COMMERCIAL
RESEARCH

Knight Frank

# NZ MAJOR CITY INDUSTRIAL REVIEW

October 2014

SPECIAL ANALYSIS

**South Auckland Industrial Market and Christchurch Industrial Market**


OCCUPIER DEMAND | INVESTOR DEMAND | VACANT LAND | FORECASTS AND TRENDS

# SOUTH AUCKLAND INDUSTRIAL PROPERTY OVERVIEW

The South Auckland Industrial market has experienced high levels of activity as it rebounds from the economic downturn of 2008 / 2009. It will be recalled New Zealand felt the impact of the Global Financial Crisis (GFC) from early 2008 that resulted in business and consumer confidence rapidly declining, thereby creating apprehension in the market place. GDP fell, due to a slowdown in a number of sectors that included manufacturing, construction, wholesale and retail and investment expenditure plummeted, largely due to the collapse of finance companies that had supported property development.

The Reserve Bank reacted over a relatively short time by lowering the Official Cash Rate (OCR) from 8.25% to an historic low of 2.5% by April 2009 to soften the effects of the GFC and stimulate the economy. Bank borrowing rates reduced as a direct result of the reduction in the OCR and mortgage interest rates hit their lowest levels in forty years. However, Industrial property development practically stalled (notable exceptions being at Auckland Airport and Goodman's Highbrook), but following the resurgent residential market from 2010, the Industrial sector has progressively recovered.

Limited new construction continues to impact the market with a shortage of modern industrial buildings for sale or lease. A characteristic of the 2014 market is an increase in design and build building as more developers actively seek opportunities in response to a perceived gap in the market. Most activity has centred on the large scale industrial sector with new builds at Auckland Airport, Highbrook and Penrose in 2014. At Highbrook, we note Goodman Property Trust is currently advertising a new premium 6,660sqm warehouse made up of 6,260sqm warehouse, 400sqm office space over two levels with an additional 720sqm of canopy. The warehouse benefits from having a minimum stud clearance of 10m with good heavy truck access.

During 2010 & 2011 Christchurch was impacted by two major earthquakes that destroyed many industrial buildings, particularly the older structures in the eastern suburbs that were damaged beyond repair. With many businesses unable to carry on trading due to their premises being damaged and hindered by time constraints around Government, Canterbury Earthquake Recovery Authority (CERA), Council and EQC planning procedures to rebuild and coupled with the volatility of the land itself, locations outside of Canterbury became more sought after. The Auckland industrial property market benefited from these relocations with cashed up buyers with insurance payouts looking to re-invest.

2013 witnessed a progressive tightening of the market as available space was absorbed, resulting in the continuation of increasing Industrial rents for A grade space throughout the South Auckland region, as illustrated by figures 1 and 2, below. An increase in rents is one indicator of a buoyant market together with other factors such as reduced vacancy rates, positive net migration and increasing construction costs, as illustrated in Rawlinson's data, figure 3.

Statistics New Zealand has indicated Labour costs have been on the rise with salary and wage rates (including overtime) having increased by1.7% in the year to the June 2014, and overtime rates up 2.3%. The June 2014 quarter results will reflect the minimum wage rise from $13.75hr to $14.25hr from 1 April 2014.

Migration does not necessarily have an immediate effect on the market but over time demand due to growth will be put on goods and services, in turn resulting in the demand for infrastructure and ultimately industrial accommodation. Currently migration is reported at 40,000 per annum, the majority of whom are expected to settle in Auckland.

*Note: Specifications of construction for figure 3 is of a warehouse with portal frame construction and concrete slab floor. Nominal lighting, power supply, fire hose reels. Colour steel roof and roller shutter doors. Excludes plumbing, HVAC and sprinklers and 1200mm high precast or block walls with Colour steel wall cladding above.*

Figure 1.
**Average A-Grade South Auckland Industrial rental sqm rates**

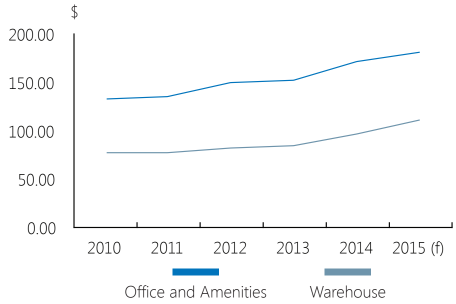



Figure 2.
**Average A-Grade Industrial yield - South Auckland**

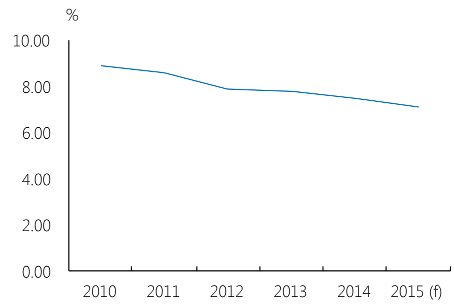
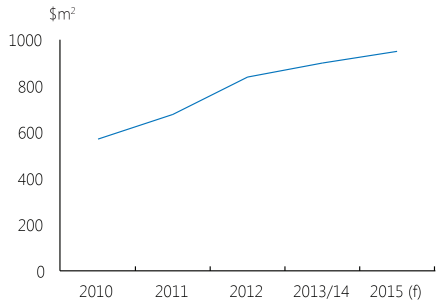



Figure 3.
**Rawlinsons Warehouse - under 20m clear span**



## Tenant Demand

### Occupier Demand and Rents

As business confidence improves, demand for modern industrial buildings has also increased, putting pressure on existing stock and consequently pushing rents upwards.

Strong demand for modern industrial space is evident with a premium on high-stud tilt-slab construction with good yard access. Motorway access is another key attribute as the majority of industrial tenants are now wholesale and logistics related businesses whilst manufacturing activities continue to decline. It follows that demand for older style, low stud industrial buildings in suburbs such as Onehunga and Penrose has declined, as such premises are often difficult for heavy vehicle access, offer limited off-street staff car parking, are built with high maintenance materials and offer limited opportunities for modern warehouse systems such as multi-tiered racking.

A modest sized industrial building situated on Lady Ruby Drive, East Tamaki and completed April 2014 provided prospective tenants with a high stud warehouse and finished to a high standard including a sprinkler system, air-conditioned offices, container space and good overall functionality. This premises provided evidence that rates as high as $120sqm for warehouse and $220sqm for office are achievable in today's market and supersedes traditional rates that appeared to plateau at $100sqm for new high stud warehouse and $200sqm for a new fitted out office.

Figure 4.
**Site plan of the spec build development at Leon Leicester Ave**

Figure 5.
**A model of the spec build development at Leon Leicester Ave**

Knight Frank has observed secondary South Auckland industrial rates and note B-Grade type properties that provide the traditional low to medium stud warehouse, inadequate truck access and aging construction materials are slowly undergoing a change of use. With changes in operational requirements for owners and tenants alike due to technology changes and requirements for space as two examples, Knight Frank has observed a range of $80sqm - $100sqm for warehouse and $120sqm - $150sqm for office depending on such factors as fit out, functionally and location. An opportunity exists for landlords to increase their returns by spending capital by way of renovating where possible but understand the upper range quoted appears to be top end for B Grade properties moving into 2015.

Highbrook has continued to out-perform other geographical areas due to its convenient location with respect to the Airport, the CBD and motorway onramps. The ongoing residential development at Flat Bush coupled with expansion of Highbrook Business Park should continue, and new commercial and retail development draws new businesses, staff and customers to the area.

A proportion of the vacancy rates can be attributed to businesses consciously reducing their overheads and down-sizing their premises to be risk adverse. Recent demand has been predominant in the high quality, investment grade premises with a key focus on a relatively low office to warehouse ratio. The leasing market overall has continued to see existing vacancy rates being soaked up, and some surveys suggest industrial stock in the East Tamaki region is as low as 1% vacancy.

Knight Frank has seen incentives progressively decrease in the last two years across the board for all industrial grade properties. Short term leases of 2 to 3 years now attract few incentives, whereas leases of 4-6 years in duration may still achieve the equivalent of a 1 month incentive for every year of lease term.

A shortage of new or "spec builds" along with limited Greenfield opportunities have put pressure on industrial stock. Thus market reaction has been focused more towards spec builds to cater to demand in 2014. A notable development on Leon Leicester Ave within the Mt Wellington Industrial Estate was completed April 2014 and provided for five high spec buildings comprising clear span high stud warehouse, corporate level office and generous canopies with excellent transport flow and operational efficiencies. Warehousing options were available from 2,760sqm to 8,800sqm in size.

Crooks Road, East Tamaki

## Investor Demand

### Sales & Investment Yields.

Sales activity over the past three years was very much directed towards low risk investment type properties which have a strong lease in place and being situated in an area of growth.

The shortage of quality investment stock has yields firming in the last 2 years. High quality tilt slab high stud warehouse with a desirable office / warehouse ratio will be in high demand with a 4 plus year lease and a sub 7.0% yield is the market position currently

The industrial sale and lease back dated April 2014 on Crooks Road within East Tamaki provided for a 3,050sqm industrial building constructed 2007/08 on approximately 4,706sqm of land. The premises included 2,613sqm of warehouse and 185.5sqm office and amenities over two levels plus a canopy of 252sqm and 20 car parks. The property sold for $4,365,000 with an annual rental of $315,000 pa on a 6 year term plus three year ROR, indicating a yield of 7.2%

A modern tilt slab industrial building on Vestey Drive was sold at auction June 2014 for $1,275,000 and provided for a 540sqm warehouse and two levels of offices at a 7.2% yield. The tenant had occupied the building for six years and has just renewed for a further five. Knight Frank has generally observed a yield range of 6.5% to 7.0% for good quality, well leased property.

Recent years saw a growing demand for the sub million dollar properties and continues to outstrip supply. Owner occupiers will often pay a premium to secure premises that suit their requirements. Shortage of new builds for sale along with development land continues to put pressure on this part of the market but we note more are starting to come to market. An example of this is the new unit development on 3 Hautu Drive that will be the first unit development in the Wiri area in the last 3 years.

Investment sales have increased over the past twelve months with a small proportion of this being helped by Christchurch earthquake insurance money. There has also been an opportunity for many owner occupiers who have had minimal opportunities to buy in the last 3-5years which has pushed sales volumes up. Industrial property continues to be seen as a low risk investment over other categories.

## Industrial Activity in South Auckland

Knight Frank has researched the quantity of industrial activity in the South Auckland market and taking a snap shot of primary suburbs within the South Auckland region.

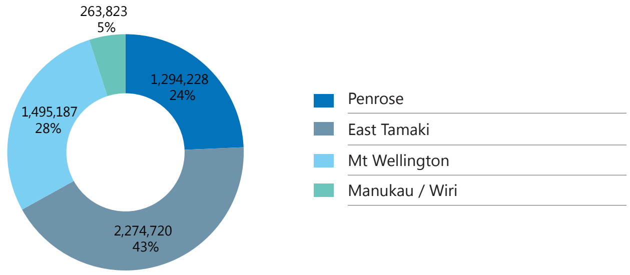
## Vacant Land and Development Activity

The most sought after industrial land is that which is zoned Business 6. This allows for heavy and large scale industrial usage, providing noxious elements of that usage are controlled. Such land tends to be located away from residential zones which would be adversely affected.

Land bankers are also entering the market once again to secure strategic sites for future benefit. In the suburbs of Mt Wellington and Penrose, vacant land has been in short supply due to the scarcity of available opportunities that exist in the market. The Auckland Council acknowledges the growing need for appropriately-zoned land to cater for future demand. It has outlined a requirement to provide an additional 1400ha to meet estimated growth up to 2041. The majority of the 1400ha of planned land will be set aside for industrial activities being 1000ha.

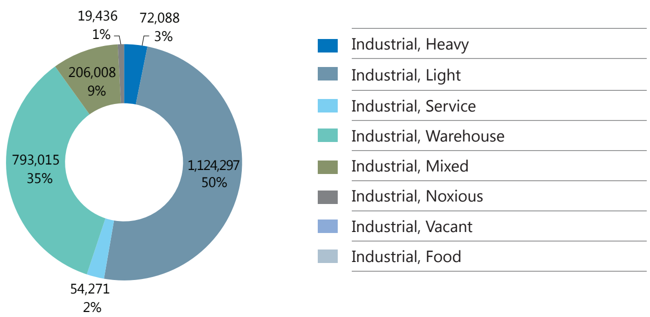
Knight Frank notes there have been few land sales of late, but a snapshot of three East Tamaki land sales include a 2014 sale of a 2,153sqm front positioned East Tamaki business 5 zoned site sold at $432/sqm within an established industrial area. Additionally, a 2013 transaction of a Business 6 zoned 7,975sqm corner positioned site with excellent profile sold for $438/sqm. Knight Frank has observed a range of between $300sqm to $450sqm depending on size but there is an expectation that the lack of readily available land will drive prices even higher in the year ahead.

Figure 6.
**South Auckland Industrial Floor Stock**




| South Auckland Industrial Floor Stock | |
|---|---|
| Penrose | 1,294,228 |
| East Tamaki | 2,269,115 |
| Mt Wellington | 1,495,187 |
| Manukau / Wiri | 263,823 |
| **Total** | **5,322,353** |

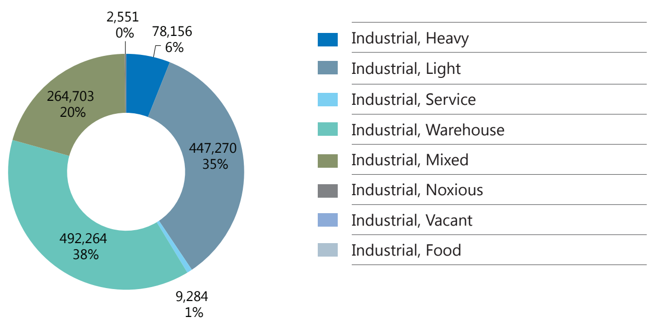
Figure 7.
**East Tamaki Industrial stock**




**East Tamaki Industrial stock**

| | | Number of sites | Total floor sqm | Total land sqm |
|---|---|---|---|---|
| Industrial, Heavy | IH | 11 | 72,088 | 179,700 |
| Industrial, Light | IL | 889 | 1,124,297 | 2,396,299 |
| Industrial, Service | IS | 144 | 54,271 | 70,606 |
| Industrial, Warehouse | IW | 400 | 793,015 | 1,632,619 |
| Industrial, Mixed | IX | 116 | 206,008 | 590,615 |
| Industrial, Noxious | IN | 13 | 19,436 | 222,935 |
| Industrial, Vacant | IV | 72 | 0 | 769,602 |
| Industrial, Food | IF | 2 | 0 | 13,661 |
| **TOTAL** | | **1647** | **2,269,115** | **5,876,037** |

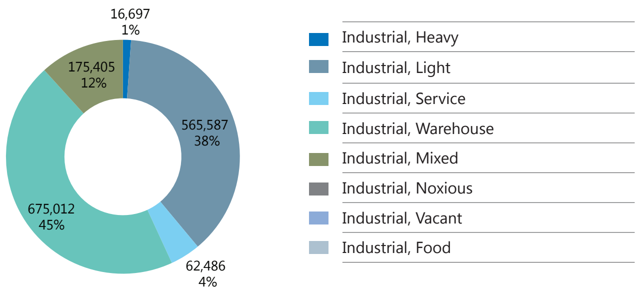
Figure 8.
**Penrose Industrial stock**




**Penrose Industrial stock**

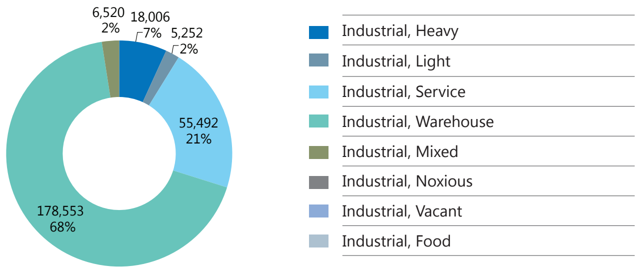
| | | Number of sites | Total floor sqm | Total land sqm |
|---|---|---|---|---|
| Industrial, Heavy | IH | 6 | 78,156 | 284,508 |
| Industrial, Light | IL | 274 | 447,270 | 853,348 |
| Industrial, Service | IS | 26 | 9,284 | 29,128 |
| Industrial, Warehouse | IW | 279 | 492,264 | 815,066 |
| Industrial, Mixed | IX | 81 | 264,703 | 693,591 |
| Industrial, Noxious | IN | 1 | 2,551 | 27,280 |
| Industrial, Vacant | IV | 25 | 0 | 132,092 |
| Industrial, Food | IF | 0 | 0 | 0 |
| **TOTAL** | | **692** | **1,294,228** | **2,835,013** |

Figure 9.
**Mt Wellington Industrial stock**




| Mt Wellington Industrial stock | | Number of sites | Total floor sqm | Total land sqm |
|---|---|---|---|---|
| Industrial, Heavy | IH | 3 | 16,697 | 75,938 |
| Industrial, Light | IL | 284 | 565,587 | 1,204,005 |
| Industrial, Service | IS | 12 | 62,486 | 127,460 |
| Industrial, Warehouse | IW | 288 | 675,012 | 1,191,885 |
| Industrial, Mixed | IX | 58 | 175,405 | 400,518 |
| Industrial, Noxious | IN | 0 | 0 | 0 |
| Industrial, Vacant | IV | 40 | 0 | 213,141 |
| Industrial, Food | IF | 0 | 0 | 0 |
| **TOTAL** | | **685** | **1,495,187** | **3,212,947** |

Figure 10.
**Manukau / Wiri Industrial stock**




| Manukau / Wiri Industrial stock | | Number of sites | Total floor sqm | Total land sqm |
|---|---|---|---|---|
| Industrial, Heavy | IH | 6 | 18,006 | 64,927 |
| Industrial, Light | IL | 7 | 5,252 | 22,519 |
| Industrial, Service | IS | 97 | 55,492 | 96,963 |
| Industrial, Warehouse | IW | 42 | 178,553 | 431,330 |
| Industrial, Mixed | IX | 2 | 6,520 | 75,960 |
| Industrial, Noxious | IN | 0 | 0 | 0 |
| Industrial, Food | IF | 0 | 0 | 0 |
| Industrial, Vacant | IV | 2 | 0 | 3,641 |
| **TOTAL** | | **154** | **263,823** | **691,699** |

## Summary

Overall the market has had a buoyant 12 months as it continues to rebound from the global recession. There is renewed interest in the Commercial and Industrial markets due to current levels of mortgage interest rates and record business confidence levels which has seen 2014 be a busy year for both sales and leasing, with many companies upsizing.

Another factor that has driven down the vacancy rates in South Auckland for both office and industrial is the shortage of new buildings / developments in the last 2-3years. This has been caused by a combination of the shortage of land, high construction costs and the difficulty developers have had financing new developments. This has created pressure on existing stock. The interest rate environment has created an opportunity for owner occupiers to become more active on the basis of cost neutrality, and that has pushed sales volumes up. Industrial property continues to be seen as a low risk investment over other investment types.

Overall East Tamaki has continued to out-perform other geographical areas due to its central location to the Auckland Airport, CBD and easy access to motorway onramps. The ongoing Flat Bush developments along with Highbrook Business Park which continues to prosper with new industrial and retail developments also draws new businesses/ staff to the area.

## Forecasts/Trends

Knight Frank expects the following trends to become evident during the next 12 months:

- Land Values are likely to increase from $350/sqm currently to be consistently over $400/sqm.
- A widening gap between A and B grade industrial properties. Developments such as Highbrook in East Tamaki offer premium space being well located with good fit out and functionally attracting higher rental rates. B grade properties, to their detriment potentially suffer from having limited heavy vehicle site access, low to medium stud warehousing and outdated construction.
- Rental rates for new, prime quality, high stud premises will increase beyond $120 psm and associated office rents beyond $220 psm.
- Rents for existing stock with obsolescence factors will stabilise or have slower rates of increase.
- Brownfields development will accelerate

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# INDUSTRIAL MARKET OVERVIEW FOR CANTERBURY

Overall, the industrial property market is in a strong position. The Canterbury rebuild is yet to reach its peak and it is having an impact on local and national growth and confidence overall. There was an initial surge in commercial and industrial activity in 2013 and there is an expectation of a second surge as consented CBD builds get off the ground and the key infrastructure projects commence.

The boom will at some point peak – but the rebuild activity can expect to last for another 5 years. Longer term growth will slow. However business is generally optimistic at the current time.

Continuing lack of building stock has resulted in strong rental and capital growth. Rental rates for prime industrial warehousing are increasing, land values are steady notwithstanding the additional land supply while yields are firming. Construction costs have been and continue to be on the rise. This is particularly relevant in Canterbury.

There is significant new development in industrial business parks and new speculative developments under construction in some of these locations are now largely committed. However, with limited new property available, particularly in the investment class sector, sales activity overall has been limited. Where opportunities have arisen the sales process has been highly contested.

## Occupier Demand

This includes both owner occupiers and leasing activity. A large proportion of vacant stock and new builds, mostly less than 500sqm, are being purchased by owner occupiers. There is little prime industrial stock available for lease while good quality secondary space is limited. This has resulted in a number of speculative builds while activity has increased in the design build sector within in the major industrial parks.

It is becoming increasingly difficult for businesses to manage growth and planning for this is a major issue for some industries as quality space is required now. Longer leases are more apparent and there are virtually no incentives available to tenants in the main.

Overall, demand is strongest in the western industrial area of Hornby / Sockburn however we are starting to see more activity in the east as industrial land subdivisions adopt engineering strategies to deal with earth quake issues. Those developments located on or near major arterial routes existing or planned are in greater demand including those master planned estates such as Waterloo, Glassworks, Izone and Portlink.

## Investor Demand

Sales activity is very low due the limited stock available for purchase although investor demand remains very high. Some developments have achieved 50% investor support without tenant commitment while under construction and investors are experiencing high levels of confidence and are expecting to secure quality tenants in the future.

The yield range has firmed for quality product now between 6.5% and 7.0% with secondary yields between 7.5% and 8.5%. There continues to be strong purchaser interest particularly for those new properties built with higher building codes.

The Property Council of New Zealand track commercial and industrial property performance by sector. The most recent release of data in relation to industrial property provides returns for the year ended March 2014. The results for industrial property indicate that this sector has kept pace with other property classes, all showing positive returns. In the first quarter of 2014, the annualised total return was 10.3% comprised of an income return of 7.9% and a capital return of 2.4%.

Figure 1.
**Cummulative Rent Growth % by Location**

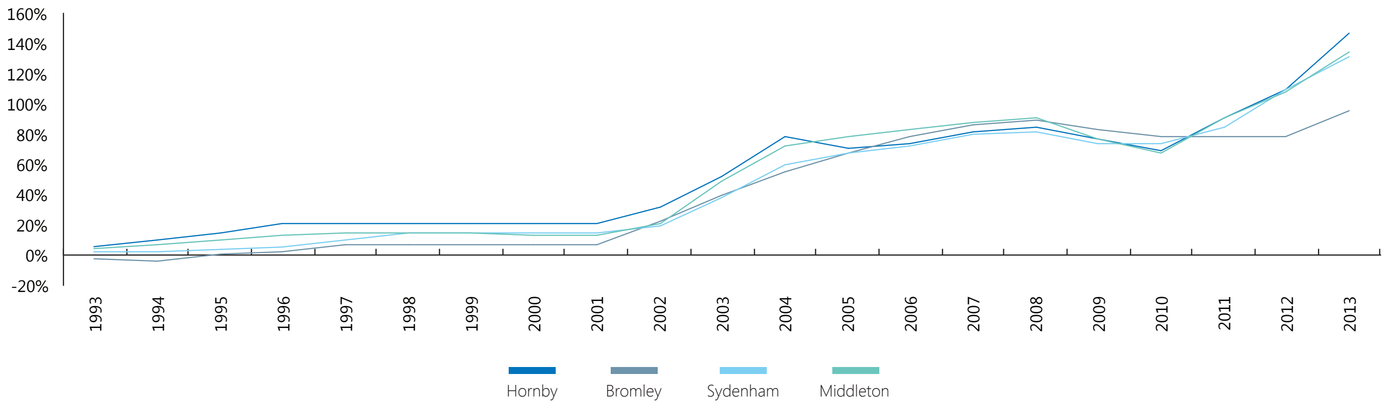


Table 1.
**Examples of analysed yields from recent investment transactions:**

| Address | | Price | Area | Core Yield | Sale Date |
|---|---|---|---|---|---|
| Hawdon Street | Sydenham | $392,500 | 179 | 7.36% | May-14 |
| Nga Mahi Road | Sockburn | $390,000 | 172 | 5.90% | Mar-14 |
| Opawa Road | Hillsborough | $1,400,000 | 712 | 7.86% | Mar-14 |
| Hayton Road | Wigram | $2,300,000 | 1400 | 8.03% | June -14 |
| Sawyers Arms Road | Papanui | $625,000 | 311 | 7.20% | Feb-14 |
| Lineside Road | Rangiora | $650,000 | 527 | 8.00% | Jan-14 |
| Mowbray Street | Waltham | $6,750,000 | 6897 | 7.74% | July -14 |
| Buchan Street | Sydenham | $2,100,000 | 2688 | 8.00% | April-14 |

Figure 2.
**Cummulative Growth % Capital Values**

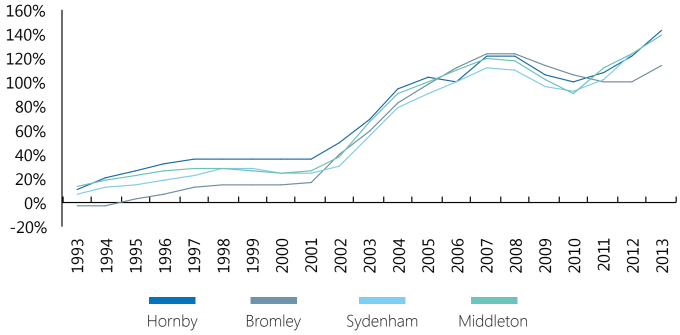
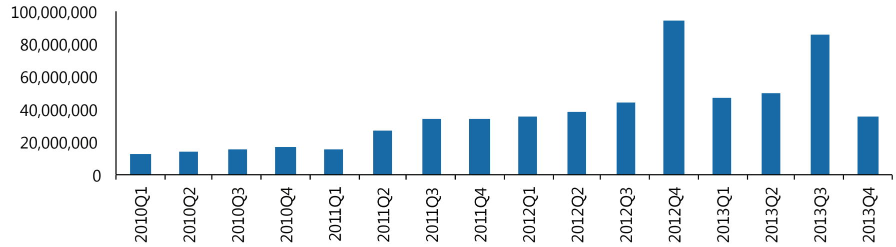
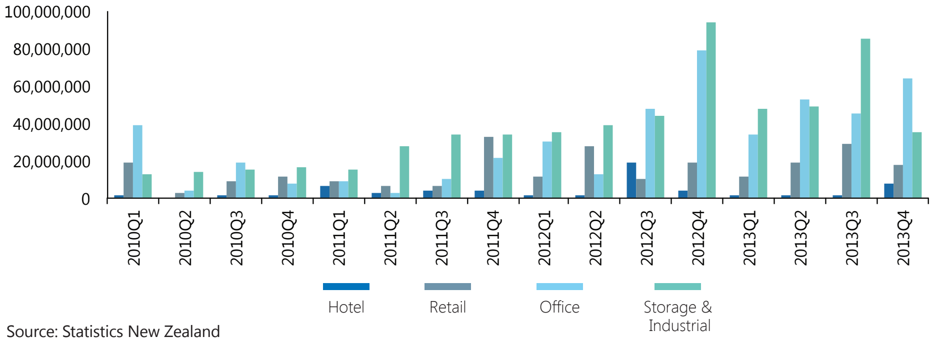



Figure 3.
**Building Consent Values Storage & Industrial Buildings**



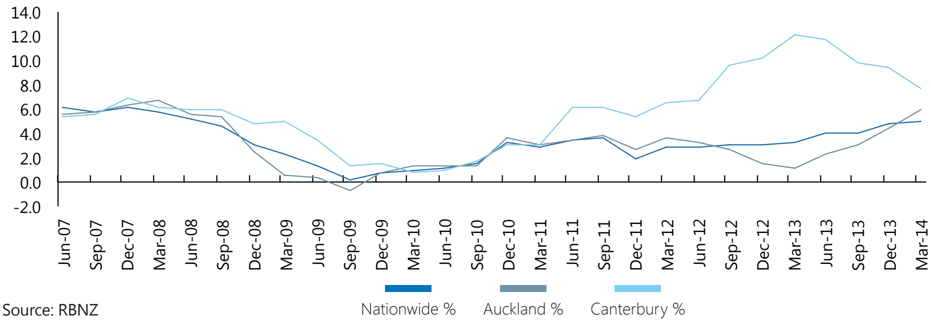

Source: Statistics New Zealand

Figure 4.
**Canterbury Building Consent Values**




Source: Statistics New Zealand

Figure 5.
**Regional Construction Cost Inflation (Annual)**




Source: RBNZ

## Building Consent Activity

Building consent applications have increased remarkably since first quarter 2013, with the increases initially focused on retail, shifting to office and industrial. Both the quantity and value of new building consents is showing an upward trend. The number of consents issued in respect of storage and industrial buildings have ranged from 31-58 consents per quarter with a steady growth in the overall value of the consents since 2012. Office and retail consents are strong in terms of value growth over the three years tracked.

The Christchurch City Council monitors commercial building development measured by consent information received. Their latest data reports that in 2013, 176,751sqm of new buildings were added to suburban zones comprising both suburban industrial and suburban commercial.

In May 2014 the value in non-residential building consents was $370,000,000 mostly in offices with a balance of industrial, education and administration. Consents can expect to peak again in 2015/16.

## Regional Construction Cost Inflation

Construction cost growth is escalating at a much faster rate within Canterbury compared with other centres although the rate of growth has recently reduced. We expect this to increase again as construction peaks in a couple of years.

## Vacant Land & Development Activity

Knight Frank has monitored the take up for industrial land over the last 20 years which on average has been 22.2 hectares per annum. Over the last two years there has been considerable industrial / business park development activity which has provided the opportunity for new industrial land supply. These include conversion of land previously occupied by meat processing companies including Waterloo in Hornby, Central Business Park in Sockburn and Belfast Business Park in Belfast. Also Hornby Quadrant has come to the market.

This provides a substantial increase in industrial land. While land is available for sale in some of these new developments, a significant proportion is being retained by the developers. Izone in Rolleston, Glassworks in Hornby, Portlink in Bromley and Dakota Park also add to the mix. While land value growth was flat through 2006 to 2013, Knight Frank is seeing a slight increase in values in Hornby and Middleton.

## Vacant Land Stock

According to Christchurch City Council, Christchurch has a total of approximately 497 hectares of vacant industrial zoned land, including 240 hectares zoned as "Airport Special Purpose" only part of which may be used for industrial purposes. The distribution of industrial activity in the City tends to correspond to major transportation networks. Substantial areas of industrial zoned land are located near the railway corridor that runs adjacent to Blenheim and Main South Roads. Other industrial areas are adjacent to State Highway 1, and close to the Lyttelton Port Tunnel access road in Heathcote/Ferrymead. Additional land has been zoned and is proposed to be rezoned so that the expected total vacant land zoned industrial is likely to exceed 1000 hectares.

Table 2 summarises the estimate total stock in the dedicated industrial / business parks.

Ensuring that the demand for land can be met to accommodate future industrial growth and to support the recovery, the proposed Christchurch Replacement District Plan identifies greenfield areas in the Land Use Recovery Plan (LURP) that are to be rezoned. (Table 3.)

In summary there is considerable industrial land available for future development. As a result Knight Frank expect land values to stabilise in the medium term.

Figure 6.
**Cummulative Land Value % Growth By Location**

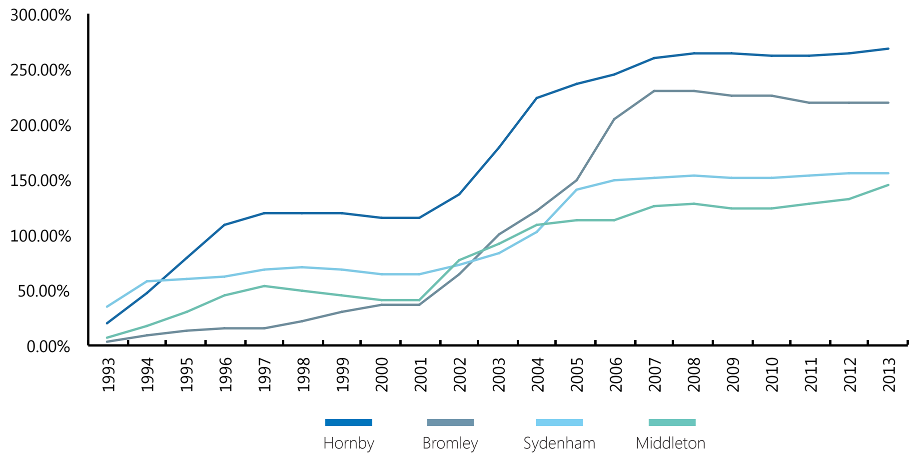



Table 2.
**Estimated Total Stock In Chch/Rolleston**

| Industrial Park | Total Land Area | Number of Lots |
|---|---|---|
| Izone | 180ha | 79+ |
| Waterloo Business Park | 91ha | 88 |
| Portlink | 17ha | 28 |
| Wigram | 25ha | 52 |
| Dakota | 80ha | Unknown |
| Airspace | 16ha | 17 |
| Glassworks | 10ha | Unknown |
| Hornby Quadrant | 200ha | Unknown |
| CBP Racecourse Rd | 12ha | 19 |

Table 3.
**Greenfield areas in the Land Use Recovery Plan (LURP) that are to be rezoned**

| Area Name | Status | Size |
|---|---|---|
| Belfast (B5) | To be rezoned as part of DPR | 95 ha |
| North West Area (B6-B8) | To be rezoned as part of DPR | 100 ha |
| North West Area ( Memorial Ave) | To be rezoned as part of DPR | 19 ha |
| Hornby (Main South Road) | To be rezoned as part of DPR | 23 ha |
| Hornby South | To be rezoned as part of DPR | 20 ha |
| Templeton (Cookie Time) | To be rezoned as part of DPR | 5 ha |
| **Total** | | **262 ha** |

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