

→ Office Property Market Report 29 | 31 July 2019

1 of 4 Macro-Office-Industrial-Retail Reports | Celebrating 21 Years!

Key observations:

- *Hawke's Bays' economic boom is starting to pull the previously challenged existing office buildings market in an upward direction that is good news. Office rents for existing buildings are showing notable growth for the first time in a decade.*
- *Hastings office market conditions improved by late 2018/19 given prior vacancy take-up (supply contraction), and CBD fringes vibrancy improvements including near the relatively new Business HQ (Queen Street).*
- *Havelock North is increasingly a significant office location alternative to Hastings – successfully for The Exchange with further developments underway and proposed including at Joll Road.*
- *Hawke's Bays' economic conditions remain exceptionally buoyant. Confidence is high driven by a coincidence of fortunes across most sectors that lead the region's economy, underpinned by persistently low interest rates.*
- *We anticipate continuance of good rates economic growth in the near term for Hawke's Bay. NZ growth is projected to be more modest in 2019/20.*
- *Slowing global growth with uncertainties is potentially a moderating factor however.*

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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Offices 116 Te Mata Mangateretere Road, Havelock North, Hawke's Bay | Post RD 10, Hastings 4180

Company Turley & Co Ltd | P +64 (6) 650 3569 | E people@turley.co.nz | W turley.co.nz

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Office Market Indicators for Napier | Hastings | Havelock North

Refer to separate same date reports for: *Macro, Industrial and Retail.*

Offices Category	Rental Range Gross TOC (\$/m ²)	Forecast Rental Growth Next 24 Months (%)	Yield Range (%)	Forecast Yield Change Next 24 Months (%)
Prime	\$200 - \$325	0% to +15%	6.0-8.0%	-0.5 to 0.5%
Secondary	\$85 - \$200	0% to +10%	8.0-10.0%	0.0 to 1.0%

Vacancy Rates: - Prime Office 5% - 7% estimate
 Secondary Office 20% plus est. incl tertiary
 Many occupied office premises are underutilised

Inducements: - Prime Office 2 to 3 months rent free equivalent
 Secondary Office 3 to 6 months rent free equivalent
 Depending on premises, term and tenant

HB Office Market | News | Quick Summary

- Office development activity was frequent 2014-19, mainly stemming from Hawke's Bay tenants reshuffling – considerable into late 2018/19
- Substantial Hastings Health Centre development was completed in 2019
- Developers offering very competitive new-build rents, with asset valuations maintained by firmer cap rates
- Some very high new premises rents apply (some with undisclosed inducements)
- Seismic performance is a relative value consideration – Napier City Civic and Library buildings major absorption effects for Napier
- 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 – successfully for The Exchange with further developments underway and proposed
- State sector office demand contained since 2008 may expand 2019-20 given Government change (although currently not obvious)
- Hawke's Bays' economic boom is starting to pull the previously challenged existing buildings office market in an upward direction. Office rents for existing buildings are showing notable growth for the first time in a decade.
- Hastings office market conditions improved by late 2018/19 given prior vacancy take-up (supply contraction), and CBD fringes vibrancy improvements including near the relatively new Business HQ (Queen Street).



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

Office Leasing and Rents

The Hawke's Bay office sector saw considerable development over the last 6-7 years. Competitive rents for new build accommodation remain typical. Very firm cap rates (asset values) provided sufficient developer headroom. Growth of the office tenant pool has been limited in terms of total m² demand (change) v. total m² supply (greater). Most market activity was by tenants wanting to upgrade or led by seismic considerations. Market reshuffling accounts for most activity rather than Hawke's Bay office sector occupancy growth.

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 it hasn't eventuated, but this would obviously absorb redundant offices and assist inner-city vibrancy. Hotel developments planned and mooted would also assist vibrancy. The Quest was recently announced for Hastings.

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. 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 which opened December 2016. In Hastings, the old courthouse adjoining the existing Police Station was demolished for a new Eastern Police HQ. It reportedly faced unexpected geotechnical results, which delayed development. The 2,600 sqm three-storey building at cost \$19.8M is well underway.

Ahuriri hosts a modern themed repurposed wool store 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 2,900 sqm development offers open plan collegial working spaces with Adoro Café 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 a Napier Central Tech Collective underway at 115 Emerson Street. Collaborative workspaces are a trending alternative to traditionally tightly-partitioned offices.

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

The quayside suburb of Ahuriri (Napier) has attracted Government agencies and professional services office tenants. Ahuriri 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 Government agencies in 2017/18, plus accountancy firm Findex (formerly Crowe Horwath). Its former Hastings offices created a large vacancy still to lease. BM Accounting relocated to Havelock North creating another Hastings office vacancy. The former BM building has sold March 2018 (201-203 Eastbourne St) and is being upgraded and retrofitted for trade retail. Refer to Turley & Co for details.

The Hastings Health Centre outgrew its former premises and constructed its own 3,900 sqm primary health centre on a site adjoining Totara Health. The former 2,700 sqm two-storey premises on Queen St is being marketed for sale and represents potentially redundant office supply. It may suit hotel or residential conversion redevelopment.

Turley & Co was a property strategy advisor and valuer to Hastings Health Centre as developer. HBT press reported a plus \$20M development outlay www.nzherald.co.nz/hawkes-bay-today/news/article.cfm?c_id=1503462&objectid=1222413

As cited in prior Turley & Co reports, the outlook for Hawke's Bay mid-quality and lesser-quality offices has been 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 and currently generally improving. 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.

In Hastings, existing buildings upgrades or developments for office and commercial uses includes:

- Former Hawke's Bay Today site and adjacent property corner Karamu/ Queen for hospitality and offices
- 211 Queen Street former LJ Hooker rework for retail/ showroom and offices
- Rainbow House corner Warren/ Queen retrofitted as smart offices for multi-tenant occupancy including shared facilities

Hawke's Bays' office market continues to be over-supplied, with little increase in demand until 2017, rippling into 2019. 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 completed at the former Noel Leeming site St Aubyn St (leaving behind vacancy). The Sports Park development added office accommodation to Hawke's Bay.

Hastings office market conditions generally improved by late 2018/19 given prior vacancy take-up (supply contraction), and CBD fringes vibrancy improvements, including near the relatively new Business HQ (Queen Street). Hastings' best quality office building Farming House (2006) in Market St Sth was fully leased but now with some accommodation available to lease.

Napier's newly-built and redeveloped office market has performed well in recent years, augmented in 2018 by the NCC and IRD relocations and civic buildings redundancy.

Wallace Development is redeveloping 105 Hastings Street Napier, with reportedly only 1 office space available to lease.

The Munroe St office building previously occupied by PwC was proposed to be redeveloped into a luxury hotel, which would see further Napier office take-up activity and supply contraction. Refer later.

Porse relocated to Hastings, creating a vacancy for Havelock North on the fringe corner site (31 Napier Road).

The proposed development by Stephen Hill and Terry May adjacent to the Karamu Stream entrance to Havelock North known as ONE Havelock, is to be a three-storey offices development with the top floor reportedly already leased.

Hawke's Bays' economic boom is starting to pull the previously challenged office market in an upward direction that is good news. **Office rents for not new buildings are showing growth for the first time in a decade.**

In summary: the outlook for Hawke's Bays' office market at mid-2019, remains mixed from good (stable to improving) 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 although this has yet to occur.

Most often landlord competition is intense for office tenants who have generally been 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 looking to reliably measure relative value.

Office Developments

Refer to *Macro Report* pp 4-8 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
Eastbourne St	Mar-19	490	\$151
Queen St East [^]	2019	214	\$200
Taradale Rd	Jun-18	113	\$238
St Aubyn St West ¹	Mar-19	910	\$250
St Aubyn St West ¹	Mar-19	180	\$280
Hastings St [*]	Oct-18	1,200	~\$300

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

¹ Net rent TOC ~12-14% greater

[^] Includes beneficial use of other facilities

Refer to Turley & Co for more data and the 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.

Other transactions: Refer to us.

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 settings advisor.

Office Property Investment

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

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

Napier’s prominent iconic three-level CPO building (over 3,100 sqm and 100%NBS), was brought to the market and sold by Bayleys early in 2018 (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.

Napier’s iconic Vautier House in Dalton Street was brought to the market late 2018. This 100%NBS partly-tenanted offices building has been touted for redevelopment as possibly office, retail or residential/ apartments www.nzherald.co.nz/hawkes-bay-today/news/article.cfm?c_id=1503462&objectid=12144609. Planning is unconfirmed.

The Sainsbury Logan & Williams building, on the corner of Tennyson St and Cathedral Lane, Napier was reportedly sold by Colliers in July for \$2.65m, reflecting 6.15% on \$163,000 annual rent www.nzherald.co.nz/property/news/article.cfm?c_id=8&objectid=12255133

The 2015 completed Kiwibank development (former Farmers), was sold in late 2018 by Colliers (Danny Blair). Potential net rent \$665,000 p.a. with Kiwibank contributing net \$435,000 p.a. reflecting 6.13% with vacancy (yield upside).

Office supply-demand conditions, letting and rent value prospects are reflected in market cap rates/ yields. 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. Change is underway and the yields spread widened but is now possibly paused.

It is obvious that borrowing rates sub 5.0% lowered prime office investment cap rates.

At present masses of local and global capital is pursuing prime attributes investment property and evidenced by competing bidder substantial oversubscription, e.g. Visy at Hamilton ~\$70m industrial sale July ~5% yield. Refer to *Macro report*.

Office Investment Yields

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

Location	Price	Date	Yield
Heretaunga St	\$1.81M	Sep-18	6.06%
Tennyson St	\$5.65M	Jul-19	6.15%
<i>Market St*</i>	<i>\$7.09M</i>	<i>Oct-18</i>	<i>6.13%</i>
Tennyson St	\$350K	Sep-18	6.36%
Queen St West	\$840K	May-19	7.14%
Clive Square	\$965K	Dec-18	9.02%

*With vacancy

Other insight: Refer to Turley & Co for most recent transactions data, lease durations, etc

Other transactions: Refer to us.

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

Turley & Co Analytics + Market Metrics

Turley & Co is a publisher of property market analytics, metrics and commentary prior to 1998, and for over 21 years maintains an extensive private database of market transactions/ valuation evidence for Hawke's Bay and NZ.

Turley & Co has published 28 prior biannual reports 2005-2019, plus one-off market metrics updates and occupancy surveys regularly www.turley.co.nz/news



Tim Whittaker Te Mata Peak Millennium Sunrise

Report Authors

M +64 (21) 33 33 93 | E pat@turley.co.nz



Pat Turley

Property Strategist | Director

Reg. Valuer, Reg. Prop. Consultant, BBS, ANZIV, SPINZ, AREINZ,
LINZ Accredited



M +64 (22) 089 1908 | E nikki@turley.co.nz



Nikki Whelpton

Property Analyst | Valuer

BBS (Valuation & Property Management) | PINZ member



Assisted by: Dayna Campbell

Turley & Co Profile

Hawke's Bay based Turley & Co was formed in 1998 employing **five professionals** www.turley.co.nz/our-people/. **Turley & Co 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 over two decades.

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 CBD Auckland. 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. This included over 400 Crown landbanking acquisitions NZ-wide for 19 years as sole services contractor to Office of Treaty Settlements (MoJ). Turley & Co is continuously engaged in high-quality commercial property analysis and valuation as a **Registered Valuer** and **Registered Property Consultant** in Hawke's Bay and **NZ-wide including Auckland**.

Definitions | Warnings | Disclaimers | Copyright | Distribution

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.

Sources | Reliability

Whilst all property data represented is believed to be correct Turley & Co does not warrant the accuracy of information published in this report. Transaction samples details may be incomplete and include: dated and newly-built premises, ground and upper-floor, first-lettings and sitting-tenant agreements, properties of various location strength, scale, lease content and seismic status, etc. The forgoing factors substantially influence relative market value and reliable application of data. In the absence Turley & Co Registered Valuer assistance, values or information in this report should be considered unreliable.

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