

→ Office Property Market Report 27 | 27 July 2018

1 of 4 Macro-Office-Industrial-Retail Reports | Celebrating 20 Years!

Key observations:

- *Developers were offering very competitive new-build rents, with asset valuations maintained by firmer cap rates (now softening).*
- *Seismic performance is a relative value consideration – Napier City Civic and Library buildings effects for Napier market.*
- *Havelock North is increasingly a significant office location alternative to Hastings – most recently and successfully The Exchange.*
- *A Government change potential effect for Hawke’s Bay and other regions commercial property, is the possibility of increased state sector office occupancy. Regional investment initiatives have strong potential.*
- *We anticipate continuance of economic growth in the near term for Hawke’s Bay, but are wary as first said by us in mid-2017.*
- *The US has started a trade war with inflation potentially a consequence possibly leading to higher interest rates (higher yields and lower asset values).*

Hawke’s Bay based Turley & Co is continuously engaged in high-quality commercial property analysis and valuation as a **Registered Valuer** and **Registered Property Consultant**.

Principal property strategist and projects leader since 2009 for acquisitions **\$120M** and disposals **\$30M** for corporate, Crown and Council clients nationally.

Since 1998 acquisitions-disposals **\$0.5B** nationally alongside considerable volumes of valuation work, litigation and related advisory.

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Office Market Indicators for Napier | Hastings | Havelock North

Offices Category	Rental Range Gross TOC (\$/m ²)	Forecast Rental Growth Next 24 Months (%)	Yield Range (%)	Forecast Yield Change Next 24 Months (%)
Prime	\$160 - \$300	-5% to +5%	6.0-8.5%	0.0 to 0.5%
Secondary	\$85 - \$160	-5% to +5%	8.5-11.0%	0.0 to 1.0%

Vacancy Rates: - Prime Office 7.0% - 10.0% estimate
 Secondary Office 25.0% plus estimate
 Many occupied office premises are underutilised

Inducements: - Prime Office 2 to 6 months rent free equivalent
 Secondary Office 4 to 12 months rent free equivalent
 Depending on premises, term and tenant

HB Office Market | News | Quick Summary

- Office development activity was frequent 2014-17, mainly stemming from Hawke’s Bay tenants reshuffling – moderated in 2018
- Substantial Hastings Health Centre development underway expected to be completed in 2019
- Developers were offering very competitive new-build rents, with asset valuations maintained by firmer cap rates (now softening) – predicted
- Some very high new premises rents apply (some with undisclosed inducements) – includes IRD Napier
- Seismic performance is a relative value consideration – Napier City Civic and Library buildings major effects for Napier market
- New to Hawke’s Bay office tenants/ businesses was a trend emerging in 2017 that is now less apparent
- Napier office occupiers migration to Ahuriri – includes the Tech Collective – other tech hubs Havelock North established and planned for Hastings
- Havelock North is increasingly a significant office location alternative to Hastings – most recently and successfully The Exchange – other development underway
- State sector office demand contained since 2008 may expand 2018-20 given Government change
- Office investment sale transactions are infrequent (developments mostly developer held or recently offered and unsold)



Village Exchange Upper Floor Offices – StockCo & BM Accounting | Photo TCL

Office Leasing and Rents

The Hawke's Bay's office sector saw considerable development over the last 3-5 years. Competitive rents for new build accommodation were typical. Very firm cap rates (asset values) provided sufficient developer headroom. Growth of the office tenant pool has been limited total m2 demand (change) v. total m2 supply (greater). Most market activity was tenants wanting to upgrade or led by seismic considerations. Market reshuffling accounts for most activity.

Backfilling lower grade office stock has been a challenge since the Canterbury earthquakes of 2011. Many Government agencies and corporates relocated (CYFs WINZ new build), to strengthened premises (Napier City Council and others). There remains an abundance of older office stock vacancy in Hawke's Bay. Hastings District Council has an initiative to encourage conversion of disused upper levels CBD office space to residential. At this stage this hasn't eventuated in a conversion that would further assist inner-city vibrancy.

Napier City Council in mid-2017 advised that its Civic and Library buildings seismic assessments were 10%-15%NBS. Council accommodation temporary relocation comprises three separate sites whilst it plans a long-term solution. The Civic building is unlikely to be strengthened or refurbished, the library may be upgraded. A hotel was suggested for the Civic building site. IRD was affected and relocated, paying a top-end rent for upmarket premises in Napier. The market effect has been office supply reduction in central Napier and vacancy take-up. The market response will likely see more development and/ or increased Napier CBD office rents.

Napier's former Police Station was rated 16%NBS, providing the impetus for a new \$5.5M station opened December 2016. In Hastings, the old courthouse adjoining the existing Police Station has been demolished for a new Eastern Police HQ. It reportedly faced unexpected geotechnical results, delaying development. Proposed is a 2,600 sqm three-storey building at cost \$19.8M.

Ahuriri hosts a modern themed repurposed wool store 2,900 sqm Tech Collective redevelopment anchored by NOW and Xero, alongside other tech enterprises including Re-Leased. Refer to www.nbr.co.nz/article/xero-opening-hawkes-bay-office-ck-196892. The development offers open plan collegial working spaces with Adoro Cafe and amenities.

Other Wallace Development Tech Collective offices include 120 sqm dedicated hot desk space at Havelock North (21-23 Napier Road) which opened in August 2017, and soon to be ready Hastings (119 Heretaunga Street East). Collaborative workspaces are a trending alternative to traditionally tightly-partitioned offices.

Occupiers by clustering gain crosspollination synergies, less real estate employed per person, making better use of the property costs. An effect of increasing office density is a slower take-up rate for existing office supply.

The quayside suburb of Ahuriri (Napier) has attracted Government agencies and professional services office tenants that over decades has progressively transformed from what was an inner-harbour industrial heartland. The vibrancy of bars, restaurants, boutique shops and apartments, has attracted Napier CBD tenants. A similar dynamic is occurring for Havelock North, with competitive effects for Hastings' CBD office sector and the city centre.

Significant Hastings CBD office leasings in prime Farming House include a Government agency in mid-2017, and this year another Crown tenant plus accountancy firm Crowe Horwath. Its former Hastings offices created a large vacancy still to lease. BM Accounting relocated to Havelock North in December creating another Hastings office vacancy. The former BM building has sold March 2018 (201-203 Eastbourne St). Refer to Turley & Co for details.

The Hastings Health Centre outgrew its current premises and is constructing its own 3,900 sqm primary health centre on a site adjoining Totara Health. HHC is committed to completing the development by early 2019. Its current 2,700 sqm two-storey premises on Queen St are being marketed for sale and represents potentially redundant office supply. It may suit hotel or residential conversion redevelopment.

As cited in prior Turley & Co reports, the outlook for Hawke's Bay mid-quality and lesser-quality offices, is mid-term ordinary and especially if seismic rating is below 65-70%NBS. For better rated, upper-third quality and new buildings the Hawke's Bay offices market is much healthier. Tenants relocating from underutilised and inefficient office layouts can often afford higher quality offices by taking less space (occupying at higher density).

The silver-lining for occupiers or new businesses considering lower-quality offices (2nd or 3rd tier), is improved rent economy. The mid-market upgradable office supply is a Hawke's Bay economy competitive advantage. The conversion potential for collaborative workspaces/ tech hubs or residential redevelopment is an upside opportunity.

Hawke's Bay's situation continues to be office over-supply, with little increase in demand until 2017, these conditions rippled into 2018. Kiwibank was a Hastings contrary example, occupying a two-storey retail property in December 2015. Tremain's Hastings is another, redeveloping former Warehouse Stationery premises in 2017. Aon added to Hastings its prominent new build. NZCU Baywide's new offices are underway at the former Noel Leeming site St Aubyn St (leaving behind vacancy). The Sports Park development will add office accommodation.

In summary: the outlook for Hawke's Bay's office market at June 2018, remains mixed from good (stable) to declining for dated or seismically challenged office properties. Government change may generate expanded state sector demand for regional New Zealand offices including Hawke's Bay. This particular office demand layer 2000-2007 was significant but contained since 2008. The pendulum may now swing back.

Most often landlord competition is intense for office tenants who are generally in the box seat. Face rent is sometimes disguised by an untold leasing inducements backstory. Effective rent may be something else, being a challenge for valuers and tenants.

Office Developments

Refer to *Macro Report* pp 4-5 for a Hawke’s Bay office development schedule.

Napier | Hastings | HN Office Rents

Sample office rents Total Occupancy Cost (refer to *TOC Definition* later):

Property	Date	Area (m ²)	Rate \$/m ² TOC
McLeod St	Dec-17	2,300	\$134
Maraekakaho Rd	Jul-17	758	\$163
Heretaunga St	Oct-17	150	\$180
Dickens St	Oct-17	700	\$191
Havelock Rd	Oct-17	430	\$291
Hastings St*	Mar-18	1,200	~\$300

*Analysis unclear ~\$300/m² TOC possibly incl fitout.

Refer to Turley & Co for more data and most recent transactions. Gross rent rates above unless stated exclude fitout and parking. Much lower rents are common for some office accommodations depending on qualities, scale, location etc.

Refer to Turley & Co for information specific to a property, and for Registered Valuer and Registered Property Consultant advisory www.turley.co.nz

Market rent is principally objective over subjective and is determined according to valuation law principles. Turley & Co Registered Valuer assistance should be preferred. Face rents are potentially misleading. Turley & Co is a successful negotiator and litigator of “market rent” and lease structures advisory.

Office Property Investment

Our macro-market commentaries (refer to *Macro Report*), broadly hold for Hawke's Bay office property investment.

There remains very limited marketed office investment stock of good traits that is mostly tightly held (or properties are developers retained).

Colliers in October 2017 sold the largest office building in Hawke's Bay for over a decade. The 100 McLeod Street property is part tenanted by the District Health Board. The sale indicates yield ~9.50%.

Napier's prominent iconic three-level CPO building (over 3,100 sqm and 100%NBS), was brought to the market and sold by Bayleys (6.98% yield). The property is fully leased with a mix of twelve retail and office tenants including NZ Post/ Kiwibank, Vodafone, Adoro Café and Napier City Council. Refer to Turley & Co for details.

The newly-developed multi-tenant Business HQ office complex in Hastings was advertised for sale in 2017 and was unsold (withdrawn).

Four of the five unit titles for the PWC Building Napier were offered for sale via Bayleys. The property has since been proposed as potentially Sebel Hotel apartments, removing Napier office supply if this occurs.

The 2015 completed Kiwibank development (former Farmers), is being marketed for sale by Colliers (Danny Blair). Potential net rent \$665,000 p.a. with Kiwibank contributing net \$435,000 p.a.

Office supply-demand conditions, letting and rent value prospects are market cap rates/ yields reflected. Considerably aged office properties or low seismic rated properties usually transact at much lower relative values (higher yields). The yield difference for investment property quality, tenant-calibre, lease term/s and any vacancy aspects, had considerably narrowed in recent years. We expect change is already underway and the yields spread is increasing.

Office Investment Yields

Office investment property sales are infrequent for Hawke's Bay:

Location	Price	Date	Yield
Marine Pde	\$3.0M	Oct-17	5.28%
Hastings St (retail-office)	\$8.0M	Feb-18	6.98%

Location	Price	Date	Yield
McLeod St	\$7.3M	Jul-17	~9.50%

Other insight:

→ Refer to Turley & Co for most recent transactions data, lease durations, etc

Refer to Turley & Co for information specific to a property, and for Registered Valuer and Registered Property Consultant advisory www.turley.co.nz



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Turley & Co Profile

Hawke's Bay based Turley & Co was formed in 1998 employing **five professionals** www.turley.co.nz

Pat is a *Registered Valuer* and *Registered Property Consultant*. He was an Auckland based practitioner with Jones Lang LaSalle and Darroch & Co for five years until 1995, before moving to Hawke's Bay. Pat has over 25 years of property consultancy and valuation experience focused on commercial and specialised property. He started his property career shortly after the crash of 1987. He has undertaken detailed appraisals and valuations, for single property assets \$4,000 value to plus \$100M in the Auckland CBD. He is an experienced valuation arbitration and Court expert witness.

Turley & Co services a loyal group of prime clients across the private, corporate and public sectors in New Zealand. Turley & Co is LINZ Accredited and a division of the firm is a longstanding preferred property acquisitions, technical and statutory services provider to Government and Council clients nationally including Ministries of the Crown. Turley & Co is continuously engaged in commercial property analysis and valuation as a **Registered Valuer** and **Registered Property Consultant** in Hawke's Bay and nationally including Auckland.

Current team: Pat Turley, Wayne Smith, Nikki Whelpton and Dayna Campbell. Sue Turley is a co-director and commercial manager. Three people have been with the firm for 20 years. Refer to www.turley.co.nz/our-people

Turley & Co Analytics

Turley & Co is a publisher of property market analytics and commentary before 1998, and for over 20 years maintains an extensive private database of market transactions/valuation evidence for Hawke’s Bay and NZ – publishing nine biannual reports 2005-2009 plus:

Q1-2 2010 Hawke’s Bay Market Report - 11	Q1-2 2013 Hawke’s Bay Market Report – 17	Q1-2 2016 Hawke’s Bay Market Report - 23
Q3-4 2010 Hawke’s Bay Market Report - 12	Q3-4 2013 Hawke’s Bay Market Report – 18	Q3-4 2016 Hawke’s Bay Market Report - 24
Q1-2 2011 Hawke’s Bay Market Report - 13	Q1-2 2014 Hawke’s Bay Market Report - 19	Q1-2 2017 Hawke’s Bay Market Report - 25
Q3-4 2011 Hawke’s Bay Market Report - 14	Q3-4 2014 Hawke’s Bay Market Report - 20	Q3-4 2017 Hawke’s Bay Market Report - 26
Q1-2 2012 Hawke’s Bay Market Report - 15	Q1-2 2015 Hawke’s Bay Market Report - 21	Q1-2 2018 Hawke’s Bay Market Report – 27 this report...
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Definition Gross Rent | TOC

Gross rent or TOC (Total Occupancy Cost) values cited in this report:

- Include tenant outgoing costs: Council rates, building insurance and may include unique occupancy costs.
- Exclude tenant opex.
- For office and retail premises reflect a sealed shell net of the added value of landlord fitout: flooring treatments, subdivision partitioning, air-conditioning, etc.
- Are net of car parking and possibly excess yard value.
- Generally adjusted for corner site value and known letting inducements (frequently an undisclosed item).

The TOC definition above applies to most sample rent evidence cited in this report. Reliable values interpretation requires Turley & Co Registered Valuer and property specific advisory. The data herein should otherwise be considered unreliable.

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