COMMERCIAL

property Research

Second Half 2008
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BAYLEYS RESEARCH

CBD vacancy up, but space remains tight | Tenants demand quality - landlords respond | Government continues to soak up prime space

WELLINGTON

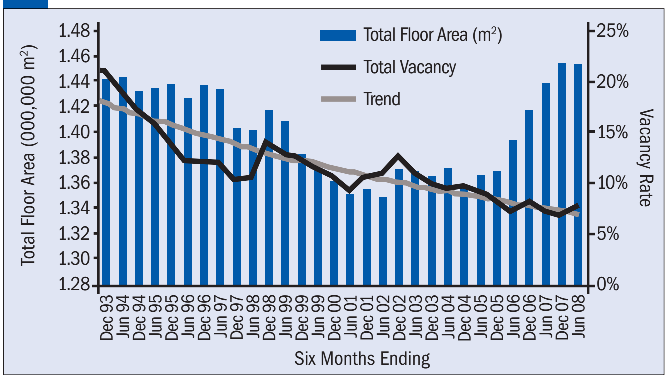
2008 has witnessed a continuation of the trends which have dominated the Wellington CBD's commercial office market in recent years.

- Vacancy rate trending down
- Incremental reduction in supply
- Tenant demand for quality
- Major refurbishment projects
- High levels of Government demand

VACANCY EDGES UP

The overall vacancy rate in the Wellington CBD office market for the June 2008 quarter was 7.76%, up from 6.79% for the previous six months period. This is despite the fact that approximately $2,000m^2$ was removed from the survey during the same period. While vacancy has softened, it is still exceptionally low, confirming that availability of space to lease is very limited, particularly for occupiers looking for large, contiguous floor areas.

WELLINGTON CBD OFFICE MARKET TOTAL FLOOR AREA v OVERALL VACANCY



Source: Bayleys Research, TelferYoung Research

The overall vacancy rate has been driven up by increases in vacancy across the CBD Core and Te Aro precincts, while marginal decreases were experienced in Thorndon and the CBD Fringe. The CBD Core experienced the greatest increase

in vacancy, softening by 1.61 percentage points. This is due to increases in available space in the lower grades of office space. Also, some businesses have been forced to consolidate their business requirements, which are expected to be magnified should current economic circumstances persist.

PRECINCT BREAKDOWN

	July 2007		January 2008		July 2008		1 Year Change	
	Total Floor Space (m^2)	Overall Vacancy	Total Floor Space (m^2)	Overall Vacancy	Total Floor Space (m^2)	Overall Vacancy	Total Floor Space (m^2)	Overall Vacancy
CBD Core	715,804	6.15%	732,196	6.37%	731,862	7.76%	16,058	1.61%
CBD Fringe	253,718	11.07%	253,718	10.94%	253,021	10.80%	-697	-0.27%
Thorndon	245,302	4.99%	245,302	4.02%	245,302	3.85%	0	-1.14%
Te Aro	222,474	7.72%	221,704	6.53%	220,836	8.00%	-1,638	0.28%
Total	1,437,298	7.07%	1,452,920	6.79%	1,451,020	7.67%	13,722	0.60%

Source: TelferYoung, Bayleys Research

The next biggest increase in vacant space was experienced in Te Aro, softening almost 1.5 percentage points. This is largely a reflection of the reduced tenant demand for the secondary stock located in this precinct.

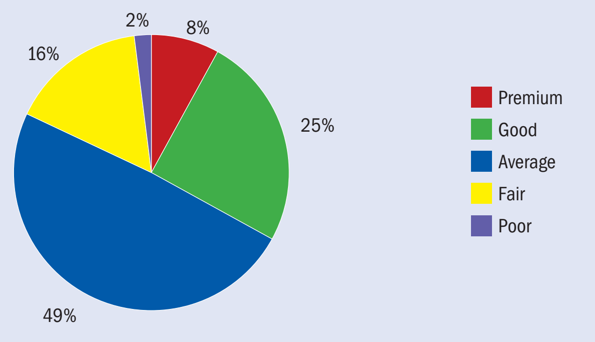
Vacancy in the CBD Fringe and Thorndon precincts decreased over the six month survey period to June 2008. In the fringe this decline has been attributed to the inclusion of the fully tenanted Chews Lane development in the survey. In Thorndon, the vacancy rate decreased to an exceptionally tight 3.85%, down from 4.01%. This is a reflection of the large supply of prime space in the area as well as continued interest from the public sector in Thorndon.

NEW BUILDS AND REFURBS LIFT QUALITY

Strong tenant preference for higher grade office space, particularly from the influential government sector, has resulted in many property owners undertaking significant refurbishment schemes in order to better place their property in the market as existing tenancies reach termination.

Only 8% of the CBD's office stock is categorised as being of premium grade by TelferYoung with the largest single sector being of average quality, accounting for almost half of the total inventory.

WELLINGTON CBD OFFICES BY GRADE



Source: TelferYoung Research, Bayleys Research

Over the last three years premium floor space has expanded by almost 10,500m^2 as a result of the construction of the Maritime Building and the Meridian Building. Over the same period, however, property categorised as being of good quality has increased 56,500m^2. During the same period poor quality space has decreased by nearly 2,000m^2 mainly as a result of conversion to apartment accommodation.

In some cases the degree of uplift following refurbishment is not significant enough to lift a building to a higher grade, but it can move it up within its current categorisation thereby improving its rental and competitiveness in relation to other premises of that grade.

TENANTS STEERING QUALITY DRIVE

A strongly performing economy, which has fuelled high levels of business formation and growth, in turn driving unemployment to historically low levels, has resulted in the property sector having experienced a significant expansionary phase.

The requirement for additional space has led to over 84,000m^2 of additional accommodation having been added to the Wellington CBD over the last four years, 64% of which is of a prime grade, reflecting tenants' preference for quality, driven in no small part by the need to compete for and retain key staff. Providing employees with a comfortable and healthy working environment has been one of the major factors driving tenants' preference for quality.

A lack of suitable development sites in Wellington's CBD has led to owners of a number of lower grade buildings undertaking intensive internal refurbishment in order to stimulate tenant enquiry. Examples include the Vogel Extension on Aitken Street and the former Defence Building on Stout Street.

SUSTAINABILITY

Social responsibility has become an important issue for companies and the impact of their activities on the environment is a significant part of this, starting with the buildings they choose to occupy. Sustainability will continue to be an important factor for employees, particularly as generation X and Y individuals, who are generally increasingly environmentally aware, move through company ranks.

While it is not essential for all buildings to refit to a green-star standard in order to attract tenants, an investor displaying an understanding of sustainable design principles will go some way to enhancing tenant interest. Some of the principles include lighting and power efficiencies, energy efficient air-conditioning and heating systems, water recycling and insulation. Some green initiatives are now becoming standard practice, such as recycling carpet tiles. Some of these do not bring about any significant savings but are considered responsible. This trend is mostly evident in the Wellington Company's Department of Conservation Building in Manner Street. It is also a major reason why Telecom have committed to the Wellington Company's new building on Willis Street.

SPACE EFFICIENCY

Despite a trend towards open plan offices, the average space allowance per person has increased over the last cycle. While it was previously approximately 8m^2 per person, including offices, meeting rooms and circulation areas, this has increased to 12 – 17m^2 per person. However, this space is being used in a more efficient manner and is increasingly used to accommodate atpoint storage. Private offices have become less popular in favour of more collaborative working spaces.

Lunchrooms are becoming less common with building owners preferring to construct cafés in their place. Boardrooms, meeting rooms and other formal meeting areas are becoming a thing of the past also, often replaced with informal common areas and break-out rooms, all of which will work towards making the workplace a more comfortable environment and meeting the demands of a growing 'meeting culture'.

Hot-desking is less common with fit-outs completed recently, reflecting a human desire to "own" individual space.

SHELL UPGRADES

One of the major incentives landlords can use to attract tenants is to undertake shell upgrades of otherwise dated premises. Refurbishment work, generally undertaken by the landlord, encompasses the general building shell, including doors, ceilings, flooring and lift lobbies, as well as building services, such as electrical, lighting, telecommunications, air-conditioning and fire protection and general building amenities.

Rob Lang, CEO of AMP New Zealand Office Trust (ANZO), notes that as market conditions start to deteriorate, landlords are required to be proactive in adding value to their properties in order to maintain tenant interest. A building upgrade will help in this way and is generally a cheaper alternative to acquiring and developing bare land.

FIT OUT COSTS

The cost of hard and soft fit out of an office suite has increased throughout the last cycle. However, the greatest cost increase has tended to be for the soft fit out, which includes individual work-station set-ups, board and meeting room chairs and tables and furnishings for break-out areas.

The average cost per work station per person is between $3,000 and $4,000. However, as previously stated, this increase includes the added cost associated with more efficient work stations.

AVERAGE COST OF FIT-OUT

	Hard	Soft
Top	$550 - 1,000	$300 - 450
Medium	$350 - 550	$200 - 300
Budget	$200 - 300	$150 - 200

Source: Gaze Commercial, Bayleys Research

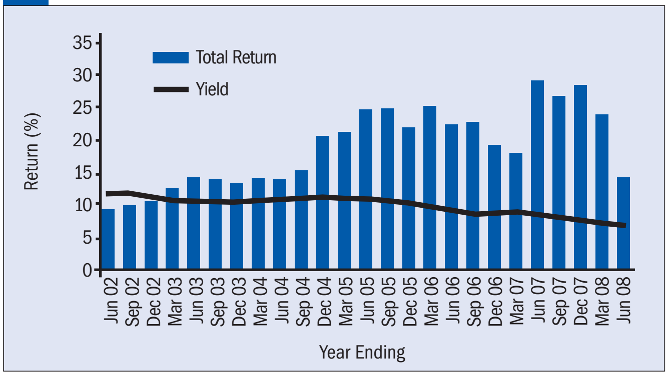
PCNZ RETURNS

Wellington CBD commercial property's average yield continued to firm since the year ending December 2004, according to the Property Council of New Zealand's (PCNZ) Investment Performance Index. The average yield for the year ending June 2008 was 6.84%, firming almost 20 basis points on the yield for the year ending the previous quarter.

Rob Lang of ANZO says that some of the larger off shore investors are sitting back and there is anecdotal evidence of a slight softening in yields off last years' highs. This probably represents an opportunity once global credit markets have stabilised and it is likely that prime property yields will continue to reflect the underlying quality of the asset.

The average total return achieved for Wellington CBD offices

WELLINGTON CBD OFFICES YIELD vs TOTAL AVERAGE RETURN



Source: PCNZ, Bayleys Research

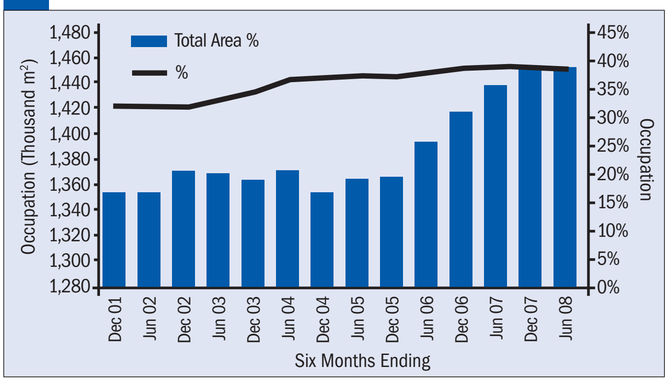
has declined significantly over the last year to a level not seen since June 2004. The average total return recorded for the 12 months ending June 2008 was 13.84%. This is a reflection of current economic constraints, leading to less rental growth and an easing in yields, along with a risk adverse finance sector. This has the effect of reducing the number of potential purchasers in the market and ultimately reducing the demand for a property once it comes to market.

GOVERNMENT OCCUPATION GROWS

The influence of the Government sector on the CBD office market continues to grow with the sector now occupying approximately 559,000m^2 or almost 40% of Wellington's total office stock.

The Government presence is particularly evident in Thorndon where it is the dominant player occupying approximately 77% of the precinct's office inventory. Demand for space from the Crown is expected to slow, particularly if there is a change of Government. However, given that a number of government departments are committed to long-term leases, within newly occupied space or space that is being developed or planned, *Bayleys Research* does not believe a changed political scene will see any significant change in Government occupancy in the short to medium term.

GOVERNMENT OCCUPATION



Source: Bayleys Research, TelferYoung Research

Projects planned or underway in Wellington's CBD, which have government departments as tenants include the following;

Vogel Extension: Owned by AMP Capital, the Vogel Extension project involves a refurbishment of the existing Vogel Building along with the construction of a new seven level auxiliary building. They will be connected via a central atrium.

The original Vogel Building was constructed in 1969 and the upgrade and extension is due for completion in 2009.

Upon completion the complex will add almost 33,000m^2 to Thorndon's inventory. The Ministry of Justice has signed up to occupy 13,000m^2 of the Aitken Street development and another government agency has pre-committed to a further 15,000m^2.

Vogel Extension

Chews Lane: The Chews Lane development by Willis Bond and Co includes five separate office buildings along with retail and residential space. The development includes a mix of brand new and refurbished buildings.

ANZO, Wellington's major provider of prime office space, has invested in one of the new office buildings in the development. It has acquired a new 10-storey building of 9,000m^2, which is completely leased to Land Transport New Zealand for an initial term of 15 years.

1 Featherston Street: Mark Dunajtschik is developing a 3,500m^2 site for the Inland Revenue Department (IRD). Currently under construction, with completion due towards the end of 2010, the total floor area of the building will be approximately 33,000m^2, 25,000m^2 of which is pre committed to IRD.

Customs Services Headquarters: Resource consent has been granted for further development at Harbour Quays for a New Zealand Customs Services headquarters. The proposed building will be the third built by Centreport as part of the Harbour Quays development and will have approximately 7,000m^2 of lettable space over seven levels. The completion date is scheduled for 2010, with development to begin late 2008. Upon completion the building will accommodate up to 500 staff.

In line with the Government's commitment that any new office space they occupy will be green-star rated accommodation, it is planned that the building will be constructed to achieve a five-star green rating.

It is not only is it Government departments, which are choosing to occupy newly developed space in Wellington. A number of national or international corporates have decided to pre-commit to office space.

BNZ, Harbour Quays: Another, bigger 24,600m^2 building is also being developed by Centreport at Harbour Quays for BNZ, due to be completed mid-2009. This building will be five levels and include ground level retail and public space.

Willis Central: The Wellington Company has undertaken to develop approximately 26,000m^2 of office space over two buildings. Telecom has pre-committed to occupy 19,000m^2 of the space. The buildings, which will be centrally located on the golden mile, will be linked by a central atrium and completed to a five-star green rated standard.

BNZ Harbour Quays

The Willis Central development is in line with The Wellington Company's philosophy that employers need to offer staff a better environment for working and living. This isn't restricted to the premises themselves, but the city and country as well. They believe that rental premiums paid for prime property will be justified by the added productivity.

MOVING FORWARD

The uncertain economic and, especially, political conditions will be upper most in everyone's minds over the balance of 2008. Whatever the outcome of New Zealand's general election in November, the true implications on future office requirements for government tenants will not be apparent immediately. The current Government dominance of Wellington office space is expected to continue but whether the existing trend of growing government dominance will continue will be determined by who wins the election.

The current global economic downturn is slowing New Zealand's economic growth and this will have flow on effects for business expansion and future office floor requirements. The anticipated slowdown in the amount of office space required is being partially offset by the tough development conditions where funding is difficult to source and expensive. This is limiting speculative office development which will help protect the current very low vacancy levels in the medium term. While overall *Bayleys Research* expects vacancy rates to increase over the balance of 2008 and into 2009, the extent of this increase will be determined by the length and depth of the current economic downturn.

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