CB RICHARD ELLIS

New Zealand ViewPoint

www.cbre.co.nz/research

March 2010

CHOOSE YOUR INVESTMENT PROPERTY SECTOR WISELY

By Zoltan Moricz
Director

By Craig Wong
Analyst

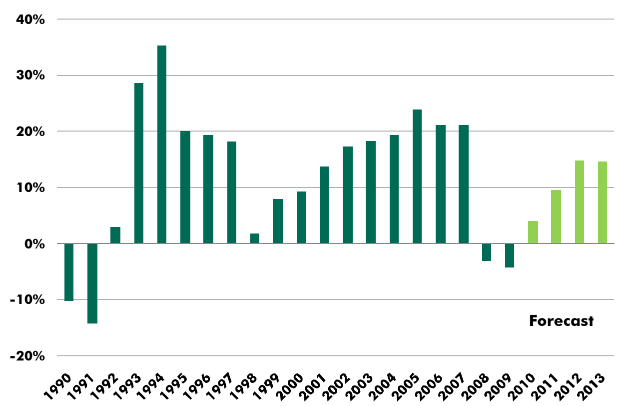
SUMMARY The analysis of aggregate property market performance often hides significant sectoral variations and real value is added when performance is analysed at a disaggregated sectoral detail. This level of detail is important in enabling investors to choose property classes that will provide the highest return as the market emerges from recession. While the various property market sectors entered the recession in a fairly coordinated manner, they are not emerging from it the same way. CBRE undertakes regular forecasts for 20 office, retail and industrial submarkets in Auckland and Wellington. Our analysis of rent and yield movements indicates significant sectoral differences which will likely have dramatic impacts on the total returns provided by the various submarkets. This report summarises the range of returns forecast by CBRE to 2013.

Total returns are the combined capital and rental returns. Overall trends to date indicate negative total returns in 2008 and 2009, the first since the downturn of the early 1990s. A question mark however remains on how the market will recover from this and given that the market is heterogeneous, sectors will not recover together. Deeper analysis into sectoral differences provides greater understanding of where gains at the subsector level can be made or lost.

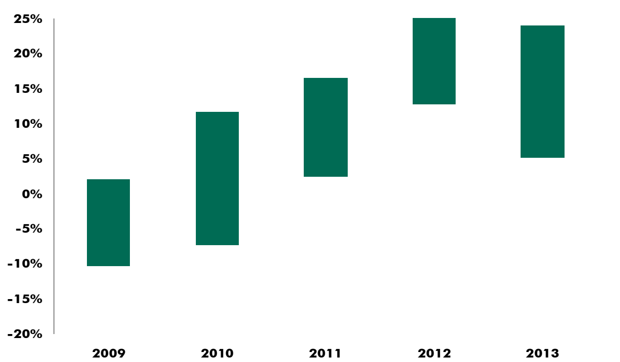
Despite emerging from a technical recession, few economic commentators are expecting this to be followed by a sharp bounce back to stronger growth until 2011 as household deleveraging takes its course and the labour market stabilises. Various sectors of the economy are also characterised by varying degrees of spare capacity. Layering capital and property market specific factors on top of these economic drivers provides the basis of our forecasts. Factors such as varying supply and demand dynamics, the intrinsic structure of individual property sub sectors, investment market dynamics and the cyclical tendencies of various sectors are some of those impacting on submarket returns.

Therefore, while average total returns are forecast to bounce back into positive territory, reaching 4% in 2010, at the subsector level this will hide substantial variation between markets which is forecast to range between a low of -7% and a high of 12%, a variation of 19%. Annual total return variations between 8% and 14% are forecast during the 2011-2013 period.

Average Total Returns Across All Sectors Per Annum

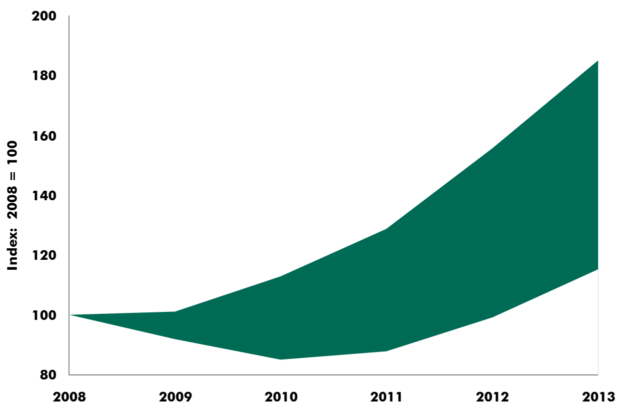


Variation in Total Returns Across All Sectors Per Annum



The cumulative impact of the forecast annual total return variations is substantial. The chart below illustrates the range of the highest and lowest returns over the forecast period amongst the various sectors. The top of the shaded area represents the highest return property sector and bottom of the shaded area represents the lowest return property sector with total returns for the rest of the property sectors distributed within the green band. Cumulative forecast total returns to 2013 range from 15% for the worst performing sector to 85% for the best performing sector.

Cumulative Range Of Total Returns Across All Sectors



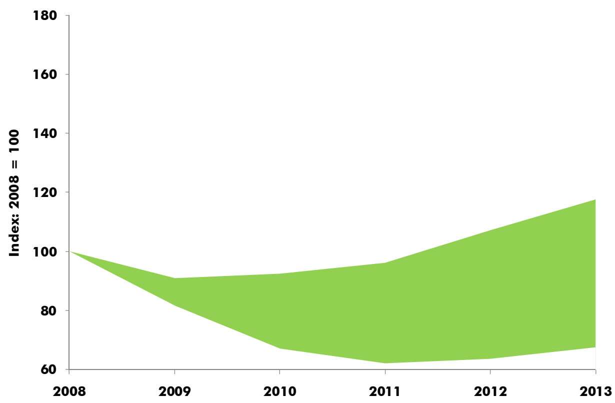
At a sectoral level, broad groupings of market performance can be made. For instance, given their supply and vacancy outlook offices are generally recognised as likely to underperform in terms of total returns. However, within offices, sub market performance is forecast to vary substantially. This partly reflects sub market variations in supply and demand profiles and the vacancy impact of relocating tenants.

In contrast to offices, the industrial sector is forecast to provide some of the highest returns as, in the absence of a significant supply cycle, its performance is closely related to the underlying economic cycle. As the economy improves, so will demand, vacancy and rents and with them industrial returns. However, in some industrial subsectors, demand will likely be adversely impacted by structural changes which, in our forecast, will offset the positive impact of the cyclical improvement in the economy. This results in some industrial submarkets underperforming and providing total returns below some office submarkets.

Further analysis into the capital and income components of total return can be performed. Capital returns are highly variable due to the yield and rental movements, and have the most significant impact on total returns. All capital returns were negative in 2009, and are not forecast to recover back to their 2008 level until 2011/2012.

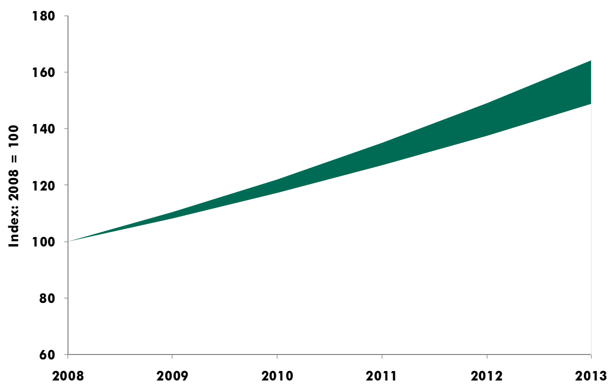
The bottom of the forecast range of capital returns, shows a deterioration through 2010 and 2011, with a only a moderate rebound in 2012 and 2013. By contrast, the top of the forecast range shows that capital returns will turn positive for the best performing property sector in 2010 with a stronger upswing in 2012 -2013.

Cumulative Range of Capital Returns Across All Sectors



Compared to capital returns, income returns are less volatile and provide a more consistent base for total returns (assuming as we do in our market rather than individual asset based analysis, that assets are fully leased at market rates.) Cumulative forecast income returns over the next five years range from 49% to 64%.

Cumulative Range of Income Returns Across All Sectors



CONCLUSION

Cyclical and sectoral variations in returns on property investment are a fact of life. Return outcomes are subject to a multitude of factors and vary depending on the stage of the property cycle. At present, we are facing a slowly recovering economy in which much uncertainty remains. This combined with supply and demand dynamics, the intrinsic structure of the individual property sub sectors, investment market dynamics and some structural changes produces a substantial range of capital return outcomes which underpins the importance of investing wisely.

This publication provides an overview of market trends, however CBRE Research offers more specific consulting services to provide analysis on specific sectors and also has a subscription service that contains data and information on submarket trends at a significant level of detail.

PLEASE NOTE Our data is calculated from CB Richard Ellis historic and forecast rent, yield and value data to represent market performance. The returns determined by this methodology overestimate total returns in real life, as they are gross returns without taking into consideration factors such as capex and vacancy periods that lower returns for actual buildings. It should also be remembered that market returns can have little bearing on actual returns that may be provided in individual assets. The level of over/under renting, fixed CPI based rather than market rent increases, the timing of rent reviews as well as vacancy issues mean a wide range of actual return outcomes are possible.

CB Richard Ellis
Research & Consulting

Zoltan Moricz, Director
zoltan.moricz@cbre.co.nz

Craig Wong, Research Analyst
craig.wong@cbre.co.nz

AUCKLAND
Level 14, 21 Queen Street
PO Box 2723
Auckland 1010
T 64 9 355 3333
F 64 9 355 3330

WELLINGTON
ASB Bank Tower
Level 12, 2 Hunter Street
Wellington 6011
PO Box 5053
Wellington 6145
T 64 4 499 8899
F 64 4 499 8889

CHRISTCHURCH
PricewaterhouseCoopers Centre
Level 6, 119 Armagh Street
Christchurch 8011
PO Box 13643
Christchurch 8141
T 64 3 374 9889
F 64 3 374 9884

HAMILTON
Cnr Te Rapa Road & Forest Lake Road
Beerescourt
Hamilton 3200
PO Box 1330
Hamilton 3240
T 64 7 850 3333
F 64 7 850 3330

SOUTH AUCKLAND
7A Pacific Rise
Mt Wellington
PO Box 11 2241 Penrose
Auckland 1060
T 64 9 573 3333
F 64 9 573 3330

NORTH AUCKLAND
Unit 8, 35 Apollo Drive
Mairangi Bay
Auckland 1080
T 64 9 984 3333
F 64 9 984 3330

CBRE CB RICHARD ELLIS