Hard ground

GREEN SHOOTS

BAYLEYS' CORE COMMERCIAL AND INDUSTRIAL BUSINESS LINE LEADERS REFLECT ON THE YEAR THAT WAS.

WITH INTERNATIONAL TOURISM and immigration back in the economic equation, as well as market acceptance of the "higher for longer" interest rate reality, notes of optimism and greater certainty have returned to some commercial property sectors as the end of 2023 approaches.

While investment activity remains subdued, the repricing of assets and the settling of other market drivers like construction costs mean the market is likely to exit 2023 in a better place than it started.

Let's look at how 2023 unfolded in each of the key sectors of Bayleys' commercial business.

Ryan Johnson

NATIONAL DIRECTOR – COMMERCIAL AND CAPITAL MARKETS

This was the year that everything happened, and nothing happened.

Significantly the bid-ask spread that was really dislocated at the start of the year has narrowed up, and deals are happening, particularly over the last few weeks.

It has taken from February last year until Q3 this year for the market to adjust to risk and re-rate. We've seen plenty of repricing across each of the asset classes, whether it's office, hotel, retail or industrial, as the market accepts that interest rates, which were forecast to come down in Q3 this year, are probably not going to come down until Q3 or Q4 next year.

The market doesn't like uncertainty. Now there is a lot more clarity around rates not coming down for probably another year. While that's not great, it is certainty which means people can start to deal with what's in front of them right now.

The issue in 2023, alongside the global macroeconomic background, has been that nobody really knew what was going to happen. Last year, we saw what we thought were historically low volumes; the lowest in about 30 years. This year they were down another 30 percent on 2022 numbers. Now that the market has adjusted to the idea of higher rates for longer, landlords can start to adjust and make plans.

On the occupier side, we've seen strong rental growth in premium assets for both office and industrial, while retail has held up reasonably well which is all helpful.

On the supply side construction costs have started to come back, about 12-15 percent which, in tandem with softening cap rates, should make feasibility for new development look more attractive over the next six months or so.

In the commercial office sector, there is a clear shift among employers away from working from home, as business margins are squeezed, company culture is key to attracting the best talent and businesses drive more productivity out of the workforce.

What we do see as employees return to the office is greater innovation and technological change, taking the workplace through another post-pandemic transformation. That will have an impact on demand for different grades of office space. Some C and D-grade buildings may be at risk of becoming stranded assets on the back of seismic requirements, as well as fit-for-purpose and sustainability demands from occupiers.

Sustainability improvements have been a high priority across all commercial real estate sectors, held back only by the cost of debt and softening cap rates combination.

Opportunity found in the market over the past year has largely been for all-equity private investors, who have had a significant amount of stock to consider, after a very crowded market over the past decade.

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RYAN JOHNSON, BAYLEYS NATIONAL DIRECTOR – COMMERCIAL AND CAPITAL MARKETS

Scott Campbell

NATIONAL DIRECTOR – INDUSTRIAL

The year has continued in the same vein as 2022 in the industrial sector with a subdued investment market. We saw a decline in investment activity of an estimated 25 percent with investors just trying to find the water level in terms of where bank funding and interest rates would go.

Conversely, we saw strong activity in leasing with vacancy rates remaining tight throughout the year as well as a rise in leasing rates, albeit not at the same pace as the previous 12 months.

We are starting to see some easing of those vacancy rates as consumer spending declines, though there's been a drop-off in construction activity in the industrial sector, which should mitigate that easing of vacancies.

Other trends apparent in 2023 are a flight to quality, which in an industrial context means businesses looking for higher cubic capacity, and the market has been relatively tight in terms of divestment.

"WE SAW STRONG ACTIVITY IN LEASING WITH VACANCY RATES REMAINING TIGHT THROUGHOUT THE YEAR."

SCOTT CAMPBELL, BAYLEYS NATIONAL DIRECTOR – INDUSTRIAL

Construction costs have also started to stabilise and the biggest opportunity in the market now is the construction of new speculative stock. There's an opportunity there with relatively high net migration expected to create the need for more industrial space in the foreseeable future.

Chris Beasleigh

NATIONAL DIRECTOR – RETAIL

2023 represented a complete turnaround from 2022 in terms of consumer spending. Having been through that exuberant post-pandemic spending period, consumers have really reined in their spending this year.

The impact of that on the retail sector has been mitigated by the return of immigration and tourism.

Crucially, while consumers have scaled down their spending, they haven't stopped, so while we have seen a few post-pandemic hangover bankruptcies and liquidations, it hasn't been a lot. Some retailers are finding it tough but it's not at the level of a full-blown recession with mass closures. The areas probably hit hardest are those selling large purchase items, and food and beverage.

We are expecting supply to slow in 2024 as developers have been waiting for market conditions to improve. With rising immigration and a growing population, that will mean increased competition for the existing stock. Leasing is still strong with good enquiry levels coming through.

Large-format retail is still ticking along as the sector's strongest performer, with a very low vacancy rate.

There haven't been a huge amount of transactions as people still look for stock at the bargain level, where vendors aren't willing to sell.

"IT'S BEEN A ROLLERCOASTER FOR THE RETAIL SECTOR OVER THE LAST FEW YEARS, BETWEEN COVID-19 AND ECONOMIC VOLATILITY."

CHRIS BEASLEIGH, BAYLEYS NATIONAL DIRECTOR – RETAIL

Overall, it's been a rollercoaster for the retail sector over the last few years, between COVID-19 and economic volatility. The retail sector is pretty hardened after all that. There are retailers out there doing well, you just have to be good at what you do.

Wayne Keene

NATIONAL DIRECTOR – HOTELS, TOURISM & LEISURE

There has been a real shift in focus towards sustainability within the tourism sector globally and in New Zealand. The World Tourism Organisation defines sustainable tourism as that which "takes full account of its current and future economic, social and environmental impacts, addressing the needs of visitors, the industry, the environment and host communities".

Most accommodation businesses and property owners are taking the view that sustainability measures are something that must be addressed or risk being left behind. With New Zealand flying the "clean green" international flag for several years now, it has become a driver of tourism to this country.

Over the years, the accommodation industry has been proactive at implementing operational changes such as using fewer plastic bottles, reducing wastage of consumables like soap bars, and giving multi-night guests the option to hold over linen rather than replacing it every day. Now sustainability measures must go deeper to cover everything from wellness and safety to climate resilience. The New Zealand Tourism Sustainability Commitment has set out 12 individual commitments as a roadmap for tourism businesses to benchmark their sustainability performance and make changes.

"THERE HAS BEEN A REAL SHIFT IN FOCUS TOWARDS SUSTAINABILITY WITHIN THE TOURISM SECTOR GLOBALLY AND IN NEW ZEALAND."

WAYNE KEENE, BAYLEYS NATIONAL DIRECTOR – HOTELS, TOURISM & LEISURE

The hotel and motel property sector has been less affected by 2023's economic volatility than other commercial and industrial assets. The accommodation industry typically appeals to a different type of client who has a focus on tourism assets as opposed to other commercial properties. Those clients have been keen to transact, rather than sitting on their hands like other, larger commercial investors, though funding remains a challenge for most investors in the sector.

Other challenges that will have ramifications into the near future are the continued use of motels by the Ministry of Social Development as long-term tenancies and a lack of new development.

Overall, the year has played out better than expected with more sales being completed than for the same period last year. Sales of some larger-sized assets have been welcomed by investors who have reacted positively with what would be considered premium value deals. With growth expected in the accommodation line and a drop in new development, existing stock will be highly sought after.

Jayson Hayde

NATIONAL DIRECTOR – BUSINESS SALES

Through 2023 we've seen a good uptick in business sales and specifically in business value. With re-opened borders, we've seen a good bounce back to hospitality, and our import and export markets have continued to strengthen which all helps.

What we have seen this year is more and more people looking to exit their business to retirement. Many of those people have been considering that decision for some years, but delayed it due to the pandemic. That means there are robust businesses coming to the market that have survived the pandemic.

The surprises this year have been just how high interest rates climbed and persistent skills shortages, which I would

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JAYSON HAYDE, BAYLEYS NATIONAL DIRECTOR – BUSINESS SALES

have expected we would have been able to address more quickly. The impact on that for businesses is that too much value rests with the owner, rather than in the business itself.

The other interesting trend has been the number of new startup businesses appearing, often based around technology opportunities, as creative Kiwis take more control over their own future.

There is market opportunity around structured acquisitions that allow for business growth. There are great opportunities for parties to acquire other businesses that bring in solid adjacencies to the buyer's core business. It's often better to buy an existing business with the skills and products that will drive your growth and diversification, rather than start a new one.

Overall, the business sales market has remained reasonably strong. It is taking people longer to make decisions but those decisions have been more meaningful to what they're trying to achieve.

I think we'll see new green shoots of opportunity as we move into the back end of this financial year.