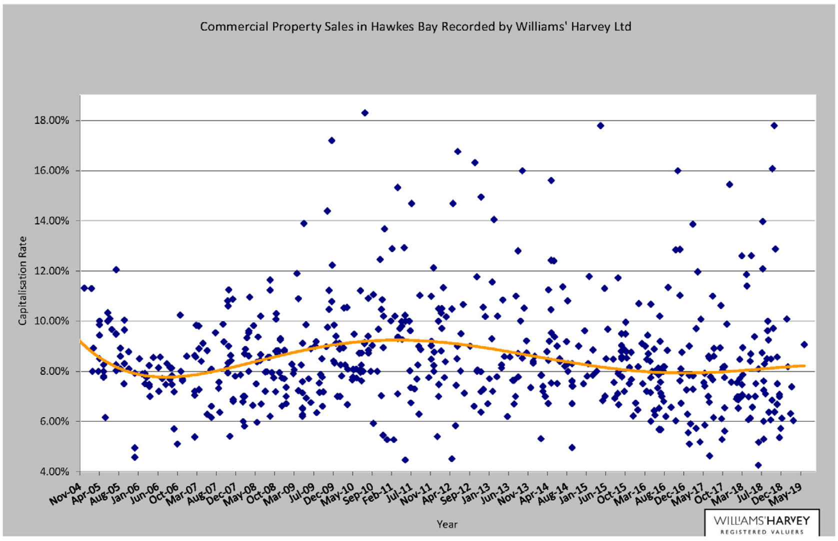
The Value of Commercial Investment

The Hawke's Bay commercial market has maintained a steady level of sales activity for the last three years and remains relatively strong. There are several contributing factors but none more so than the continued construction boom underway in Hawke's Bay at present, within excess of $600 million's worth of commercial developments boosting our economy. These developments cover the entire region from development in Napier, Hastings, Havelock North and in between. Suffice to say the commercial marketplace is buoyant and there is a drive from tenants and investors alike for superior quality premises.

Although the market has shown an upward improvement there continues to be a wide gap between properties varying in quality with strong demand for good quality investments with yields ranging between 5.5% and 7.5%. Not surprisingly, our office has seen an increased trend of interest from out of town investors as they seek superior returns than in the larger centres. However, any commercial property that is of a more secondary nature, average locality, lesser quality improvements, low seismic rating, vacant, short lease terms or inferior tenant covenant appears to lack market interest and has been slow to sell and at increasing capitalisation rates of 9.0% to 12.0%-plus and lowering value levels.

A major factor now influencing the commercial market is the age and construction of the structure and its seismic strength, insurance premiums and new Health and Safety laws. We are aware of larger corporates and government tenancies that have made policy decisions around the earthquake prone rating of a building. Such entities will generally vacate and will not return unless the property owner strengthens the building to an acceptable level. This has influenced the office and retail market where demand for single level, modern, premises has increased. The large-scale redevelopments recently



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undertaken in Napier CBD are largely due to seismic issues.

Generally, market conditions have been strong and there has been a drive from tenants for superior quality premises. This has driven the new build segment as well as made redevelopments or refurbishments feasible. This superior quality accommodation has driven the upper end of the rental market and the Napier City Council relocation has soaked up a large amount of the second-tier market leaving a short supply of any reasonable quality office accommodation within Napier CBD. Also, in late March 2018 it was reported that the French based Accor Hotels network may purchase the four storey PwC Centre and turn the top three floors of what was previously office space into 50 serviced apartments. This did not proceed, but we now understand the Hilton Group has picked up the project and the premises are being converted to a Double Tree by Hilton Hotel.

This will serve to only further reduce office accommodation in Napier and will result in upward rental pressure as supply is constrained. Hastings however still has an oversupply of secondary office accommodation and evidence would suggest the secondary quality accommodation is taking longer to re-let and there is a general increase in vacancies of older less desirable property.

All things considered we have enjoyed and continue to enjoy a buoyant commercial property market. The question now being around the longevity of this trend.

There are concerns of financial global head winds and that a fall in international trade activity is now impacting inflation and business confidence. So far New Zealand commodity prices have been resilient to the global slow down and this has helped shore up local economic confidence. It is expected that we will have lower interest rates for a while longer with the current official cash rate (OCR) being lowered to 1.5% in May 2019 to support the outlook for employment and inflation.

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