The Whillans Report

AUCKLAND MARKET UPDATE / 1ST QUARTER 2017

Over $260 million in sales in the first quarter

This year is promising to be another great year for Whillans Realty Group. Already in the first quarter of 2017, we've achieved over $260 million in sales.

Winning formula leads to remarkable sale

Our most notable recent transaction in this first quarter was the sale of the Westfield WestCity Shopping Centre in Auckland for $153 million, reflecting a 7.38% initial yield. We worked jointly on this sale with Sydney-based McVay Realty.

Westfield WestCity Shopping Centre was promoted through a two-staged Expression of Interest process. The combination of our own connections and McVay's international buyer base proved to be a winning formula. By lifting this property out of the local market and showcasing it to the world we received a total of five offers, all from offshore parties who had not previously invested in New Zealand.

Of the five bids received at the close of tender, the first four were made up of a sovereign wealth fund out of Singapore, one Korean Group, and two Australian fund managers. The fifth, a private investor from Adelaide, eventually won the tender.

We noted with interest that during this campaign there was a substantial difference in the perceived value of the asset between local and offshore groups. International investor pricing was often as much as 100 basis points firmer than local fund manager and syndicator expectations.

Further significant sales in our first quarter

Other notable transactions in the first quarter included:

- 358-364 Remuera Road (sold by Henry Thompson)
- a 200ha Waikato dairy farm (sold by Bruce Whillans)
- 24 Mackelvie Street (sold by Henry Thompson)

The changing face of business in 2017

While land sales dominated our business last year, we are now seeing a clear slowdown in the development sector. Rising construction costs and funding restrictions are taking the heat out of this market.

However, we continue to experience strong demand for investment property. Local and offshore investors, fund managers, and sovereign wealth funds are all chasing income-producing stock.

In this edition of the Whillans report, our Senior Analyst Brendan Keenan explores the reasons behind this offshore demand and how new funding models could offset the current development funding gap.

I trust you find value within this quarterly report and I look forward to doing business with you in the future.

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358-364 Remuera Road, Remuera

WestCity Shopping Centre

24 Mackelvie Street

Market 2016 Fourth Quarter Update

CBD Commercial (Q4)

2016 ended on a strong note for the CBD office market with solid tenant demand, rising rentals and surging investor activity propelling office values to new highs.

In the 12 months to December 2016, prime and secondary office yields firmed by 33 and 39 basis points respectively. Over the same period, prime office rents increased by 5% and secondary office rents increased by 8.5%.

Vacancy rates edged up marginally from 6.9% in December 2015 to 7.1% in December 2016 with new office supply coming on stream. However, when measured against Australia's capital cities, Auckland continues to hold the second lowest CBD office vacancy rate behind Sydney.

Most major research houses are pencilling in modest rental growth across 2017, albeit rising tenant incentives and new office supply are tempering effective rental growth rates. This weaker rental growth combined with the prospect of higher interest rates could see yields begin to level off over the year ahead.

Auckland CBD Commercial Market Summary* (CBRE)

	PRIME	SECONDARY	PREV 6MTH TREND
Vacancy	3.3%	10.3%	Decreasing
Effective Rent	$404	$240	Increasing
Yield	6.59%	7.20%	Firming
Incentives*	7.9 mths	7.9 mths	Increasing

***Based on an indicative new 9 year prime and 6 year secondary lease**

SOURCE: Statistical data in this market update has been sourced and summarised from CBRE research and is intended for general guidance only. No responsibility is accepted by CBRE or Whillans Realty Group Limited for any omissions or errors contained within this report.

Market 2016 Fourth Quarter Update Continued

Auckland Industrial (Q4)

The industrial market recorded strong growth in the 12 months to December 2016, with prime and secondary effective rentals increasing by 3.6% and 6.2% respectively. A shortage of industrial stock combined with significant investor demand saw yields across both sectors of the market firm by 75 basis points.

Industrial vacancy rates remain tight at 1.7%, with increasing material and labour costs and land shortages placing additional constraints around new development.

For many developers, Auckland's industrial market remains elusive. They are forced to compete with owner-occupiers and larger developers who have the benefit of large, long-term land banks. At current land prices ($465/m²), many developers are unable to speculate new projects with only a handful of players like AIAL and Goodman continuing to corner the prime industrial market. Looking at the year ahead these constraints will place further upward pressure on rents with property values following suit.

Auckland CBD Industrial Market Summary* (CBRE)

	PRIME	SECONDARY	PREV 6MTH TREND
Vacancy	1.0%	2.1%	Decreasing
Effective Rent	$128.80	$97.40	Increasing
Yield	5.74%	6.94%	Firming
Land Value	$600	$225	Increasing

CBD Prime Retail (Q4)

The prime CBD retail market experienced exceptional rental growth in the year ending December 2016, with rents improving by 10.7% to $3,892/m². Over the same period, yields firmed by 30 basis points to 4.95%. Strong employment and residential growth coupled with a booming tourism industry continue to underpin this market. In addition, the pipeline of major new public and private infrastructure projects is driving pedestrian foot traffic numbers higher in the core CBD, supporting further rental growth into 2017 and beyond.

Auckland CBD Prime Retail Market Summary* (CBRE)

	AVERAGE	HIGH	LOW	PREV 6MTH TREND
Rent	$3,892	$4,500	$2,800	Increasing
Yield	4.95%	4.75%	5.25%	Firming

International Investors Circle Back on Auckland

In this edition of the Whillans Report we explore the market forces that have placed Auckland on the radar for Australian and other offshore investors. We investigate the reasons why these groups are turning their attention to New Zealand, and where and how they are looking to invest.

Demand for Australian assets reaches boiling point

Last month the chief economist for REA Group, which owns realestate.com.au and realtor.com, reported an interesting fact about sales in 2016. According to the chief economist, for the first time ever, over 50% of all Australian commercial property deals were either directly purchased or indirectly financed from offshore sources of capital. The chief economist also noted that Sydney, and to a lesser extent both Melbourne and Brisbane, are witnessing a recalibration of commercial property yields, as offshore capital drives asset prices skywards.

Global investors now see Sydney on par with London, New York, and Tokyo, and yields have followed suit. The indicative yield for prime office space in the Sydney CBD is now 5.7%. These yields are expected to firm further across 2017 as a result of accelerating rental growth and heightened offshore interest.

In 2016, when capital was measured by total cross-border transactions, Sydney was the sixth largest market in the world. New York and London took out the lion's share of this capital flow. Interestingly, Los Angeles, San Francisco, and Paris were only slightly ahead of Sydney, despite being substantially larger cities.

An attractive entry point for Asia Pacific investment

International fund managers are having a significant influence on yields as they attempt to create global property portfolios. As a stable western democracy with a deep pool of investment-grade stock, and as one of the best-performing economies in the OECD, Australia is an attractive entry point for investment in the Asia Pacific region. This capital bypasses countries like Thailand, Indonesia, and China, where the perceived risks around transparency, corruption, political instability, and market volatility deter investment. To a lesser extent, political uncertainty in Europe, the UK, and the United States is also rerouting investment to Australia.

Australia and New Zealand's political stability will continue to make these markets an international destination for capital. We're not only witnessing offshore groups acquire assets in Australia, but we're also seeing some of the world's major property investors establish a physical presence in Australia.

And US investment groups Blackstone, AEW Capital Management, Pembroke, and TH Real Estate are all building substantial operations in Sydney.

Capital spilling over into New Zealand

As a result of this offshore interest and aggressive pricing, Australia's capital cities are no longer seen as affordable. Investors are actively pursuing better opportunities elsewhere in the Asia Pacific region.

These investors view New Zealand as a logical alternative and are attracted by our zero stamp duty and capital gains policy. New Zealand also shares Australia's market advantage as a stable western democracy with a transparent business environment.

As one of the fastest growing cities in Australasia, investors are attracted to Auckland's longterm need for new infrastructure, more housing, and more commercial real estate projects. However, we do not have a deep pool of investment grade stock. And this is a major hurdle for offshore institutions who are looking to place upwards of NZD $100 million into our property market.

International Investors Circle Back on Auckland

Alternative funding model to create new stock

Investors' appetite for stock valued above $100 million has led to greater interest from Australian and other offshore groups in funding New Zealand development projects. These projects offer an effective way of creating and securing prime investment stock. Having seen this 'fund-through' model work well in Australia, investors appear to be comfortable shifting their attention to projects in New Zealand. And this is at a time when traditional New Zealand lenders are battening down the hatches and curbing the flow of credit.

By using the fund-through model, those groups investing in New Zealand development projects are able to lock in a return from day one. They can finance projects through to completion at an interest rate equivalent to or near the end return of the asset. The developer for the project can then obtain funding at a low interest rate with a buyer guaranteed on completion.

A similar situation has been playing out in Australia after the 'big four' banks reduced their exposure to commercial property and development funding. In 2016, Australian superannuation and offshore pension funds stepped in to fill this funding gap by actively participating in Australia's commercial real estate debt market.

In keeping with this new form of investment, Whillans Realty Group took a large fund-through development (circa $150 million) to the market in February this year.

We received a total of 11 bids for the project, ten of which were from offshore groups including fund managers from Australia, Switzerland, Germany, and Korea. These groups represented a combined $1.4 billion investment pool ready to be deployed into the New Zealand property market.

Will institutional capital follow the current flow of smart money?

The current wave of Australian interest in our commercial property market is very different to the cycle we witnessed between 2005 and 2007. The previous cycle was driven by hyper-leveraged investment funds from groups like Orchard, Valad, and Becton. But what we're witnessing now is the arrival of a new breed of well-capitalised offshore investor.

Australian private investors dominated the 2016 landscape with their smart money flowing into the country. These investors are agile, flexible, and can move faster than their institutional rivals. But will institutional money follow them in 2017?

Examples of this smart money include the recent Whillans/McVay sale of the Westfield WestCity Shopping Centre, one of the largest property deals in 2016. The centre was purchased for $153 million by Angaet Holdings, a private Australian development company. During the campaign a number of Australian and Asian institutional investors commented that they now have a mandate to invest in New Zealand for the first time ever. At the close of the sales process we had received five bids, all from offshore parties who had not previously invested in New Zealand. The combined value of these bids was over $750 million. In January 2016, Australian private investor Shaun Bonett purchased the Shore City Shopping Centre for $90 million. The deal was financed by Bank of China. Then in June 2016, another private Australian investor purchased two Auckland CBD office assets for $77 million.

Operating successfully in a changing market

As we move into 2017, underlying property fundamentals in Auckland are the strongest they have been in decades. But will a lack of traditional sources of lending threaten to disrupt this growth? Is our market mature enough to support this new wave of investment and could global events turn the trickle into a flood?

New Zealand's commercial property and development industry is entering a new phase of credit rationing. But we believe that identifying, unlocking, and directing opportunities for offshore investment is paramount to operating successfully in this changing market.

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Auckland CBD Land and Conversion Sales

CBD Land Sales

Address	Property	Proposal/Development	(m²)	Sale Price	$/psm	Date
155-167 Fanshawe Street	Ex-Caltex Site	No known consents.	3,879	$23,247,000	$5,993	Nov-16
38 Fort Street	Ex Brothel House	High-rise mixed use tower under construction.	282	$5,060,000	$17,943	Aug-16
128 Anzac Avenue	Bare site	Student accommodation tower.	710	$8,200,000	$11,549	Jul-16
79 Airedale Street	On-Grade Car park	Sale included 40 strata car parks. Consented for 17 level tower.	1,092	$7,600,000	$6,690	Jun-16
29-31 Anzac Avenue	Waterfront Union House	Maritime Apartments	761	$5,500,000	$7,227	Jun-16
57 - 59 Wakefield & 28 Airedale Street	1940's building	Apartment development site	768	$6,200,000	$8,073	May-16
121 Grafton Road	Vacant Land	Consented for student accommodation.	3,006	$15,200,000	$5,057	May-16
26 Airedale Street	Two Level Building	No known consents.	220	$2,920,000	$13,273	Apr-16
50-52 Cook Street	Ex. Workshop Outlet Store	Fiore Cook Residences under construction	1,732	$9,900,000	$5,715	Apr-16
201 Hobson Street	The Eve Apartments	Plans for residential apartments.	563	$4,700,000	$8,338	Apr-16
147 Victoria Street West	NZ Tourism	Plans for a Ramada Hotel.	1,176	$9,000,000	$7,653	Feb-16
29 Beach Road	Liquor Centre	Marketed as a development site.	245	$2,550,000	$10,408	Dec-15
10 Commerce Street	Tasman Building	Apartment presales underway for The Pacifica.	1,388	$27,760,000	$20,000	Nov-15
7-9 Halsey Street	Millar Paterson Metals	Apartment presales underway.	561	$3,085,000	$5,500	Oct-15
438 Queen Street	Real Groovy	Conrad Properties are building 236 apartments and 9 retail units.	1,965	$13,800,000	$7,022	Oct-15
26 Poynton Terrace	Car Park	Oasis Apartment building under construction.	334	$2,200,000	$6,586	Oct-15
151 Beach Road	Ideal Electrical	Sold to a developer. No known consents.	1,032	$6,800,000	$6,589	Sep-15

CBD Fringe Land Sales

Address	Zone	Description	(m²)	Sale Price	$/psm	Date
376 Great North Road	THAB	1970's Warehouse / Office	570	$3,850,000	$6,754	Dec-16
409 Great North Road	THAB	Character Bungalow	427	$1,959,000	$4,588	Dec-16
562-562A Richmond Road, Grey Lynn	Mixed Use	Retirement Village	4,501	$14,500,000	$3,222	Nov-16
57-59 France Street, Eden Terrace	Mixed Use	Kings Arms Tavern	2,112	$7,450,000	$3,527	Nov-16
12 Nixon Street	Mixed Use	1960's Warehouse	531	$2,250,000	$4,237	Sep-16
667 Great North Road	Mixed Use	Car Yard	1,727	$5,900,000	$3,416	Sep-16
103-104 Great South Road, Epsom	Mixed Use	1980's Office	2,076	$7,850,000	$3,781	Sep-16
10 Maidstone Street, Grey Lynn	Mixed Use	1980's Warehouse	634	$3,300,000	$5,205	Sep-16
7 Sarawia Street, Newmarket	THAB	1930's Flats	711	$3,100,000	$4,360	Aug-16
25 Exmouth Street , Eden Terrace	Mixed Use	1980s Warehouse / Office	2,053	$5,700,000	$2,776	Aug-16
3 Abbey Street, Newton	City Centre	1970s Office	607	$3,525,000	$5,807	Aug-16
15 Nugent Street, Grafton	Mixed Use	1980s Warehouse / Office	1,988	$6,700,000	$3,370	Aug-16
6 Akepiro Street, Mount Eden	Mixed Use	1980s Warehouse	1,681	$6,125,358	$3,644	Jul-16
159 Great North Road, Grey Lynn	Mixed Use	1970s Office	1,968	$8,000,000	$4,065	Jun-16
9 Madiera Lane, Grafton	Mixed Use	1980s Warehouse / Office	1,040	$3,550,000	$3,413	Mar-16
6 Nikau Street, Eden Terrace	Mixed Use	1980s Warehouse	903	$2,907,000	$3,219	Feb-16
22 Randolph Street, Eden Terrace	Mixed Use	Bare Site	1037	$3,100,000	$2,989	Feb-16

CBD Conversion Sales

Address	Property	Proposal/Development	(m²)	Sale Price	$/psm	Date
96 Albert Street	Media Design School	Plans to be converted into a hotel.	11,377	$36,000,000	$3,164	Oct-16
8-10 Whitaker Place	Whitaker Park Central	Plans to be converted into 80 units.	4,537	$16,500,000	$3,637	Mar-16
16-22 Anzac Avenue	Tasman House	Plans to be converted into student accommodation.	2,556	$6,400,000	$2,503	Dec-15
9 Princes Street	Ex Fonterra Building	Potential residential conversion.	12,389	$45,380,285	$3,663	Oct-15
10-12 Exmouth Street	The Citizen	Presales underway for conversion into 94 apartments.	3,530	$7,500,000	$2,125	May-15

The Whillans Report

AUCKLAND MARKET UPDATE / 1ST QUARTER 2017

Auckland Investment Sales

Office Investment Sales

Address	Suburb	Asset Type	NLA (m^2)	Parking	Occupancy	WALT	Sale Price	Date	Initial Yield
519-521 Lake Road	Takapuna	B-Grade	4,882	74	100%	7.0	$24,500,000	Nov-16	5.7%
92 Albert Street	CBD	B-Grade	11,380	25	84%	2.9	$36,000,000	Oct-16	6.4%
Millennium Centre, 600-604 Great South Road	Greenlane	A-Grade	43,500	1,567	100%	4.9	$210,023,756	Jul-16	7.3%
The Telco Building, 60 Federal Street	CBD	B-Grade	7,828	41	92%	2.2	$31,750,000	Jul-16	7.0%
Fletcher HQ, 581-585 Great South Road	Penrose	B-Grade	8,903	478	100%	9.2	$40,900,000	Jun-16	7.1%
AUT Tower, 2-14 Wakefield Street	CBD	B-Grade	13,987	43	100%	8.2	$47,200,000	May-16	6.7%
Cider Building, 4 Williamson Avenue	Ponsonby	A-Grade	13,200	537	100%	10.0	$93,000,000	Dec-15	6.7%
NZ Invest House, 32-34 Mahuhu Crescent	CBD	A-Grade	7,224	69	100%	2.9	$18,560,000	Dec-15	9.1%
Grant Thornton House, 152 Fanshawe Street	CBD	A-Grade	6,697	66	100%	4.2	$28,100,000	Dec-15	9.8%
49-51 Symonds Street	CBD	B-Grade	10,027	256	100%	5.1	$49,700,000	Dec-15	5.9%
Auckland Club Tower (8F-17F), 34 Shortland Street	CBD	B-Grade	8,137	76	100%	3.4	$44,500,000	Dec-15	7.1%
56 Wakefield Street	CBD	B-Grade	9,586	367	100%	2.2	$43,000,000	Nov-15	7.7%
151 Victoria Street West	CBD	B-Grade	4,790	75	100%	6.7	$27,350,000	Oct-15	6.2%
Woods Portfolio	CBD	Character	3,235	0	100%	3.0	$21,200,000	Oct-15	6.4%
Lufthansa House, 36 Kitchener Street	CBD	B-Grade	3,250	27	94%	1.8	$16,500,000	Sep-15	7.1%
Radio NZ, 54 Cook Street	CBD	B-Grade	3,717	33	100%	0.7	$15,000,000	Sep-15	6.2%
8 Nugent Street	Grafton	A-Grade	7,684	244	100%	5.0	$42,000,000	Aug-15	7.1%
X Gallery, 18-26 Wellesley Street East	CBD	Character	2,713	0	100%	4.7	$25,360,000	Aug-15	5.8%
51 Corinthian Drive	Albany	A-Grade	3,242	125	100%	5.4	$15,150,000	Jul-15	7.2%
7 City Road	CBD	B-Grade	6,470	151	89%	2.0	$22,800,000	Jul-15	8.1%
Heartland House, 35 Teed Street	Newmarket	A-Grade	2,903	99	100%	5.2	$17,000,000	Jun-15	6.9%
The Blacketts Building, 86-92 Queen Street	CBD	Character	900	0	83%	2.6	$13,000,000	Jun-15	4.4%
Fletcher Building, 810 Great South Road	Penrose	A to C-Grade	13,243	523	100%	20.0	$80,000,000	Jun-15	7.1%
1 Nelson Street	CBD	B-Grade	4,089	70	72%	1.3	$14,800,000	May-15	5.1%
44 Taharoto Road	Takapuna	B-Grade	5,478	251	100%	2.9	$19,500,000	Apr-15	7.6%
Telecom Building D, 167 Victoria Street West	CBD	A-Grade	7,592	75	100%	9.0	$70,120,000	Apr-15	7.0%
246 Queen Street	CBD	B-Grade	8,116	0	100%	2.8	$35,000,000	Apr-15	7.4%
Datacom Building, 58 Gaunt Street	CBD	A-Grade	16,735	152	80%	15.0	$86,200,000	Mar-15	8.5%
79 Carlton Gore Road	Newmarket	A-Grade	3,438	100	100%	12.0	$33,278,935	Mar-15	6.2%
ANZ Building, 9-11 Corinthian Drive	Albany	A-Grade	5,736	216	100%	5.3	$27,000,000	Feb-15	7.4%
SAP Tower, 151 Queen Street	CBD	A-Grade	17,648	313	100%	2.7	$97,000,000	Nov-14	7.8%
229 Queen Street	CBD	B-Grade	4,500	0	100%	4.5	$23,200,000	Nov-14	7.0%

Retail Investment Sales

Address	Suburb	Asset Type	NLA (m^2)	Parking	Occupancy	WALT	Sale Price	Date	Initial Yield
Bunnings, 167 Great South Road	Takanini	Bulk Retail	10,433	230	100%	12.0	$26,500,000	Oct-16	5.2%
DFS Galleria, 22 Customs Street West	CBD	Retail	5,129	0	100%	2.0	$33,500,000	Oct-16	Confidential
Three Kings Shopping Centre, 528 Mt Albert Road	Three Kings	Shopping Centre	10,000	NA	NA	NA	$37,000,000	Aug-16	5.9%
Shore City, 52 Anzac Street	Takapuna	Shopping Centre	13,990	830	98%	NA	$90,150,000	May-16	Confidential
Mitre 10 MEGA, 72 Lunn Avenue	Mt Wellington	Bulk Retail	14,600	NA	100%	NA	$46,000,000	Dec-15	5.5%
85 Cavendish Drive	Papatoetoe	Bulk Retail	3,893	162	100%	6.7	$10,000,000	Nov-15	7.1%
Countdown, 235-239 Lincoln Road	Henderson	Supermarket	4,200	200	100%	20.0	$20,200,000	Jul-15	6.7%
Bunnings, 459 Ellerslie-Panmure Highway	Mt Wellington	Bulk Retail	11,327	272	100%	10.0	$26,850,000	Jun-15	6.0%
Southgate Centre, 230 Great South Road	Takanini	Shopping Centre	21,157	571	100%	8.45	$58,500,000	Dec-14	7.5%