The Whillans Report

AUCKLAND MARKET UPDATE / 4TH QUARTER 2015

2015: A Great Year for Whillans Realty Group

2015 has been another stellar year for Whillans Realty Group with exceptional growth in both sales volume and value. Once again, land sales to resident and off-shore Chinese buyers represented over 50% of our business. Demand for residential land near Auckland continues to outstrip supply. Notable transactions in 2015 included 246 Queen Street for $35 million, Springpark Mt Wellington for $28 million, land in the Albany Estate for $80.4 million and a portfolio of CBD heritage buildings for $21.2 million.

With business confidence high, low interest rates, and a continuing stream of capital flowing from China, 2016 promises to be another record year for the New Zealand property market.

In this edition of the Whillans Report we review the impact China, migration, and interest rates will have on the year ahead. Guest contributors Jared Lynch of Newgate Capital provides insight into minimising interest costs and the credit margins banks charge and Jarrod De Pont of Crombie Lockwood covers the changes in the insurance industry and how you can benefit from competitive insurance pricing.

We wish you a Merry Christmas and all the very best for a happy and prosperous New Year, and I look forward to doing business with you in 2016.

Bruce Whillans
Managing Director — WHILLANS REALTY GROUP
bruce.whillans@whillans.co.nz

What to Watch Out For in 2016 **Brendan Keenan** *Senior Analyst*

All eyes will be on China in 2016. Weaker economic growth across Asia is forcing Chinese insurance giants, developers, and billionaire class property investors to diversify outside the region. Many of these groups are turning their focus to the US, Australia, the UK and New Zealand which are all perceived as safer, less volatile markets.

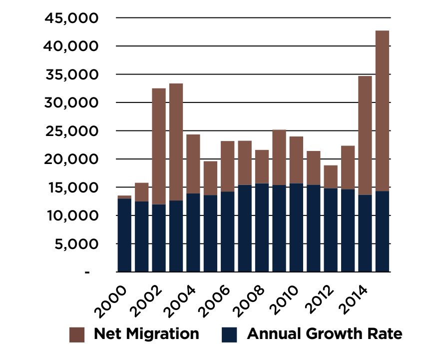
To cool an overheated property market, Beijing, has until recently restricted many property developers from raising capital in the domestic market, forcing them to look elsewhere. This policy resulted in property developers borrowing off-shore, mainly in US dollar debt to fund new projects across Asia. However, faced with a strengthening dollar and the prospect of interest rate hikes, Chinese developers are facing the one-two punch of higher borrowing costs and weaker local currencies to service their debt. The race is on to diversify outside of Asia.

While Chinese interest for residential real estate in New Zealand has waned, demand for institutional investment property and large scale development opportunities is growing. Larger investors looking for land and investment stock over $10 million will remain very active across 2016 with several new players expected to enter the market next year.

However, a lack of stock in Auckland and stiff competition from local investors could see these groups look for property in other local markets such as Wellington and Queenstown.

The introduction of a bright-line capital gains test, new reporting rules aimed at offshore investors, and tighter capital controls in China have dampened interest for New Zealand residential property. However, these new rules appear to have had little impact on the commercial real estate market.

Auckland's Population Boom
Annual Growth Rate/Net Migration (Statistics NZ)



NZD Tumbles Against RMB
RMB/NZD Exchange Rate (Statistics NZ)

Finally, and this is a statistic that is often forgotten by the mainstream media, the New Zealand dollar has actually depreciated 23% against the Chinese RMB since June last year. From a wealthy Chinese businessman's perspective, our commercial property market looks very affordable, particularly once you overlay our relatively high investment yields to those found across Asia.

New Zealand is in uncharted waters with net migration surpassing 60,000 people annually, pushing annual population growth to 2%. This is a statistic most Western countries wish they had and what Bill English calls "the right kind of problem to have".

Many commentators believe the current migration cycle may be the only thing keeping our economy from sliding into a recession. It is no coincidence that GDP is growing around the same rate as the population.

What is clear is that people fuel the property market. More people means more houses, more offices, more factories and more retail. This growth will ultimately underpin the market into 2016 and beyond.

With the construction sector desperate for more workers and several major projects set to break ground next year the building industry is going to face several bottlenecks, which in turn will constrict the supply of new commercial space.

Heightened global volatility, particularly in Asia and a sluggish Australian economy, means New Zealand will remain attractive to migrants. However, if we are unable to generate real economic growth and provide enough jobs the flood could quickly become a trickle.

With annual inflation running below 1% (currently 0.4% in the 12 months to September), weak dairy prices and the prospect of a summer drought, the Reserve Bank has indicated it will maintain its easing bias into 2016. In its latest October forecast The International Monetary Fund (IMF) predicts the global economy will grow 3.6% in 2016. However, the IMF cautioned that there is a 50% chance global growth will fall below 3% next year. If low interest rates hold and most economists think they will, we believe the commercial property market in Auckland will continue to deliver investors a robust combination of capital and income growth.

While there is a gathering sense the party can't last forever, strong population growth, cheap credit, a lack of new supply, and capital flowing out of Asia should keep the music playing a little while longer.

The Whillans Report

AUCKLAND MARKET UPDATE / 4TH QUARTER 2015

Minimising Your Interest Costs Jared Lynch, Newgate Capital

For the majority of commercial property investors, interest is the single largest cost item in your financial statements and usually by some distance.

You should not be worried about asking your bank to review the margin charged. In fact, the bank should be concerned if you are not asking as it implies you do not manage your business as effectively as you could.

Prior to the global financial crisis (GFC) it was very easy to compare interest rates offered by the banks as it was simply made up of your base rate and the credit margin.

Since the GFC however, the banks have introduced liquidity premiums to effectively recover the differential between the base rates and their actual cost of raising the funds.

More often than not, these premiums are now included within the margin quoted – though sometimes they are a separate item. When it is included in the margin, it can mean the bank receives the benefit when the cost of raising money reduces.

The other factor making up your interest rate margin, is the credit margin. Each bank needs to put the loan through an approved capital allocation model. This is in the most part an objective model that uses property and lending fundamentals (such as WALT, gearing, interest cost, tenancy strength etc) to determine how much capital the bank has to allocate to the loan.

This capital allocation has a big impact on how competitive the bank can be when pricing as they will have their own internal hurdles for return on capital – the more capital allocated the higher the cost.

During the course of a loan, there are two main ways that a credit margin could be further improved. Firstly, the capital required to be allocated to the loan could reduce. Examples of how is an improvement in the WALT, amortisation payments made or an increase in valuation.

Secondly, if a bank is under pressure to grow, it will lower their expectations for the return on capital. In effect, this can mean that new business is priced better than existing business.

To have a good pricing conversation with the bank, you need to understand whether your loan is business that all of the banks would be enthusiastic to write or if the bank is actually giving you good non-pricing terms.

You also need to decide whether you are willing to pay a premium for service, relationship and to maintain a track record with the same bank.

Just as you would review your income from a property, trying to maximise this through rent reviews and further improvements to the property, you should review the interest margins you are paying. Think of this as a financial health check.

A bank should prefer to have an open conversation with you on pricing rather than suddenly being refinanced one day.

If you would like us to complete a financial health check on your business or have any other property banking requirements contact Jared Lynch on 0212-436-144 or jared@newgate.co.nz.

A More Competitive Insurance Industry Jarrod De Pont, Crombie Lockwood

Crombie Lockwood is New Zealand's largest insurance broker providing tailored business and personal insurance through a 23 branch nationwide network. As an Arthur J. Gallagher company (listed on the NYSE as 'AJG'), Crombie Lockwood has the global reach and expertise to source underwriting both locally and internationally from a position of strength, ensuring we can always promise our clients the very best coverage and terms.

We have provided broking services to the commercial property industry for almost 40 years and it is a key sector for us. With the current strong demand for commercial property and wide ranging construction across New Zealand, it is timely to look at relevant developments in the insurance sector. Insurance pricing is extremely competitive at present and provides businesses with a great opportunity to improve their insurance cover while reducing premium cost. These conditions reflect the strong capital supply globally. With low yields in other sectors, insurance is attracting new capital which has flowed to both direct insurers and reinsurers. This has created the inevitable downwards price pressure, and a search for new opportunities to underwrite risk to employ the increased capital available.

Essentially what this means for commercial property owners and developers is that both the established local insurers and new entrants to the New Zealand insurance market are keen to do business. In the past few months, the new and established markets merged, with all insurers now actively competing; the established insurers to protect their market share; the new entrants to gain share; a *perfect storm* for insurance buyers. How long these market conditions continue remains to be seen, but through a combination of capital in-flows and generally low insured catastrophe losses we don't anticipate a short to medium term change.

While every insurance programme for commercial property portfolios and developments are specifically tailored to the risk there are a number of areas where we can significantly improve overall policy coverage, which means your property asset is better protected. We can review the pros and cons of each policy on your behalf, effectively present your risk and then negotiate the best insurance solution with those underwriters who are currently displaying a willingness to consider a wide variety of risk.

Excess levels, including natural disaster deductibles that may have applied are now often reduced. Without spending more you can, for instance, secure improved cover for rental income over longer indemnity periods with allowances for growth over this time. We can improve cover for any development or building upgrade being done and for any mechanical or electrical breakdown of any plant in your property. Across the board we are finding good results for our clients and a number of areas where we can improve the overall protection provided.

We also pride ourselves on exceptional customer service throughout the entire insurance process and have a specialist claims team who are dedicated to achieving the best results for our clients when a loss is suffered. We have also recently launched a specialised Asian Division which includes fluent Mandarin and Cantonese speakers, enabling them to convert complex technical insurance policies into simplified terms for non-English speaking clients who may be new to the New Zealand property market.

If you would like a comprehensive review of your insurance programme or to discuss how Crombie Lockwood can assist, please contact Jarrod De Pont on 027 448 6420 or jarrod.depont@crombielockwood.co.nz.

The Whillans Report

AUCKLAND MARKET UPDATE / 4TH QUARTER 2015

Block A1, Albany

Price	$23,776,500 / $750 psm
Date	Dec 2015
Area	31,702m²
Zoning	Metropolitan Centre (PAUP)

Hobsonville Village

Price	$16,150,000 / $397 psm
Date	September 2015
Area	4.06 hectares
Zoning	Mixed-Use (PAUP)

Springpark, Mount Wellington

Price	$28,000,000 / $451 psm
Date	August 2015
Area	6.20 hectares
Zoning	Terraced Housing & Apartments (PAUP)

Albany Land Sales

Price	$80,400,000
Date	January 2015 - Dec 2015
Zoning	Metropolitan Centre (PAUP)

Block C4 and C5, Albany

Price	$8,130,150 / $780 psm
Date	July 2015
Area	1.04 hectares
Zoning	Metropolitan Centre (PAUP)

35 Whitaker Place, Auckland

Price	$14,100,000 / $4,590 psm
Date	June 2015
Area	3,072m²
Zoning	City Centre (PAUP)

3 - 11 Rendall Place, Eden Terrace

Price	$6,000,000 / $2,633 psm
Date	June 2015
Area	2,279m²
Zoning	Mixed-Use (PAUP)

112 Pavilion Drive, Airport Oaks

Price	$5,700,000 / $347 psm
Date	June 2015
Area	1.64 hectares
Zoning	Light Industry (PAUP)

55 Corinthian Drive, Albany

Price	$2,900,000 / $369 psm
Date	April 2015
Area	7,864m²
Zoning	Business Park (PAUP)

Avondale RSA

Price	$8,902,000 / $1,465 psm
Date	April 2015
Area	6,077m²
Zoning	Mixed-Use (PAUP)

74 - 76 Royal Road, Massey

Price	$12,500,000 / $154 psm
Date	February 2015
Area	8.11 hectares
Zoning	Mixed Housing Urban SHA (PAUP)

14-16 Shelly Beach Road, St Mary's Bay

Price	$5,080,000 / $2,870 psm
Date	February 2015
Area	1,770m²
Zoning	Terraced Housing & Apartments (PAUP)

The Whillans Report

AUCKLAND MARKET UPDATE / 4TH QUARTER 2015

272 Parnell Road, Parnell

Price	$11,250,000
Date	October 2015
Income	$788,126 + GST p.a. net
Yield	7.00%

Lincoln Road Countdown

Price	$20,200,000
Date	October 2015
Income	Confidential
Yield	Confidential

86 Parnell Road, Parnell

Price	$8,625,000
Date	September 2015
Income	$645,892 + GST p.a. net
Yield	7.48%

KFC and Carls Junior, Albany

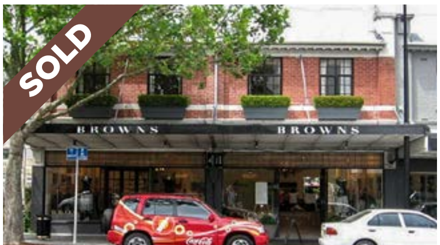
Price	$5,989,000
Date	September 2015
Income	$294,900 + GST p.a. net
Yield	4.92%

Bunnings, New Plymouth

Price	$5,350,000
Date	July 2015
Income	$395,923 + GST p.a. net
Yield	7.40%

251-253 Great South Road, Greenlane

Price	$7,750,000
Date	June 2015
Income	$304,533 + GST p.a. net
Yield	3.93%



411-413 Remuera Road, Remuera

Price	$5,000,000
Date	April 2015
Yield	Vacant Possession
$psm	$14,619psm (Land and Buildings)

246 Queen Street, CBD

Price	$35,000,000
Date	April 2015
Income	$2,579,418 + GST p.a. net
Yield	7.36%

229 Queen Street, CBD

Price	$23,200,000
Date	January 2015
Income	$2,101,088 + GST p.a. net
Yield	7.36%

COMMERCIAL BROKERS

With over $1.5 billion dollars in sales in our first five years of business,
my team has achieved some of New Zealand's largest and most notable property transactions. This enviable track record provides an excellent platform for our continued success into 2016.

We have an opportunity for commercial brokers with proven experience to join our high-calibre, Shortland Street team. For a discussion in confidence please call me.

Bruce Whillans
T. +64 (09) 304 1453 M. +64 (021) 985 619
bruce.whillans@whillans.co.nz