

2nd Quarter 2010

CBD Office Markets Still Doing it Tough

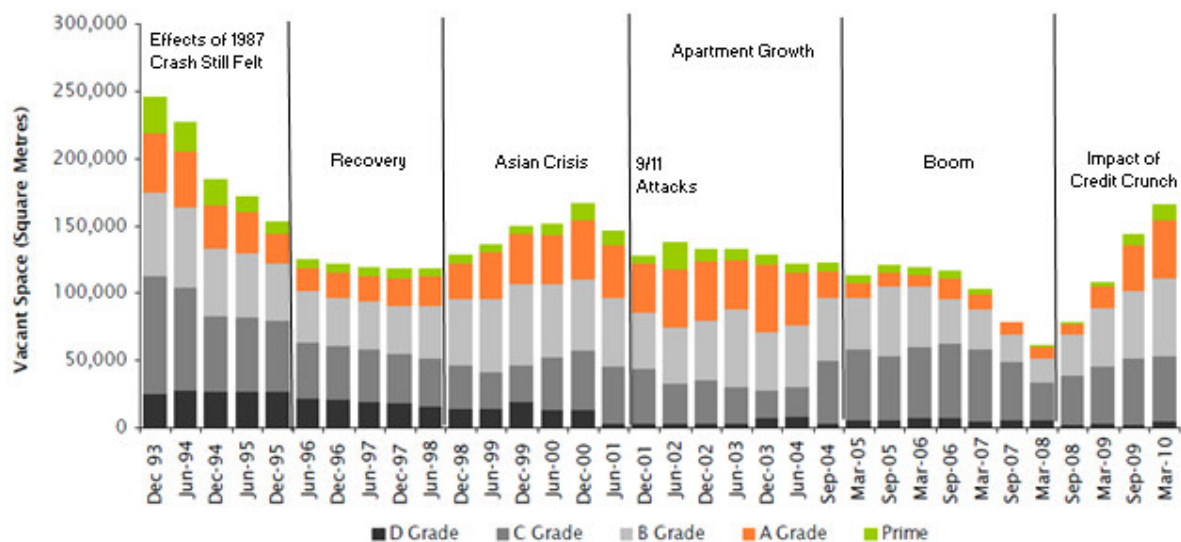
➤ Vacancy Rates Move Up Again as Expected

CBD office markets in Auckland and Wellington continue to weaken as the lag effects from the recession take effect. Last year Darroch forecast that vacancy rates in our two key cities would increase to between 16% and 18%, resulting in a decline in net effective rents by 15% to 20%. To date, we have not seen anything of note to significantly alter our opinion. The latest CBD office surveys show occupancy levels have deteriorated further, net effective rents are continuing to ease and tenant demand remains weak.

In Auckland the overall CBD office vacancy rate as at March 2010 rose to 13.3%, up from 11.7% in September 2009 and 9.0% in March 2009. This represents an increase of 1.6 percentage points in the six months since September 2009 and 4.3 percentage points in the last 12 months alone. In Wellington, vacancy levels continue to rise as well. The overall CBD office vacancy rate as at December 2009 was 10.2% - up 1.4 percentage points from 8.8% recorded in June 2009.

In both cases, a combination of weak tenant demand, new office construction and vacated space remaining untenanted is expected to have significant impact. In Auckland, a number of major tenants including BNZ, Deloitte, Westpac, Ernst and Young and Telecom are relocating to pre-committed office developments. Much of this vacated space will require refurbishment to attract new tenants. But the economic recovery is not yet significantly strong enough to generate adequate new demand. We calculate that the total area of occupied space in Auckland will continue to contract in 2010. In Wellington, weak demand continues to impact on the market along with the National led administration's drive to limit the size of the public service. Total area of occupied space is also forecast to contract over the next 18 months.

Auckland CBD – Vacant Office Space



Source: Darroch Research

Investment Market

The investment market for CBD office buildings remains subdued with transactions scarce. Rising vacancies increase risk and many investors (and lenders) are still risk averse when large capital sums are involved. Institutional investors are essentially out of the current market as purchasers, and many are net sellers. There is limited demand for non-liquid assets i.e. \$15 million and over in both Auckland and Wellington. Some of the sales that have occurred in Wellington in the last six months have been properties sold by receivers.

Wellington CBD Office sales:

- Morrison Kent House at 105-109 The Terrace was purchased by Farmers Trading Company in March 2010 for \$32.8 million, at an initial yield of 7.1%. The building was sold by Petherick Properties, in receivership. Farmers occupy all the retail levels on the lower floors of this building;
- Guardian Trust House at 15 Willeston Street was sold in January 2010 for \$13.9 million, at an initial yield of 11.3%. The building was sold by Petherick Properties, in receivership;
- Petherick Tower at 38-42 Waring Taylor Street was purchased in December 2009 by an unknown purchaser for \$9.0 million, at an initial yield of 5.2%. The building was also sold under the instructions of the Petherick Properties receivers;
- Telegroup House at 330 Lambton Quay sold in November 2009 for \$7.0 million to an unknown purchaser, at an initial yield of 8.4%;
- The State Services Building at 100 Molesworth Street, Thorndon was purchased by local investor Paul Benjamin for \$25.5 million, at an initial yield of 9.2%. The office space is fully leased to State Services Commission.

Auckland CBD Office sales:

- In early 2010 the Peace Building at 98-100 Symonds Street was sold for \$9.25 million by Axa Asia Pacific Holdings to a private investor on a yield of 10.5%. The building is tenanted by Peace Software and UUNZ Institute of Business;
- In November 2009 35 High Street was purchased for \$7 million by Kegg Investments Limited on a 7.1% yield;
- In November 2009 166 Queen Street was purchased by Hq Property Investments Limited for \$15.6 million;
- In October 2009 the Kean's Building at 150-152 Queen Street was sold for \$8.3 million by The New Zealand Guardian Trust Company to the Standard Trustee Company Limited on a yield of 7.7%.