Indicators on

The commercial and industrial real estate environment is responding to market signals and corners will be turned this year.

With annual inflation falling to 4.7 percent in the last quarter of 2023 – the smallest annual rise in the consumer price index (CPI) in over two years – and wholesale interest rates inching south, Bayleys commercial and industrial business line leaders are upbeat about the year ahead.

We check in across the sectors for a take on what's to come.

Ryan Johnson

NATIONAL DIRECTOR COMMERCIAL AND INDUSTRIAL

Despite witnessing a 31-year trough in 2023 – with the lowest number of commercial and industrial sales transacted since the 1990s according to CoreLogic's national agency dashboard – Bayleys sales picked up month-on-month as the year progressed with December 2023 our biggest month all year.

Our sales data is a good reflection of the general market due to the sheer number of deals we do and I expect to see an increase in sales volumes and values as vendors make the decision to proceed in 2024.

It's going to get better – it has to – and this is supported by cyclical trends. Historically, in years where there was more than a 20-percent drop in sales volumes, the market recovery was seen around one to three years later.

Wholesale interest rates are dropping, and market interest rates will drop, too, albeit not as much as our vendors would like and I expect to see some market repricing across all commercial and industrial segments.

The real cost of debt is sitting at around 8.5 percent while we're seeing yields of six to eight percent which doesn't stack up, and even if interest rates drop by 100-150 basis points, that cost of debt-yield spread will remain sticky. Scraping by will not be a feasible strategy for many commercial and industrial asset owners as banks re-examine debt servicing, interest times cover and loan-to-value ratios.

Leasing is going off the charts with the top three concerns for occupiers being property of the right quality, the right scale and the right location.

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> **RYAN JOHNSON**
> BAYLEYS NATIONAL DIRECTOR COMMERCIAL AND INDUSTRIAL

From a total returns perspective, cap rates have softened while rents have held and looking ahead, I suspect we will see some tapering off of rental growth across all sectors, particularly secondary sectors with net effective rents becoming more subdued.

On the landlord side, a reluctance to refurbish has created a growing divide between premium and secondary-grade vacancies and rents.

Landlords that can offer practical solutions for occupiers – including incentives – are doing well, while those owners not prepared to put the work in will struggle with occupancy and cash flow.

With the new National-led coalition government still thrashing out policy, there are changes to come.

I expect the build-to-rent sector to scale up significantly, the purpose-built tertiary student accommodation segment of the market to reignite, and the removal of depreciation deductions as an expense on commercial buildings to have an impact on landlords.

Scott Campbell

NATIONAL DIRECTOR INDUSTRIAL

After a couple of relatively subdued years following off the back of fairly frenetic activity during the height of the pandemic, I'd expect to see some levelling out of the industrial investment market in the next three to six months.

Although consumer spend is dampened, unemployment is ratcheting up, yields have softened and there are signs that rental growth may slow this year – the industrial sector won't go backwards.

Inventory is still tight on both the sales and leasing sides of the coin, with occupiers still actively scoping out space in key locations.

With pandemic supply chain issues now largely resolved, demand for "just-in-case" space has tapered but New Zealand, and in particular Auckland, still needs more industrial footprint – especially warehousing and logistics capacity.

The migration story is a positive for the industrial market. Solid net migration growth will enhance New Zealand's appeal for global industrial property investment and will help provide confidence to the development sector which has been cautious.

We'll need 600,000-700,000sqm of new space per year if migration continues on its current trajectory, with the bulk of this naturally in Auckland, but spilling over into the regions

The development pipeline has all but stalled but we have to see developers come back into the market one way or another. Steel and concrete costs

have come back off recent highs, and there's definitely opportunistic growth to be unlocked to increase the current industrial space in the market.

Nationwide infrastructural efficiencies are still required to make the industrial sector really hum. Significant pieces of the infrastructure puzzle still need to be addressed before developers click back into gear, and the undersupply of live industrial-zoned land will continue to be a handbrake in coming years.

Wayne Keene

NATIONAL DIRECTOR HOTELS, TOURISM AND LEISURE (HTL)

With occupancy levels trending back to 2019 levels, the return of corporate/conference and tour group business, and encouraging international visitor numbers, 2024 is looking promising for the HTL sector.

Because the accommodation industry is quite small in New Zealand relative to international levels, there is always limited opportunity to purchase quality stock. This is especially so in the hotel sector as evidenced by the fact that there was only one on-market hotel sale nationwide last year, with Bayleys selling Nugget Point Hotel, Queenstown.

There's good appetite from local and offshore investors for larger hotel assets, while freehold going concern (FHGC) assets in the sub-$15 million bracket are also in demand – largely from local buyers.

Lending is still tricky across the board, with mainstream banks particularly hard on the accommodation market with their seemingly fickle policies, although we are seeing some lenders coming back into the space having been absent from it for a year or so.

It's certainly easier to get funding for the larger transactions since those in a position to purchase have a good asset base and reasonable cash reserves.

Purchasers for HTL assets are generally very clear on the sort of stock they will consider, rather than looking merely for any opportunity. For example, people looking for a FHGC in Taupō won't generally buy a lease (business only) just because it's good value.

Sustainability and corporate responsibility remain high on buyer, customer, and lender agendas, however, something we also need to pay more attention to is New Zealand's ageing room inventory across the motel and hotel market segments.

This is particularly evident where a lessee simply doesn't have the cash reserves to undertake a full refurbishment, and with the cost of living impacting customers' decisions about how they spend discretionary dollars, it's the domestic tourism market that will vote with its feet.

To end on a positive note, the demand for accommodation assets remains high whether it's a $600,000 business or an international hotel. There is capability from well-resourced New Zealand residents to buy even the largest hotel in the country, so it's about securing the asset for sale.

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> "Business owners have a much-improved environment to get their businesses sold.
>
> **WILLIAM CHEONG AND JAMES MACMILLAN**
> NATIONAL DIRECTORS BUSINESS

Chris Beasleigh

NATIONAL DIRECTOR RETAIL

Subdued consumer spending thanks to reduced discretionary income hovers over the retail sector. With mortgage rates remaining higher for longer and tangible relief still some time away, food and beverage spending is notably down, bigger purchases are being put on the back burner and retail margins are being compressed.

Any opportunity for a sale event is being grasped by retailers and when the likes of Michael Hill start retrenching sites and revising management structures (offshore outlets at this stage), off the back of lower profits in New Zealand – you know trading conditions are tough.

Developers and purchasers of retail assets are still looking for more guidance and surety from the Reserve Bank and from lenders, and monitoring consumer spending data for glimmers of positivity.

While the development pipeline has largely paused until some of the core fundamentals come back into line, encouraging net migration inflows could fuel an uptick in new retail space over the next few years.

Leasing will carry on despite headwinds as business owners persevere and attempt to ride out the storm. Regardless of market cycles, the retail sector always has a fair bit of churn, but now landlords are also under pressure to get decent returns on their investments and do not want to see vacancies.

Local suburban retail centres continue to trade well but retailers need to be better than their competitors to get the spend. Those that don't evolve to the new ways of retail are left behind and e-commerce remains central to the retail picture regardless of market segment, business size, or location.

The infiltration of offshore entities like Temu reinforces the impact of the global marketplace, while the Amazon-esque business model of same-day delivery is starting to make an impact.

Countdown has launched its Milk Run app using Uber drivers to fulfil 30-minute delivery timeframes, and Mighty Ape's same-day delivery service seven days a week is now in Auckland, Hamilton, Wellington and Christchurch.

Staffing dynamics have improved, although long delays by Immigration New Zealand in approving job checks for work visa applications are impacting hospitality businesses that rely on migrant workers for staffing.

William Cheong and James MacMillan

BAYLEYS NATIONAL DIRECTORS BUSINESS

There was a definite shift in the market following the change of government, given the National-led coalition is keen to provide a more supportive environment for business and the wider economy.

Coupled with the prospect of reducing interest rates later in the year, buyers now have more confidence to re-enter the market and business owners needing to exit their businesses have a much-improved environment to get their businesses sold.

Both of these factors will help close the gap between buyer expectations and valuations, so we expect transaction numbers to be significantly higher through 2024.

The banking sector continues to be supportive of borrowers with solid experience and track record, however, business owners wanting to sell need to have their administrative ducks in a row to smooth the way.

At this point in the economic cycle, health and well-being, manufacturing and security-related businesses are performing well but in addition to this, long-standing trusted brands across all business segments have prospered as consumers and customers gravitate to what they know.

For buyers – now is the time to act. Valuations in a lot of sectors have come down over the past 12-24 months and there are an increasing number of motivated vendors looking to exit their businesses. That said, competition for good businesses has already strengthened which we expect will drive higher valuations this year.

It is also important to note that with increased competition we expect deal mechanics such as earn outs and vendor finance, which are used by buyers to improve returns and mitigate risks, will become harder and harder to negotiate.

For those business owners considering an exit strategy, early engagement with the Bayleys' business team – up to five years in advance – can provide you with feedback about your business's current value, a roadmap to improve that valuation and optimise your chances of a sale, and time to build a trusted working relationship with us.

Prospective buyers along with business advisors, accountants, lawyers and bankers close to the pulse and sentiment of businesses they oversee, are also encouraged to get in touch – given that some businesses we represent ask us to sell via targeted off-market processes.