THE WHILLANS REPORT

AUCKLAND MARKET UPDATE 4TH QUARTER 2022

Navigating the changing market ahead

Experience is key to navigating the changing market

Having spent nearly forty years in the industry, I've witnessed the ups and downs of commercial property cycles. Each cycle is different, and no downturn is ever the same.

In the 1980s, deregulation and speculation reigned supreme, setting off a once-in-a-generation boom in construction and commercial property. The stock market crash of '87 triggered a painful period of deleveraging, and commercial property values fell by nearly two-thirds.

Then, in the 2000s, the rise of poorly regulated mezzanine finance companies supercharged our commercial property industry. This breathless growth accelerated and intensified the impact of the credit crunch and global recession that followed.

Global repricing and liquidity challenges today

Today's property market is facing an uncomfortable period of global asset repricing. Despite signs that inflation is beginning to peak, the gap between vendors' expectations and buyers' perceptions of value continues to grow.

Aligning with the right partners

The challenge in this market is liquidity. Lateral thinking is needed to get deals over the line.

Structured sales involving trades, third-party underwrites and vendor finance can help bridge the gap. Successful outcomes depend on access to key decision-makers and the correct source of capital.

Alignment with the right real estate partners is critical for what lies ahead.

Weathering the storm

Whillans have navigated these cycles before and weathered every storm. We know how to maximise asset value and capital return for our valued clients – whatever the prevailing market conditions.

My team are the most experienced commercial team in New Zealand. Our reputation is built on reliable, expert partnerships. We're renowned for our confidentiality, our professionalism and our negotiation skills – our results are proof of the team's experience and ability.

We welcome the opportunity to work with you in 2023.

Hurricane Watch

In this edition of The Whillans Report, our senior analyst Brendan Keenan looks at the effect of higher interest rates on property prices. He reviews where New Zealand is in the cycle, and how long the storm will last.

We trust you find this report valuable. We wish you a very Happy Christmas, a safe holiday and a Happy New Year.

Bruce Whillans
Managing Director

T +64 (09) 304 1453
M +64 (21) 985 619
bruce.whillans@whillans.co.nz

2022 Whillans third quarter notable sales

Northlands Shopping Centre, Christchurch
$160,000,000 (in conjunction with Colliers)

Pier21 Marina Complex, Central Auckland
$20,702,000

Market 2022 third quarter update

CBD Office —Auckland's CBD office market continued to diverge over the course of 2022.

In the 12 months to September, the prime sector held its ground with net effective office rents increasing by 2.1%. Over the same period, secondary office rents decreased 2.4% with larger lease incentives eroding real rental growth. Deal volumes ground to a halt in 2022. Higher funding costs have driven a wedge between vendor and purchaser pricing aspirations. In the 12 months to September, indicative prime CBD office yields softened by 83 basis points to 6.14%. Indicative secondary CBD office yields expanded 118 basis points.

Without substantial sales evidence and a clear affirmation that we have past peak inflation, it will take time for the market to find its footing again.

Auckland CBD Office Market Summary*

	PRIME	SECONDARY	PREV 6MTH TREND
Vacancy	8.8%	20.1%	Increasing
Effective Rent	$408	$227	Diverging
Yield	6.14%	7.66%	Softening
Incentives*	13.7 mths	14 mths	Increasing

*Based on an indicative new 9-year prime and 6 year secondary lease

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Market 2022 third quarter update

CBD Retail — Prime CBD retail rents stabilised in the 12 months to September 2022, halting a prolonged period of falling rents in the wake of the pandemic.

Foot traffic counts taken from Queen Street's three busiest intersections suggest that October foot traffic is still 33% below pre-pandemic levels. However, a steady flow of tourists and overseas students will help to narrow this gap.

Encouragingly, Auckland Transport patronage figures show more and more workers returning to the office each month, despite flexible/work from home policies.

Indicative prime CBD retail yields expanded 40 basis points in the year to September. Mirroring the CBD office market, sales evidence remains scarce as the market goes through a period of price discovery.

Auckland CBD Retail Market Summary

	AVERAGE	HIGH	LOW	PREV 6MTH TREND
Rent	$3,758	$5,000	$1,650	Flat
Yield	5.40%	5.00%	6.15%	Softening

Auckland Industrial — Auckland's industrial market continues to outperform the wider commercial property sector.

In the year to September, prime net effective industrial rents increased 20.3% to reach $\$178/\text{m}^2$. Over the same period, net effective secondary industrial rents increased by 15.6%, reaching $\$138.3/\text{m}^2$.

Land values rose by over 12% in the 12 months to September.

However, beneath this headline figure, land values actually flatlined between March and September.

Despite solid rental growth and record low vacancy, prime and secondary industrial yields have begun to unwind. In the 12 months to September, indicative prime and secondary office yields expanded by 67 and 52 basis points respectively.

Auckland Industrial Market Summary

	PRIME	SECONDARY	PREV 6MTH TREND
Vacancy	0.5%	0.6%	Decreasing
Effective Rent	$178.0	$138.3	Increasing
Yield	4.78%	5.71%	Softening
Land Value	$1,650	$700	Flat

Source: Statistical data in this market update has been summarised from CBRE research and is intended for general guidance only. No responsibility is accepted by CBRE or Whillans Realty Group Limited for any omissions or errors contained within this report.

Hurricane Watch - investors batten down the hatches — *Brendan Keenan, Senior Analyst*

In early-June, JPMorgan Chase CEO Jamie Dimon said he was preparing America's largest bank for an economic hurricane – and advised investors to do the same.

"I said there's storm clouds but I'm going to change it ... it's a hurricane," Dimon said during a financial conference in New York. While conditions seem "fine" at the moment, nobody knows if the hurricane is "a minor one or a superstorm," he added.

Global asset prices have been upended this year, as investors scramble to reprice risk in an environment of inflation and rising interest rates.

In this report, we review the market forces weighing down on Auckland's commercial property market. We look at where New Zealand is in the cycle, and ask the question on everyone's mind: how long will the storm last?

Interest rate hikes crash down on real estate markets

New Zealand has just experienced one of its steepest interest rate hikes in a generation. 10-year government bond yields have risen nearly fivefold over the last 2 years, pushing up the cost of borrowing and the risk-free rate of return.

This major reset, first felt by New Zealand's bond and equity markets, is now flowing through to property prices. Median residential prices across the country are already down 10% from their peak last November. In Auckland, median house prices have fallen by over 16%.

In the commercial market, New Zealand's listed property stocks have tumbled from their September 2021 highs. The sector is trading at approximately 30% below net tangible asset value, suggesting that property book values are out of sync with the market. This discount in the listed sector may be a bellwether for the wider commercial property market. The last time the sector was trading at a similar discount was during the 2008 financial crisis.

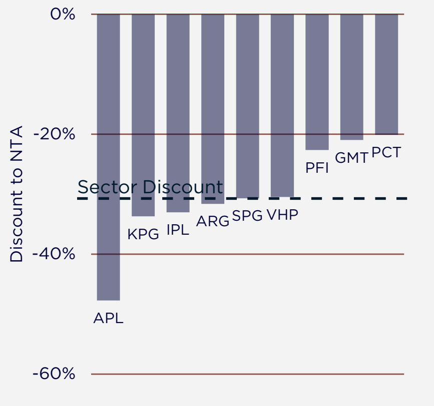
Listed real estate investment trust share prices should be taken with a grain of salt. They are inherently more volatile than their underlying asset base.

Hurricane Watch - investors batten down the hatches — *Brendan Keenan, Senior Analyst*

Nonetheless, in September, the head of property for Australia's largest superannuation fund told the Australian Financial Review it would be "naïve" to think the public markets got it wrong, "because I don't think they have."

Without commercial sales evidence, it will take time for the real impact of higher funding costs to come to light. And this impact will not be evenly felt. Non-cyclical assets and properties with the rental growth to keep ahead of rising yields and debt costs will remain relatively unscathed. Others are already under pressure.

Good value or sign of the times?
REIT Share price to NTA (NZX - 16th Nov)



Where are we now – the calm before the storm?

The spread between yields for commercial property and 10-year NZ government bonds has tightened at lightning speed. It is now at its narrowest point since the 2008 global financial crisis.

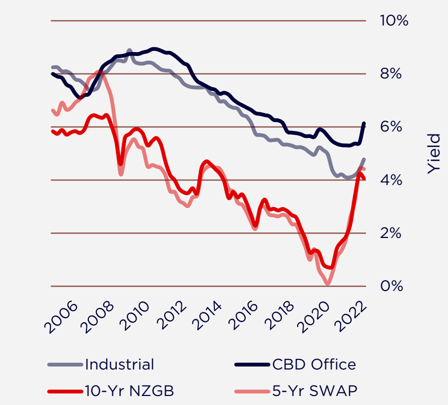
Funding costs have increased accordingly, with 1-year interest SWAP rates nearly trebling since the start of the year.

The yield spread between prime and secondary assets has also diverged, as investors re-evaluate risk and place a premium on quality assets.

For many commercial properties, borrowing costs have eclipsed near-term rates of return, negating the use of debt entirely. In other words, adding debt to these properties causes their leveraged return to be less than their unleveraged return – this unusual situation has been a rare sight since 2008.

Buyers who have relied on debt to fund purchases are either sticking to the sidelines – reducing total market liquidity – or shifting their pricing downwards. This is driving sale volumes lower, with vendors pinning their expectations on 2021 pricing and buyers pushing for discounts to reflect borrowing costs and risk.

Rate shock
Prime Auckland property yields vs debt costs



Eventually, something will have to give. How long will this standoff last?

Investors hate uncertainty. Until inflation evens out and a consensus emerges around how far central banks will have to raise interest rates, this stalemate is likely to continue.

Leaks are beginning to spring in the meantime, with a handful of deals in the secondary market trading well below recent valuations. Some borrowers are already under pressure; rising debt costs are eroding their cash flow and interest cover ratios. Despite this, distressed sales are few and far between. For now, it seems lenders would rather take a more cautious approach to enforcing banking covenants than risk triggering a steep correction.

Every cloud has a silver lining

But if these storm clouds have any silver lining, it's that offshore, central bank narrative is shifting towards more incremental rate rises. Some economists predict interest rates will be falling by this time next year. But, given the long lag between monetary policy and its economic impact, there is a growing fear that central bankers may have overshot the mark. Falling interest rates will be bittersweet if they arrive too late to avoid an economic downturn.

Few predicted this time last year that interest rates would be where there are today, and fewer still know where they will be in a years' time. For every chart that shows we're nearing the inflation peak, another suggests the darkest clouds are yet to come.

However, we still see room for optimism. Overall gearing levels are lower than they were in the lead up to 2008. Construction costs and red tape have kept a cap on new supply. And a large amount of dry powder capital has been building and waiting, patiently, for a moment like this to arrive.

Picking the bottom is never easy, but opportunity abounds in volatile and uncertain times. If 2022 was the year investors held their ground against gale force winds, will 2023 be the year they capitulate to an economic hurricane?

Auckland Office And Mixed-Use Investment Sales

Address	Suburb	Asset Type	NLA	Parking	Occupancy	WALT	Sale Price	Date	Initial Yield
190 Great South Road	Epsom	Secondary	1,095	28	0%	NA	$6,615,000	Oct-22	Vacant
3 Union Street	CBD	Conversion	17 units	7	100%	NA	$5,000,000	Jul-22	6.66%
8 Rockridge Avenue	Penrose	Secondary	3,149	144	NA	2.8	$15,750,000	Jun-22	Confidential
Pier21 Marina Complex	Wynyard Quarter	Office/Drystack	6,653	159	Conf.	Conf.	$20,702,000	Jun-22	Confidential
3 Brian Smith Drive	Silverdale	Medical/Childcare	1,727	41	100%	NA	$14,200,000	Jun-22	5.57%
47 New North Road and 22 Exmouth Street	Eden Terrace	Character	925	5	100%	0.5	$4,700,000	Jun-22	4.73%
27 Nugent Street	Grafton	Secondary	675	12	0%	NA	$6,800,000	Jun-22	Vacant
4 Osterley Way	Manukau	Secondary	3,780	24	Leaseback to Council		$14,200,00	May-22	7.3%
22 Dundonald Street	Eden Terrace	Secondary	1,063	31	NA	NA	$5,400,000	Apr-22	6.19%*
80 Greys Avenue	CBD	Secondary	5,451	94	100%	3	$22,500,000	Apr-22	Confidential
35 Teed Street	Newmarket	Secondary	2,865	99	NA	~6	$24,500,000	Apr-22	5.65%*
35 Graham Street	CBD	Secondary	12,515	-	0%	NA	$65,000,000	Apr-22	Vacant
110 Carlton Gore Road	Newmarket	Prime	13,541	115	100%	10.5	$213,000,000	Apr-22	5.1%
6 Nixon Street	Grey Lynn	Build-to-Rent	32 Apartments		NA	NA	$23,500,000	Mar-22	4%*
60 Khyber Pass Road	Grafton	Secondary	5,117	93	34%	2.7	$21,000,000	Mar-22	9.3%*
2-8 Chancery Street	CBD	Character	3,580	-	55%	<2	$15,500,000	Mar-22	2.26%
105-111 Hurstmere Road	Takapuna	Secondary	1,113	33	100%	NA	$11,250,000	Mar-22	4.04%
385 Queen Street	CBD	Secondary	8,711	165	80%	3.9	$25,500,000	Dec-21	8.46%
99-115 St Georges Bay Road	Parnell	Character	3,878	18	100%	3.5	$42,500,000	Sep-21	4.47%
81 Carlton Gore Road	Newmarket	Secondary	4,540	133	0%	-	$34,750,000	Sep-21	Vacant

*Yield based on estimated fully let net income. No adjustments made for lease-up, refurbishment or holding costs.

Auckland Retail Investment Sales

Address	Suburb	Asset Type	GLA	Parking	Occupancy	WALT	Sale Price	Date	Initial Yield
Placemakers, 547-557 Don Buck Road	Westgate	Bulk Retail	7,184	70	100%	4.5	$14,700,000	Sep-22	4.62%
Burger King, 270 Mount Wellington Highway	Mt Wellington	Fast Food	2,273m² site		100%	NA	$11,080,875	Jul-22	NA
46 Hurstmere Road	Takapuna	Suburban Retail	473	NA	100%	NA	$5,400,000	Apr-22	4.8%
492-500 New North Road	Kingsland	Suburban Hosp.	704	NA	100%	4.4	$9,400,000	Jan-22	4.78%
Countdown Portfolio	Mangere/Hamilton	Supermarket	9,235	486	100%	10	$66,798,000	Dec-21	4.19%
Gull North Island Service Station Portfolio	North Island	8 Service Stations	NA	NA	100%	11	$32,000,000	Oct-21	4.40%
34 Barrys Point Road	Takapuna	Retail/Office	3,556	100	100%	3.5	$17,000,000	Nov-21	5.82%
7-19 Croftfield Lane	Wairau Park	Bulk Retail	3,276	145	100%	NA	$17,280,000	Nov-21	4.98%
8 Kent Street	Newmarket	Character	818	-	100%	3.8	$11,200,000	Apr-21	4.1%
Ex Nido Furniture Store	Henderson	Bulk Retail	27,682	325	-	-	$46,300,000	May-21	Vacant
Countdown Grey Lynn	Grey Lynn	Supermarket	4,374	203	100%	10.4	$48,000,000	May-21	3.12%
Albany Lifestyle Centre	Albany	Bulk Retail	26,667	616	100%	7.95	$87,500,000	Feb-21	6.23%
204 Quay Street (Leasehold)	Auckland CBD	Hospitality	5,469	-	100%	5.9	$20,000,000	Dec-20	6.8%

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Auckland Non-CBD High Density Land Sales

Address	Zone	Proposal/Development/Description	(m²)	Sale Price	$/psm	Date
5 Burns Avenue, Takapuna	THAB	Consented for seven, 200m² luxury townhouses. 22.5m height limit.	1,039	$4,360,000	$4,196	Sep-22
66 Kauri Heart Avenue, Takanini	Local Centre/MHS	Bare site. 3,600m² Local Centre and 650m² Mixed Housing Suburban.	4,250	$3,700,000	$870	Aug-22
3 Park Avenue, Grafton	Mixed Housing Urban	MHU site with 9 residential flats. Returning $140,00 p.a.	771	$3,900,000	$5,058	Aug-22
28 Norwich Street, Eden Terrace	Mixed Use	Mixed Use site - 21m height limit. Single level warehouse office conversion.	296	$2,600,000	$8,783	Aug-22
80 Cawley Street, Ellerslie	Mixed Use	Bare mixed use site. Minimum 6-level height limit under Plan Change 78.	3,303	$6,606,000	$2,000	Jul-22
181 Jervois Road, Herne Bay	THAB	THAB site with four, two-bedroom flats. Returning $126,880 p.a.	701	$3,680,000	$5,250	Jul-22
11 St Benedicts Street, Newton	Mixed Use	Mixed Use site - 32.5m height limit. Single villa. Sold with vacant possession.	344	$2,282,000	$6,633	Jul-22
18 Norwich Street, Eden Terrace	Mixed Use	Corner lot overlooking Basque Park. Improved by 1960s warehouse.	306	$2,800,000	$9,150	Jul-22
68 East Tamaki Road, Papatoetoe	Business - Town Centre	Opposite Mobile, Z-Service Station and KFC.	2,280	$5,008,000	$2,196	Jul-22
213 Ponsonby Road, Ponsonby	Business - Town Centre	Improved by single level bungalow. 13m height limit.	718	$5,300,000	$7,381	Jul-22
80 Ascott Avenue, Remuera	Mixed Use	Bare site overlooking Ellerslie Racecourse. Purchased by Vital.	3,415	$16,000,000	$4,685	Jun-22
12 Brigham Creek Road, Whenuapai	Future Urban - THAB	Zoned future urban with proposed THAB zoning under the structure plan.	4,725	$3,450,000	$730	Jun-22
3008 Great North Road, New Lynn	General Business	Corner of Portage and Great North Road.	1,109	$3,300,000	$2,975	Jun-22
62 Great South Road, Epsom	Mixed Use	Consented for 59 room hotel. Purchased by Sime Darby.	1,042	$5,500,000	$5,278	Mar-22
50 Northcote Road, Northcote	Mixed Use	Mixed Use site purchased by Restaurant Brands.	1,849	$5,000,000	$2,704	Mar-22
11 York Street, Parnell	Mixed Use	Consented for 8-level, 5,607m² commercial building and 84 parks.	1,514	$12,350,000	$8,157	Jun-22
339 Parnell Road, Parnell	Town Centre	Consented for mixed use building in 2020.	497	$4,000,000	$8,048	May-22
57-61 Parnell Road, Parnell	Mixed Use	18 metre height limit. Returning $60k holding income.	573	$3,100,000	$5,410	May-22
8 Alpers Avenue, Epsom	THAB	Development site. Returning $102k holding income.	822	$4,050,000	$4,927	Mar-22
12 Karaka Street, Newton	Mixed Use	Development site with 32.5 metre height limit. $131k gross holding income.	472	$3,100,000	$6,567	Mar-22
1A Edgerley Avenue, Newmarket	Mixed Use	Development site with 12-24 metre height limit.	611	$2,200,000	$3,600	Mar-22
161 & 165 Guys Road, Huntington Park	THAB	Four contiguous titles with dual street access.	5,823	$13,500,000	$2,318	Mar-22
65-71 & 73-75 The Strand, Parnell	Mixed Use	Ground lessors interest - returning $275k p.a.	2,107	$12,600,000	$5,980	Mar-22
352 Great North Road, Grey Lynn	THAB	Corner site improved by tilt slab tyre repair centre.	556	$3,015,000	$5,422	Feb-22
1 Mangahoe Road, Mt Wellington	THAB	Development planned for 140 terraced homes.	21,686	$25,700,000	$1,185	Feb-22
38 Sackville Street, Grey Lynn	Mixed Housing Urban	Occupied by childcare provider; Best Smart for 5 years.	1,597	$5,100,000	$3,193	Jan-22
25-27 Crowhurst Street, Newmarket	Metropolitan Centre	38.5-40 metre height limit. $315k holding income.	1,411	$10,500,000	$7,441	Dec-21
212-214 Rosebank Road, Avondale	THAB and MHU	Corner site opposite Eastdale Reserve.	3,366	$8,174,556	$2,428	Dec-21
518-520 New North Road, Kingsland	THAB	Marketed as development land.	1,873	$5,430,000	$2,899	Dec-21

Auckland CBD Land Sales

Address	Property	Proposal/Development	(m²)	Sale Price	$/psm	Date
536 Karangahape Road	Car park	Corner development site with 15 metre height limit.	1,283	$8,000,000	$6,235	Apr-22
103 Vincent Street	YWCA Hostel	Ex 173-room, YWCA hostel and police barracks. Purchased by HNZ.	1,324	$11,650,000	$8,799	Dec-21
50 and 52 Cook Street	Bare site	Consented for a 15-level apartment building. 50m height limit.	1,732	$10,500,000	$6,062	Dec-21
17-27 Beresford Square	CRL site office	35 metre height limit. $755k holding income from CRL site office.	1,777	$16,000,000	$9,003	Oct-21
51-71 Victoria Street	2-level retail block	Corner development site with 13:1 MFAR. 3.6% initial yield.	860	$19,300,000	$22,442	Jul-21