

The tipping point

“Confidence” is the word most often heard from financial and economic analysts in the wake of the Reserve Bank’s first OCR cut since March 2020, but it is quickly followed by “caution”.

Cautiously optimistic is how most of New Zealand’s economic commentators greeted the Reserve Bank of New Zealand’s (RBNZ) August announcement that it would cut the Official Cash Rate (OCR) 25 basis points to 5.25 percent.

Analysts spoken to by *Total Property* heralded the change as the start of recovery for both the wider economy and the commercial property sector, but with heavy emphasis on “start”. The unanimous message is the outlook is improved and change is afoot, but there are challenging waters still to navigate and patience is essential.

TONY ALEXANDER
ECONOMIST

There is a lot of water still to go under the bridge. The main short-term impact of the OCR cut in August will be on rising sentiment and helping the housing market get back on an upward track.

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TONY ALEXANDER
ECONOMIST

We can expect cuts in future Reserve Bank statements of probably 0.25 percent but maybe a 0.5 percent cut somewhere in there if the data is bad.

We can expect better growth through 2025, but there is still a lot of restructuring to be done which will mean higher unemployment. There are still post-pandemic challenges for

some sectors like retail, residential construction and other sectors that support it, as well as hospitality. Returns for some farmers are also not so good. The outlook for the economy and the housing market is better but don’t get carried away.

By this time next year, I’d expect housing construction to have bottomed out with it picking up through 2026. The thing to watch is migration figures because they’ve fallen away sharply so there’ll be talk about that being a drag on economic improvement.

Ultimately, though, interest rates will be lower than they are at the moment so that’s clearly a positive.

PHIL BENNETT
BNZ HEAD OF PROPERTY FINANCE

Whilst the 25bp reduction will have limited impact immediately it has sent a clear signal to the market, and we are starting to see green shoots emerging, as borrowers have clarity that we have now moved past the “peak” of the rate cycle.

Current market wholesale pricing (effectively pricing in further reductions) should prevent any deeper correction in commercial property values, so I expect things to stabilise from here.

We won’t see the “speedy drop” in the OCR that we saw on the way up so the benefits of reduced interest rates will be a slower journey, but to acceptable positions.

The BNZ economist is predicting an OCR around 2.75 percent come mid-2026, so there is an opportunity now to take advantage of lower rates in the short term.

It bears repeating that there’s significant uncertainty around any interest rate forecasts over that sort of time horizon. The RBNZ’s projections have the OCR ultimately falling to a similar level as BNZ, but at a slower pace. By contrast, financial market pricing implies a much more front-loaded easing cycle.

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PHIL BENNETT
HEAD OF PROPERTY FINANCE, BNZ

One thing to bear in mind is that wholesale market pricing already factors in an OCR at about three percent by the end of 2025. That means it’s reasonable to assume additional declines in wholesale and retail rates will not be as rapid as those seen through August. Shorter dated mortgage rates (floating to 18 months) have more room to fall than longer-term rates.

The commercial property forecast for 2025 is steady with those forecast OCR reductions improving interest cover ratios to within the banks’ preferred ranges. That will take pressure off some investors and likely see yields improve.

NICK BULLICK
MAXCAP GROUP NZ CHIEF INVESTMENT OFFICER

The most significant impact the OCR change is having in the short-term is on confidence levels. What the cut has done is send the signal that we are entering a new stage of the economic cycle, and that should be enough to start encouraging owners to consider bringing buildings back to the market for sale, or developers to kick start projects they’ve had on the back burner.

It is still very early days and we’re not going to see a sudden or dramatic rise in property prices, residential or commercial, and we’re not going to bounce straight back to pre-Covid levels, but the change is huge in terms of market sentiment.

“The key thing for landlords and developers through this period of change will be to know your market intimately. The days of “if you build it, they will come”, are gone.

NICK BULLICK
CHIEF INVESTMENT OFFICER,
MAXCAP GROUP NEW ZEALAND



It might give some buyers the confidence to pay just that bit more without the fear that they'll be overpaying for something that's going to drop in value. These early days of the shift could see some good deals still available.

The thing is interest rates haven't been at soaring levels but the amount of change at speed did shock the commercial property sector and brought a lot of things to a halt. We should see that start to shift now.

The key thing for landlords and developers through this period of change over the next year, will be to make sure you know your market intimately; know who will want your end-product. The days of “if you build it, they will come”, are gone.

CAMERON BAGRIE
ECONOMIST, BAGRIE ECONOMICS

The OCR cut is just one part of the story. What the RBNZ has flagged with the cut, and what markets are now anticipating, is ongoing cuts down to near three percent.

The second and third quarters of 2024 will probably still see a negative GDP result, but the good news is we will start to see that change through the fourth quarter of this year. All eyes will then be on what sort of recovery we get in 2025. It is likely to be sluggish as there are still structural problems across the economy, such as weak productivity growth.

In the commercial property market, there's been a standoff between what buyers think properties are worth, and what sellers have been prepared to sell for. We haven't seen cap rates move at the same pace as interest rates, leading to questions over valuations. Lower interest rates will dampen pressure for cap rates to keep rising, dissipating pressure on commercial valuations.

The other thing we're starting to see is more tenancy risk. Low vacancy rates mean you can demand good rent, which supports valuations. Though valuations will now be supported by lower interest

rates, weak economic conditions can put tenancies at risk making it hard to achieve the same rental growth.

This time next year I think the economy will still be operating below capacity with an unemployment rate around five percent, but the good news is we'll be heading in a positive direction. Real GDP growth will be around two to three percent and house prices will be positive again.

The big picture is how durable the economic upswing will be. That has to come back to one variable: productivity growth and New Zealand has been awful at that for the past 10 years. The Reserve Bank can give interest rate relief, but you need substance and economic backbone as well, which comes from productivity.

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CAMERON BAGRIE
ECONOMIST, BAGRIE ECONOMICS

NICK TUFFLEY
ASB CHIEF ECONOMIST

Those with plans, who have been biding their time, waiting for what they perceive to be the right opportunity, and those who have been heavily focused on when interest rates would start to come down making financing costs lower, will now have some certainty that it's safe to move.

Investors know there are opportunities when they are in at the early part of the upwards journey rather than jumping on later.

It has been hard to get an accurate benchmark for what larger commercial properties are selling for, simply because transactions have been

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CHIEF ECONOMIST, ASB

slow. We should now see commercial investors being prepared to pay a slightly higher price, as financing costs come down and investors become more comfortable with a lower yield.

One interesting aspect of the commercial sector over the past couple of years has been how well reported construction activity has held up, in contrast to residential. The other durable sectors have been industrial and premium office, though others like, lower grade office space and high street retailers remain under pressure. The Wellington commercial market will be another unique case to watch in the short term as government cost savings and ongoing earthquake works make themselves felt.

The rest of 2024 is likely to remain fairly flat but by this time next year we'll have gone through most of the journey towards lower interest rates. That should mean we see retail spending coming back, and residential construction picking up as well, with property prices making reasonable gains.

KEVIN MILES
VEGA COMMERCIAL FINANCE
SPECIALIST

There will be more OCR cuts coming this year, and in the early months of next year so this first cut was really all about signalling a change in the cycle, and in the short term, the biggest impact will be on market sentiment. The questions now are how many cuts are coming and how quickly?

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KEVIN MILES
COMMERCIAL FINANCE SPECIALIST, VEGA

Yields are up slightly, and interest rates are coming down so we're moving back to a more normal state of affairs, where interest rates will move to being below yields. That should drive people back into investment because they'll be willing to borrow to buy.

Interest rates on deposits are also falling so those who were thinking it was great having cash in the bank at six percent, will be thinking about what to do when it is 3.5 percent and looking at investing in property. We're going to see a lot more investors and a lot more willingness to buy something a bit larger.

In terms of interest rates, I think the commercial sector looks less at what the Reserve Bank and the OCR are doing, and look more to the residential market for trends, because those numbers are always published. Typically, commercial rates for prime borrowers sit about one percent above a residential rate, while for “mum and dad” commercial property borrowers it's usually two to three percent above so you can benchmark the costs of finance off residential rates.

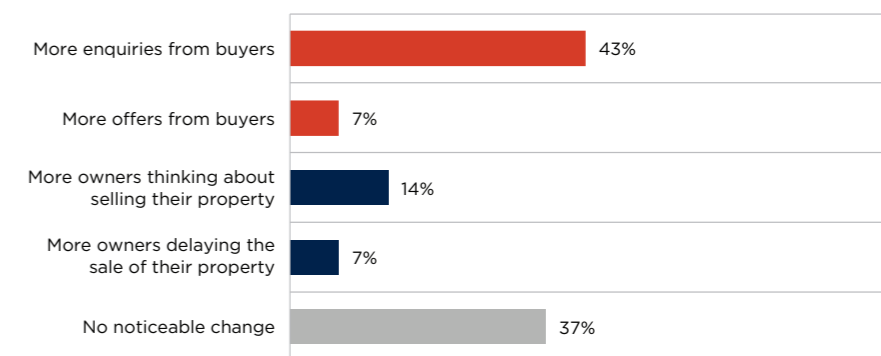
You can see residential rates are just collapsing at the moment, so I expect we will see a significant return to commercial investment in the not-too-distant future. A lot of shrewd investors will also see that this is the time to buy when bargains are around.

EAR TO THE GROUND
Bayleys insights & data team's latest frontline survey of commercial brokers across New Zealand showed that 43 percent have seen more enquiries from buyers since the OCR cut in August. Meanwhile, 37 percent said they seen no noticeable change and 14 percent said more owners were thinking about selling their properties.

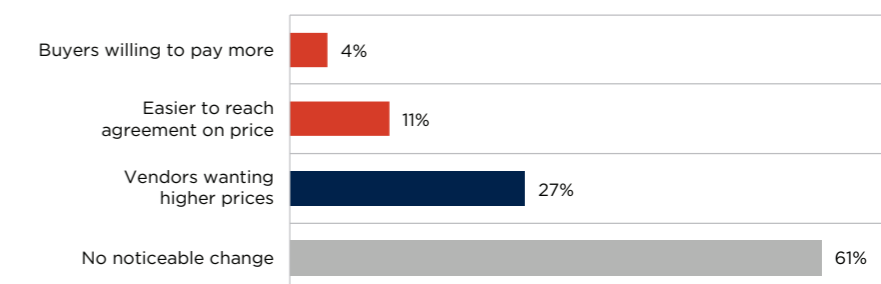
When asked what impact the OCR move had had on prices, 61 percent of Bayleys commercial brokers reported that there had been no noticeable change and 27 percent reported that vendors were seeking higher prices for their properties.

IMPACT OF THE OCR REDUCTION

HOW HAS ACTIVITY CHANGED?



HOW HAVE PRICE DYNAMICS CHANGED?



Data: Survey of Bayleys commercial brokers (September 2024) N = 70. Totals exceed 100% as multiple responses were allowed.

