Back in the money

With yields trending towards eight percent, juxtaposed by cost of debt at around five percent, commercial real estate's positive spread is becoming highly attractive in 2025.

Backdropped by lingering economic, social and employment challenges, and despite further promised cuts to the official cash rate (OCR), it won't all be roses for the commercial and industrial sector in 2025 – but activity is expected to follow the more positive path cemented in Q4 2024.

Bayleys national director commercial and industrial, Ryan Johnson says the money tap has been turned on again for commercial real estate. This is best illustrated by the attractive positive spread in 2025 and the fact that Real Estate Investment Trusts (REITs) are switching from being net sellers for most of the past 24 months, to active net buyers as they rebalance and recapitalise their asset books.

"Local and offshore REITs demonstrate a more inquisitive buyer market where creative and flexible deals are being stitched together, structuring debt and settlement dates to allow transactions to be inked.

"There's also greater interest from REITs and wholesale investors in value-add assets where entities can utilise management expertise to generate higher returns rather than buying core assets with elevated cost of debt."

Sales volumes rose through Q4 2024 and Johnson expects that trend to continue as the year unfolds.

"Much of that increased activity was driven by lowered cost of debt against declining deposit rates, causing those wanting fixed returns to look elsewhere. The erosion of money in the bank has also bolstered the syndicated market, but importantly, enquiry across all asset classes and sectors is tracking up.

"The classic interest rate curve with lower costs at the short end and higher at the two to five-year mark is returning – largely off the back of central banks and US dynamics.

"Traffic to the Bayleys website soared when Trump was elected and again when the greater Los Angeles wildfires broke out – proof that New Zealand's safe haven status has traction for offshore capital despite the fact that entry to the property market has significant thresholds to be met."

Johnson says the impact of geopolitical tensions and climate risk on capital flow cannot be underestimated, with New Zealand perceived as an attractive place to park money, and our property assets seen as relatively low risk with stable returns.

"Money out of Asia and Australia, which has a smoother pathway to ownership, was very active through 2024 and we expect that to continue as the repricing of core assets makes investment appealing in a global context."

"Traffic to the Bayleys website soared when Trump was elected and again when the greater Los Angeles wildfires broke out – proof that New Zealand's safe haven status has traction for offshore capital.

RYAN JOHNSON
BAYLEYS NATIONAL DIRECTOR COMMERCIAL AND INDUSTRIAL

LISTED SECTOR RALLIES

Rohan Koreman-Smit, senior equities analyst with Forsyth Barr, says the listed property sector has been trading below net asset value since the end of 2021 but has largely managed the economic cycle well and is well positioned to move forward with some confidence.

"Towards the end of 2024, we saw a slower decline in net asset values and more stable share prices. We think that there's still some adjustment to come on asset book values and we expect share prices to slowly trend upwards as the listed sector becomes more attractive against other income-generating vehicles – particularly as bank deposit rates fall."

Based on half-year results for listed sector portfolios to the end of September 2024, Koreman-Smit says vacancy rates rose due to softer tenant demand, and following a sustained period of rising rents, overall market rent growth had slowed. Rents were flat for certain asset classes, like lower-grade office stock, and parts of the Wellington office market were starting to feel the impact of the downsized public sector workforce.

"The industrial/logistics and prime office sectors were fairly robust, with rental rates remaining reasonably firm. With build costs now trending down and economic activity subdued, industrial rents will likely consolidate around current levels.

"Also notable was the stabilising cost of debt, with lower average debt costs now starting to support earnings."

A lack of transactional evidence made portfolio valuations difficult for listed entities says Koreman-Smit, with the sector tending to manage balance sheets through capital management mechanisms, like asset sales and lower dividend payouts.

"We haven't seen large capital raises like post-GFC as this cycle has had a softer landing," he explains. "The market is stabilising and asset value declines have moderated, but given full balance sheets, asset acquisitions are still largely on hold in the near-term."

> We haven't seen large capital raises like post-GFC as this cycle has had a softer landing.

ROHAN KOREMAN-SMIT
SENIOR EQUITIES ANALYST
FORSYTH BARR

More cross-border capital partnerships are likely to be fostered in the listed sector he says, with some early adopters of this model pushing ahead.

"In the last decade, we've seen many New Zealand listed entities transition from having external management teams to internalised management. This allows them to reduce expenses, diversify income lines, and be better placed to recycle capital.

"It's also opened the door to managing assets on behalf of others via capital partnerships. Examples are Precinct Properties partnering with GIC and PAG, and Kiwi Property Group buying into Mackersy Property.

"Goodman is also looking for capital, Stride Property Limited has been transitioning from asset ownership to asset management, and New Zealand-based Vital Healthcare Property Trust has been looking for a capital partner in Australia."

MEETING A FUNDING GAP

MaxCap Group NZ chief investment officer Nick Bullick says a boost to confidence is the key short-term change following any OCR drop announcement but cautions that improved sentiment won't immediately result in value rises.

"It might give some buyers a push to pay just that bit more without the fear that they'll be overpaying for something that's going to drop in value. I think there will be some good deals still available as the changes filter through."

Bullick says with continued regulatory pressure, banks will remain conservative towards commercial real estate debt. As a commercial property financier and investment manager, there's a gaping hole for MaxCap to fill.

"While construction funding will always be a large part of what we do, we also see great opportunity in the investment value-add space where real estate assets across all sectors are being transitioned.

"Our view is that banks will always be there for borrowers once leases have been renegotiated and capex work completed, but it is in the one to three-year period before the asset is stabilised where Maxcap can step in."

The debt market playing field is evolving, with Bullick saying as traditional fixed income returns begin to fall in line with interest rates, more institutional investors will seek private credit as a way to achieve sound risk-adjusted returns.

"Superannuation funds will play a big part in the commercial real debt market over the next 10 years but how they enter the market will be interesting. Some may choose to build in-house capability which will take time, but I think most will choose to use a specialist private credit manager to ensure they are getting access to the highest quality opportunities."

Bullick says asset class preferences and performance will come and go, but Maxcap is sector agnostic. "If a project makes sense and we buy into

> We see great opportunity in the investment value-add space where real estate assets across all sectors are being transitioned.

NICK BULLICK
MAXCAP GROUP NZ CHIEF INVESTMENT OFFICER

the owners' strategy we will fund it – simple as that."

He says with 2024 in the rear vision mirror, 2025 is going to be a great year in real estate.

"New Zealand is desperate for residential housing. This needs to be the focus of local and central government in the next 12 months and any headwinds will be driven by lack of supply more than anything else."

CAPITAL PUNISHMENT

When there is an economic downturn, Wellington looks inwards and really tightens its belt, says Mark Hourigan, director Bayleys Wellington Commercial.

"Public sector workforce contraction has definitely impacted confidence in the capital and impacted office space requirements. While there's been a value shift for commercial property and repricing due to the softened market, the leasing side has largely held up overall with good quality industrial stock in high demand.

"Suburban markets are also doing well, with private investors including family trusts seeing value in satellite commercial property."

Hourigan says property developers are inching back, with residential development picking up pace thanks to interest rate drops.

"Fund managers are also looking for opportunities, private investors are hunting for returns in the commercial/industrial sector given the drop in bank deposit rates, and banks are reopening commercial lending books."

A big handbrake to the capital's progress is well-documented dysfunction within the Wellington City Council, with financial and behavioural challenges leading to a Crown Observer appointment to oversee governance.

"Plans to 'get Wellington moving' have effectively imploded with cycle-lane construction and congestion bringing parts of the city to a standstill, leading to the exodus of many long-established businesses. Pinch points on Lambton Quay, Thorndon Quay, Kent and Cambridge Terraces, and Molesworth and Murphy Streets are ongoing," says Hourigan.

"Reality and geography dictate that Wellington cannot be a car-less city and these structural inner-city roading problems have seen our brokers resort to scooters to get them to CBD appointments.

"Wellington will bounce back, general sentiment will improve and until then, there are some compelling property deals to be done and we expect to see some standout stock come to the market this year."

The beleaguered 1.5ha Reading Cinema site in Courtenay Place, shuttered since 2019 due to being earthquake-prone, has now been purchased by local developer Primeproperty Group and Hourigan says the market – and the public – will be watching closely.

"The Courtenay Precinct needs a boost so eyes will be on the Reading site."

SOUTHERN CHARM

There was a momentum shift in the Christchurch commercial property market by the latter part of 2024, as interest rate cuts and money coming off term deposit took effect, according to William Wallace, Bayleys general manager South Island commercial and industrial.

"Bucking the national trend, Christchurch saw capital and rental growth and there were some encouraging acquisitions made during the year.

"Willis Bond, who have been really proactive in delivering world-class developments in Wellington and Auckland purchased Eastgate Shopping Centre, after earlier acquiring the Entertainment Exchange in the CBD. They've voted with their money, showing confidence in the Christchurch market.

"This will set the tone for private investment, and banks are reaching out to let us know that they're actively lending. I'm feeling good about 2025 and what it will mean for Christchurch landlords, occupiers and investors."

With the rural sector seeing uplift from increased farm gate milk prices and reported stronger sentiment, Wallace says there's money circulating from well-resourced farmers and aligned individuals looking to deploy capital in Canterbury.

"These rural landowners want to invest back into their local communities and Christchurch itself – showing that parochialism and provincialism are alive and well in the best way.

"Likewise, fund managers are currently active in Canterbury and overall, there's just a more optimistic feeling in the air. The traditionally quieter New Year period was anything but for Bayleys Christchurch, with presentations and client meetings kicking straight back in after the mandatory days off."

> I'm feeling good about 2025 and what it will mean for Christchurch landlords, occupiers and investors.

WILLIAM WALLACE
BAYLEYS GENERAL MANAGER SOUTH ISLAND COMMERCIAL AND INDUSTRIAL

AGENT PERCEPTION

Referencing the quarterly sentiment survey (December 2024) across the Bayleys network, head of insights and data Chris Farhi says the majority of residential salespeople now perceive the market to be in a neutral state due to lower interest rates – an improvement on the weaker sentiment noted earlier in 2024.

"By contrast, commercial sales remain a mixed bag with brokers picking the market somewhere between weak and neutral. However, 45 percent of our commercial sales brokers perceive the market is getting stronger.

"Last year, interest rates were a major pressure point for buyers – now the issue is largely the availability of finance, alongside generally less urgency to transact."

Farhi says price expectations on both sides of the transactional coin remain a key challenge.

"If looking to buy or sell during 2025, then getting honest and accurate advice on pricing will be critical. Having a pragmatic appraisal that is grounded in market reality is important.

"On the leasing side, our brokers report that tenants are typically seeking either better quality premises or better locations, with key challenges being tighter rental budgets and slower decision-making in response to softer economic conditions.

"Meanwhile, tighter capex budgets for landlords are making it difficult to implement the upgrades needed to retain and attract good tenants."