Proactive capital

Viewed through an international lens, New Zealand is a desirable commercial investment destination for global private wealth, with opportunities for residency pathways sweetening some deals.

Well-capitalised private investors were the most active global real estate buyers for the third consecutive year according to Bayleys' international real estate partner, Knight Frank's 2024 edition of *The Wealth Report.*

Knight Frank found almost a fifth of ultra-high net worth individuals (UHNWI) planned to invest in commercial real estate in the next 12 months, and Asia-Pacific was identified as the world's newest wealth hub.

Private active capital is circulating in New Zealand at levels higher than last year according to Bayleys national director commercial and industrial, Ryan Johnson. With identified market runway left before interest rates markedly ease, he's expecting continued strong enquiry and activity from both local and offshore UHNWIs and family office buyers.

"Bayleys recently took a delegation to Australia and Southeast Asia to promote several high-profile property and business opportunities, and to connect with some of the Knight Frank team.

"That exercise confirmed that New Zealand remains a high-performing and attractive destination for global private and family office wealth, particularly as there's an opportunity to buy ahead of the curve with arguably greater value to be realised and less market competition."

Johnson says there is significant institutional 'dry powder' capital out of Singapore and Hong Kong that may be deployed in Q3-Q4 this year, including capital raised in a cheap debt environment, and that will start to compete with private wealth.

"Chinese capital is currently less active in the New Zealand market, while Singaporean capital is expected to become more inquisitive as yields hit around seven to eight percent.

"Transactions are coming in at or around the all-in cost of debt which now sits in that seven- to eight-percent band and is likely to hover there over the next six months.

"Heightened geopolitical risk around the world is driving UHNWIs and family office buyers towards New Zealand where returns are less volatile, and there's a potential pathway to residency if certain thresholds are met."

The Government is reviewing and intends to revamp immigration settings and expectations around the type of capital it wants to attract to New Zealand, and has signalled that it would like to open foreign capital doors wider for certain asset classes like build-to-rent and healthcare, core infrastructure projects, and for private-public partnership ventures.

> "New Zealand remains a high-performing and attractive destination for global private and family office wealth.
>
> **RYAN JOHNSON**
> NATIONAL DIRECTOR COMMERCIAL AND INDUSTRIAL, BAYLEYS

"At a helicopter view, office remains a 'wait and see' sector, retail is quite attractive – especially to the ultra-high net worth market in Australia and Asia which sees value in our large format and shopping centre assets – while industrial is still popular but needing built-in rental growth to get deals across the line.

"The Bayleys Business team has also noted strong interest from the "baby boomer" investment market for opportunities with an enterprise value of $5-50 million.

"And while it's fair to say this is a relatively 'thin' buyer group in New Zealand, some business owners with a great local management platform are looking for passive foreign capital to co-invest for liquidity purposes, to allow an exit from the business."

Johnson says investor appetite is also high for commercial hotel, tourism and leisure assets, however, finding the stock for them to purchase remains the challenge.

AUSTRALIAN DYNAMICS

In line with global activity, private investors took a record share of overall commercial property transactions in Australia last year.

National head of capital markets for Knight Frank Australia, Justin Bond says Australian property markets have generally been subdued off the back of a softer economy where higher mortgage interest rates have impacted disposable incomes and household spending.

"We expect things to improve in the second half of the year and by that time we hope to see a further decline in inflation which will help to build sentiment in property markets.

"The Reserve Bank of Australia is currently trying to balance downside risks to growth with the need to maintain downward pressure on inflation. The current cash rate of 4.35 percent looks likely to endure until at least late in the year – we'll be watching closely for signs that central banks globally are shifting their stance and getting closer to cutting rates."

Bond says with reduced institutional and cross-border transactional activity, well-resourced private investors with less reliance on debt have been opportunistic in the commercial real estate market.

"Private investors have positioned themselves to benefit from the early stages of recovery, which we believe will start to emerge in Australia later this year," he explains.

"The investor base will gradually normalise as offshore investors and domestic institutions return, but this process will take time and private investors will continue to take significant market share.

"In recent months we've started to see more interest from Singaporean

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JUSTIN BOND
NATIONAL HEAD OF CAPITAL MARKETS, KNIGHT FRANK AUSTRALIA

investors, who typically form a large part of the Australian market, and this is a sign that institutional capital is returning to acquisition mode."

Strategically, Bond says investors are seeking greater diversification into alternative sectors with the living sectors at the front of the queue, led by build-to-rent but also encompassing co-living, student accommodation and retirement living.

"This partly reflects a preference for more defensive strategies at this point in the real estate cycle, but is also due to structural under-supply in rental markets and the ability to adjust rental income streams more quickly than other sectors in response to high inflation.

"Industrial markets also remain in favour, supported by continued rental growth and an ongoing need for new developments to accommodate the latest technology surrounding warehousing, distribution and stock tracking."

In the office market, Bond says the adjustment of formal valuations has still not entirely played out and will remain a brake on activity in the sector for a little longer.

"Workplace practices have changed to varying degrees in different Australian cities and are unlikely to revert to pre-pandemic models so the market is adjusting to this.

"While this brings challenges, there's also opportunity for investors to acquire assets at the most attractive pricing in many years. Most assets do not have a problem with occupancy and remain attractive to tenants so as this becomes clearer to more investors, liquidity will return to the office market."

While many institutions and cross-border investors favour Sydney and Melbourne, private capital tends to be spread more evenly around the country, enabling investors to home in on the cities seeing faster growth regardless of market size, explains Bond.

"The smaller markets of Brisbane and Perth are currently outperforming Sydney and Melbourne with strong Queensland and Western Australian economies helping to drive activity.

"Sydney and Melbourne are experiencing higher vacancy rates in parts of the office market, but prime assets in the core CBDs are more resilient and we expect investor sentiment to start to improve once it becomes clear that rates have definitively peaked."

Having a close neighbourly relationship, Bond says it's a natural step for Australia-based investors to consider investment options in New Zealand.

"It's not a matter of one market being better than the other as the markets are very similar, but the cycles can be different and offer good buying opportunities at different times, so it pays to cast the net wider than just one city or one country."

APAC AND BEYOND

Knight Frank data shows that private investors continue to have strong buying intentions, raising their investment exposure in 2023 to account for 45 percent of all transactions over $50m globally.

Until the market starts to see interest rate cuts and institutional investor activity rebounds, private capital is expected to persist as a driving force in the commercial real estate market in the higher-for-longer interest rate environment says Neil Brookes, partner and global head of capital markets for Knight Frank Asia Pacific.

"Revisions to the interest rate outlook due to delays in interest rate cuts and geopolitical uncertainty mean that overall investment volumes remain subdued.

"As inflation eases further and rate cuts eventually come into place towards the end of the year, pressure will be easing.

"Signs of a recovery and improvement in activity can already be observed with the seller-buyer price gap narrowing, and more investors striving to get deals done perceiving the current period to be the opportune time to hunt for under-valued assets."

Brookes states that according to privately held London-based investment data company Preqin Limited, family offices more than tripled between 2019 and 2023 from 1,285 to 4,592 with between half and three-quarters of these family offices globally having some exposure to alternative asset classes.

"While not insulated from recessionary drivers, the tumultuous macroeconomic environment has prompted these UHNWIs and family offices to review their investment strategies.

"In the face of higher cost of capital and differentiated returns from non-traditional asset classes, more are turning their attention towards real estate which offers the potential for higher non-correlated returns, diversification benefits and better inflation hedge through stable rental income and long-term capital appreciation.

"While UHNWIs are traditionally more interested in residential property investment, and *The Wealth Report* 2024 shows that 22 percent of wealthy individuals want to invest in residential property this year, interest in commercial property is actually not that far off, with 19 percent of the UHNWIs planning to invest in commercial real estate in 2024."

Brookes says much of the 45-percent decrease in overall global cross-border investment activity last year was the result of US investors stepping back from the international market, and this was acutely felt in the office sector, which saw a more than 80-percent decrease in US outbound flows.

"On a positive note, our Knight Frank *Capital Gravity Model* shows US investment beginning to flow back into the global market this year, albeit remaining around five percent below the long-term post-GFC average.

"So while we predict an uptick in investment from the US, we don't expect volumes to necessarily be back to 2022 levels – and the office sector will lag.

"Following a beds, sheds, eds and meds theme for the year ahead, we predict logistics and the living sectors to be the top two outbound sectors of interest by US investors, followed by retail, office and hotel."

Knight Frank forecasts that US-headquartered private equity will begin to re-engage in international markets, with half of this activity picked to target logistics, especially in the UK and key European locations, along with strong interest in the residential sectors in the UK, Spain, Germany, Japan, Australia, and Canada.

"Japan could see a record year for outbound investment with the majority of capital targeting the US (35 percent), the UK (26 percent) and Australia (19 percent), while forecasts for Singaporean outbound investment are also better than the long-term average," proffers Brookes.

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NEIL BROOKES
PARTNER AND GLOBAL HEAD OF CAPITAL MARKETS, KNIGHT FRANK ASIA PACIFIC

For the first time in four years, the living sectors now lead the global investor wish list (14 percent of respondents were interested in this asset class) with the strongest interest coming out of Europe, the Middle East, North America and Asia.

Healthcare is not far behind on 13 percent, however, Brookes cautions that intentions do not necessarily equate to transactions, due to factors including availability of stock, market size and competition.

In another twist of the tail, as credit conditions tighten, the range of distressed opportunities has also increased, with investors globally – including private capital – seeking greater exposure to these assets at reasonable valuations.

"With traditional banks maintaining a conservative lending stance, there are also increased opportunities for non-traditional debt and equity providers – including private capital – to gain traction tempered by attached risk and the need for specialised expertise to gain access to such opportunities."

When asked what New Zealand can offer to global active private capital, Brookes says net migration-driven higher population growth and a returning city centre workforce indicate that New Zealand is well positioned for increased investment.

"Repurposing office assets may be a feature of the New Zealand market, while a lack of quality institutional stock may be holding buyers back."