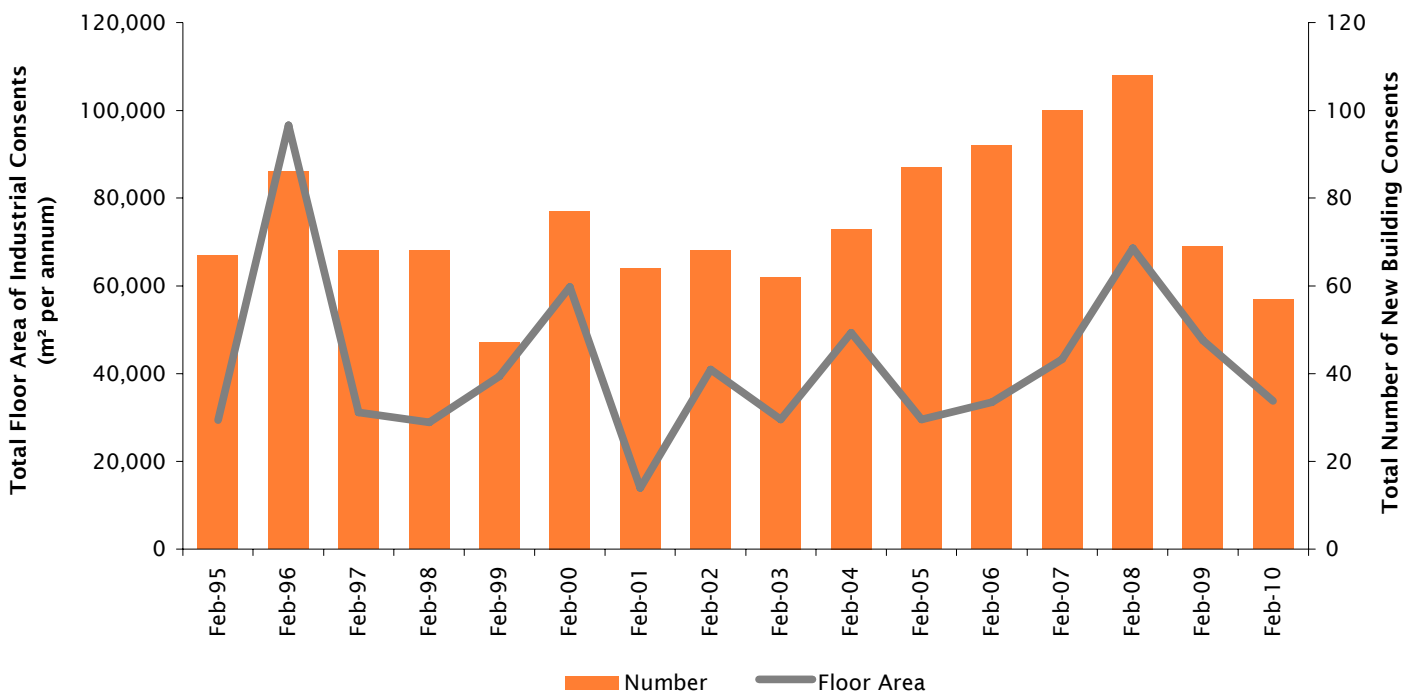
Address	Location	Site Area (m <sup>2</sup> )	Sale Date	Sale Price	Sale \$psm
Wareham Place	Seaview	836	Apr 10	\$400,000	\$485
94-98 Nelson Street	Petone	1,115	Apr 10	\$702,000	\$629
8 Makaro Street	Porirua	1,451	Dec 09	\$266,000	\$179
3 Kinleith Grove	Elsdon	14,273	Aug 09	\$2,280,000	\$160
19-21 North Point Street	Plimmerton	1,272	Aug 09	\$250,000	\$235

Source: Darroch Research

## Development Activity

Industrial development activity has fallen significantly in the Wellington region over the last two 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

There has been a decline in both the number of industrial consents issued and the floor area associated with industrial consents across the Wellington region over the past two years. The number of industrial building consents issued fell from 69 in the year to February 2009 to 57 in the year to February 2010, a decline of 17.4%. The floor area associated with industrial consents also decreased, down from 47,548 square metres in the year to February 2009 to 33,801 square metres in the year to February 2010, a fall of 28.9%.

Recent development has focused primarily on the refurbishment of existing buildings, although some smaller new builds have been completed over the past two to three years. Examples of recent new industrial developments include:

- North City Business Units, Matiu 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 have been 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 a field, such as Trentham, Levin and Palmerston North.

## Leasing Activity

Prime and secondary rents for industrial property have eased since 2008, however, rents would appear to be stabilising. Table 3 presents some examples of recent leasing and lease renewal activity.

**Table 3: Leasing Activity**

Tenant	Location	Area Leased (sqm)	Term (Yrs)	Start Date	Office (Gross \$psm)	Warehouse (Gross \$psm)
24 Carrot Food Produce	Te Aro	520	6	Mar 10	-	\$120 - \$130
Ex Budget Car Rentals	Lower Hutt	500	6	Jan 10	\$145 - \$155	\$105 - \$115
ACM (Linfox Armaguard)	Ngauranga	2,639	10	Nov 09	\$160 - \$170	\$120 - \$130
Levin Bobcats Ltd	Porirua	629	3	Nov 09	\$145 - \$155	\$105 - \$115
Fire Security Services	Ngauranga	622	4	Nov 09	\$150 - \$160	\$120 - \$130
Lamp Specialist Ltd	Lower Hutt	350	3	Oct 09	-	\$135 - \$145
Western Milling Ltd	Seaview	1,856	2	Sep 09	\$95 - \$105	\$70 - \$80

Source: Darroch Research

Comments include:

- 24 Carrot Food Produce has leased an industrial property on Torrens Terrace, Te Aro. The lease is for a term of six years at a rental of \$77,000 per annum;
- An undisclosed tenant has leased an industrial property located on Wakefield Street, Lower Hutt. The lease is for a term of six years at a rental of \$70,000 per annum;
- ACM (Linfox Armaguard) has leased an industrial warehouse property with associated office space located on Tyers Road, Ngauranga. The lease is for a term of ten years and five months at a rental of \$335,000 per annum;
- Levin Bobcats Limited has leased an industrial property comprising workshop, office and yard space located on Broken Hill Road, Porirua. The lease is for a term of three years at a rental of \$95,000 per annum;
- Fire Security Services has leased the former Cadbury premises, comprising warehouse and office space located on Jarden Mile, Ngauranga. The lease is for a term of four years at a rental of \$101,000 per annum;
- Lamp Specialist Limited has leased an industrial property comprising a low stud showroom and medium stud warehouse on Victoria Street, Lower Hutt. The lease is for a term of three years at a rental of \$50,000 per annum; and
- Western Milling Limited has leased an industrial property comprising close to 2,000 square metres of warehouse space and limited associated office amenities located on Port Road, Seaview. The lease is for a term of two years at a rental of \$140,000 per annum.

## Investment Market

Yields across most grades of industrial property have stabilised over the last nine months after significant increases over the previous 18 months, in particular across yields for secondary quality property.

Recent investment sales include:

- 69 The Esplanade, Petone, was sold in December 2009 for \$2.0 million on a yield of 6.4%. The property comprises 1970's warehouse space, reasonably modern office space with harbour views and good profile;
- 62 Kaiwharawhara Road, Kaiwharawhara, was sold in December 2009 for \$1.315 million on a yield of 11.7%. The property comprise seven industrial units currently leased to four tenants;
- 20-24 Toop Street, Seaview, was sold in December 2009 for \$6.05 million on a yield of 8.2%. The property was purpose built as a bakery dating from the 1980's and comprises close to 4,500 square metres of industrial space;
- The Transfield Building at 2 Jarden Mile, Ngauranga, was sold in December 2009 for \$2.74 million on a yield of 7.6%. The property comprises a two level fully refurbished office / showroom complex with 3 separate self contained tenancies and 43 onsite carparks located on a prominent intersection;
- Wingate Industrial Park at 25 Peterkin Street, Lower Hutt, was sold in October 2009 for \$7.6 million on a yield of 11.8%. The property comprises over 19,000 square metres of industrial space occupying a 36,600 square metre site. At the time of the sale the property had nine tenants and one vacancy; and
- 16-22 Elizabeth Street, Mt Victoria, was sold in October 2009 for \$1.4 million on a yield of 6.7%. The property comprises an industrial workshop with small showroom, offices and amenities, plus a covered forecourt area for on site parking. The property was sold to the tenant, Goodyear Tyres, for owner occupation. Had previously sold in December 2006 for \$1.3 million.

Table 4 presents a summary of investment trends in the Wellington area.

**Table 4: Wellington Industrial Investment Trends**

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

Source: Darroch Research

Table 5 presents the total return delivered by retail, industrial and CBD office property over the last year, two years, five years and ten years.

**Table 5: Retail, Office and Industrial Annual Compound Returns**

To December 2009	NZ CBD Office	NZ Industrial	NZ Retail
1 Year	-9.8%	2.4%	-1.3%
2 Years	-1.9%	3.6%	-1.2%
5 Years	11.8%	11.8%	10.7%
10 Years	10.0%	11.5%	11.5%

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 5 to 10 years, however, the past 24 months has seen a significant fall in returns across all property sectors. Both the CBD office market and retail market have under performed the industrial sector in terms of annual returns, whilst the industrial market is the only property category to maintain positive returns over the last 2 years. Typical yields for industrial property have increased, albeit only slightly, over the past year, ranging between 8.00% and 9.75%.

## Market Outlook

The significant realignment of financial markets coupled with questions around the strength of the economic recovery, has resulted in an extremely uncertain operating environment for many businesses. Market conditions are unlikely to improve until the regional economy experiences a number of quarters of strong economic growth. This uncertainty coupled with increased borrowing costs and a reduction in the availability of credit is likely to constrain future development activity over the short to medium term. Consequently, over the next year, we would expect industrial development activity in the Wellington region to remain low.

The investor market too, will continue to be impacted by the increased cost and reduced availability of credit although good opportunities will continue to be available to those investors not constrained by credit. Investors are still seeking good quality industrial investments, however, investment activity is stronger at the lower value end and as property values increase the number of potential investors falls away. The occupier market, in the face of a likely still relatively weak economy, will continue to remain cautious around relocation. It is likely that the majority of the increase in the industrial yields, in terms of the current cycle, have already occurred.

The period up until late 2008 saw industrial rents increase as a result of strong demand and increased development costs. The escalation in rents has reduced 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.

Over the last couple of years rent levels, in the face of much weaker demand and increased vacancy, have fallen across the market, although more recently they appear to have stabilised. Yields have largely stabilised over the past nine months, and while some further easing is possible we anticipate a degree of continued yield stability emerging over the next twelve months.

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