National industrial run-through

The industrial leasing sector around the country is flexing to meet changing occupier priorities and operating models.

The latest *New Zealand Industrial Market Update* from Bayleys Insights and Data team highlights some of the mega trends noted in the sector at the midpoint of 2024.

While overall the market remains relatively tight, industrial vacancy rates are edging up around the country. It's tricky to accurately gauge a true figure on the amount of square meterage available, as much of this vacancy has been created by off-market sub-lease opportunities and this space is not always captured by real-time data.

With occupiers continuing to right-size their property requirements in response to changing market conditions, sub-lease space is providing greater choice for occupiers and could potentially have a knock-on effect on rental growth which had been strong when vacancy was persistently tight.

There's also a growing trend for tenants to become owner-occupiers. To sidestep any uncertainty over tenure and rental increases, and with banks keen to finance well-performing businesses with healthy cash flow into their own property, the owner-occupier market is evolving and is changing the face of the sector.

Industrial-zoned land is still in short supply in most parts of the country, and with economic fundamentals yet to fully line up for the speculative development sector, there's limited new industrial stock coming to the leasing market.

Construction costs appear to be stabilising as supply chain issues are resolved and building subcontractors are actively seeking work so there are some early signs that the development market could rebound.

Rents are largely holding up for industrial space, and any increase should be at a more moderate pace, particularly as the impact of sub-lease opportunities takes effect in the market.

Bayleys head of insights, data and consulting Chris Farhi confirms that after several years of strong performance on the leasing side, there's evidence of some slowdown.

"From what we're observing in the market, now is the time for occupiers to get the best advice possible when making decisions.

"In particular, they should seek a very clear understanding of local market conditions before assuming that the 'same old situation' from last year still applies because there are shifts happening.

"Outside of that, our latest New Zealand industrial market update highlighted several regional areas with very low vacancy rates for industrial stock which may indicate opportunities for new development.

"Warehousing is tight in Whangārei, Rotorua, Gisborne, Whanganui, Greymouth, Nelson, Queenstown and Invercargill and this could result in occupiers seeking out opportunities for new premises."

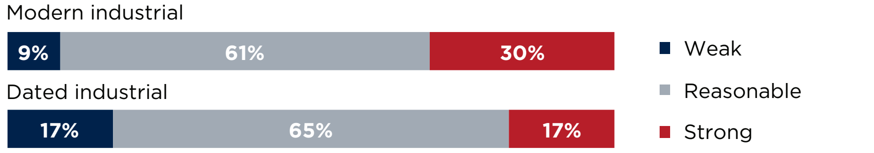
OCCUPIERS HAVE OPTIONS

Bayleys national director industrial and logistics, Scott Campbell says occupiers in the wider Auckland region have been making pragmatic and prudent decisions around space commitments, largely underpinned by changing consumer spending patterns.

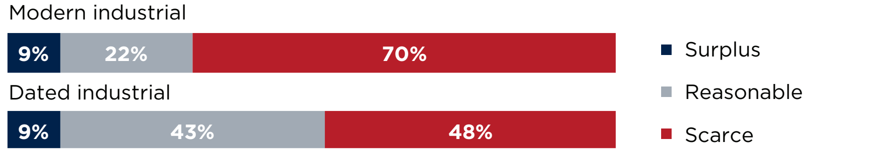
"Sentiment among industrial business owners is still pretty good however, and we're not seeing snap decision-making or obvious distress but there is some rejigging of space happening for operational and budgetary efficiencies.

"The cost-of-living crisis and the resulting drop in consumer spend across most market segments has contributed to the growing amount of sub-lease space available – something we haven't seen much of until now as pandemic-related drivers propped up demand for warehousing."

BROKER SENTIMENT: HOW IS OCCUPIER DEMAND FOR INDUSTRIAL WAREHOUSING?



HOW IS THE SUPPLY OF INDUSTRIAL WAREHOUSING FOR LEASE?



Source: Bayleys Insights & Data - Market sentiment based on a survey of Bayleys brokers across New Zealand.

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>
> **CHRIS FARHI**
> BAYLEYS HEAD OF INSIGHTS, DATA AND CONSULTING

Campbell says the rise of sub-lease space is giving occupiers far more choice than they have had in recent years.

"There's a reasonable amount of inventory available right now in the Auckland market, so occupiers wanting to relocate or right-size have options and some leverage over lease structures.

"This sub-lease space is also plugging a gap caused by a slowdown in speculative new development, with occupiers sometimes taking additional space in an alternative location to give them scale and flexibility."

There's strong demand for cold storage, cold chain logistics facilities and food-grade premises which are costly to build and fit out.

"We could expect to see existing warehousing properties retrofitted to create fit-for-purpose space for this growing market segment."

Rental rates appear to have largely plateaued in the Auckland market, but Campbell says they will find their new market level as 2024 progresses with some movement upwards still expected as rents come up for annual/lease renewal review.

DEALS TAKING LONGER

Demand might have softened, but industrial rents haven't yet been significantly impacted in the Wellington region, says Fraser Press, Bayleys Wellington commercial and industrial director.

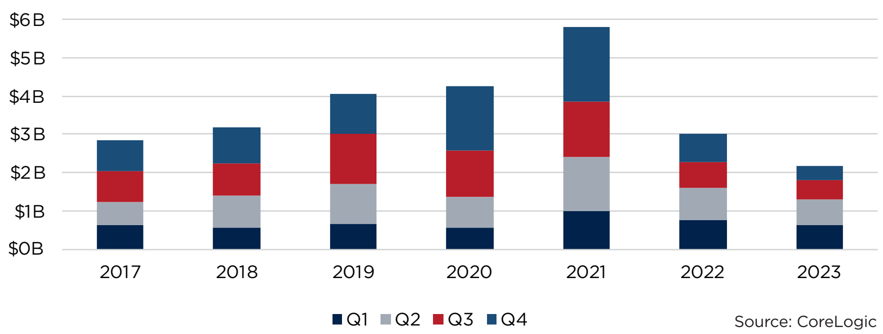
"Rents have plateaued as some of the heat has subsided in the market, but then we were coming off a really high base.

"Leasing enquiry has definitely been a lot softer and deals are taking longer to come together as both landlords and occupiers get their head around what the economy is doing."

Occupiers are weighing up the amount of space they need, and what their business can sustain. With businesses reining in costs and typically not being in growth mode, there's downsizing occurring.

"Sometimes, the costs and logistics of relocating don't always stack up, so to reduce rental outgoings, there's been some sub-lease space become available," says Press.

TOTAL INDUSTRIAL SALES OVER TIME



Source: CoreLogic

"But we're also seeing more standalone stock for lease in the market across the different size bands, with an oversupply of vacant micro-units, and multiple buildings with more than 1,000sqm of lettable space available – something we certainly didn't see 12 months ago.

"There is still reasonable activity in the under-$100k rent roll market with the roughly-700sqm segment of the market still performing well, and some well-capitalised smaller businesses are opting to ditch the landlord and become owner-occupiers."

The upside of a slower market is the choice and potential negotiating power that occupiers now have, says Press.

"The Wellington market has always been constrained geographically, with limited scope for new development and with the prime precincts having virtually nil vacancy.

"With a more subdued economy, landlords are starting to show greater motivation to fill buildings, with more incentives being offered and some readjusting of rents.

"Occupiers considering a move should take advantage of current conditions to explore the market with the Bayleys leasing team as we have plenty of intel around current vacancy and upcoming opportunities."

ROBUST CHRISTCHURCH MARKET

With exceptionally low vacancy levels, there's a very limited supply of quality industrial stock for lease in the Christchurch market according to Bayleys Canterbury associate director industrial and commercial, Sam Stone.

"Space has been snapped up and new construction has slowed which puts pressure on an already constrained market.

> "We have a shortage of industrial units between 200-500sqm and there is a willing occupier market holding out for these opportunities.
>
> **SAM STONE**
> BAYLEYS CANTERBURY
> ASSOCIATE DIRECTOR INDUSTRIAL AND COMMERCIAL

"There is land available for development, but increased land values, cost of consultants, reserve contributions, build costs and the still-elevated cost of debt is creating hesitancy from developers unless it's for a dedicated design-build with pre-commitments.

"Properties with 500-1,500sqm floor area are our bread and butter stock and the rate of uptake is high. Right now we have a shortage of industrial units between 200-500sqm and there is a willing occupier market holding out for these opportunities."

Properties with yard space are also in demand, and hotly-contested by occupiers that require yards for freight movements, storage and operational reasons.

At the other end of the market are the micro-units which have been sought-after by tradespeople and e-commerce retailers. The last two stages in the Factory Drive precinct in Rolleston have opened up with Stone saying take-up has slowed down somewhat from the frenzied activity seen in Stage 1, which was fully leased prior to completion.

There have been some significant tracts of land developed for industrial use, with lots in Stage 13 of Rolleston's 150ha master planned IPORT business park now for sale, and another 98ha of Rolleston land rezoned to Business 2A, which allows industrial development. Meanwhile, NZX-listed CDL Investments New Zealand Limited has purchased 10.08ha in Burnside to create multiple well-sized industrial lots.

"Ngāi Tahu has been acquiring land in Hornby and Rolleston and in some instances, undergoing private plan changes to facilitate industrial and commercial growth, but along with other owners of large land portfolios – like Christchurch Airport – they're looking closely at how they will develop in the future."

Stone says Christchurch's industrial market saw a lot of rental growth over a short period of time, but if demand softens then rents could start to flatten.

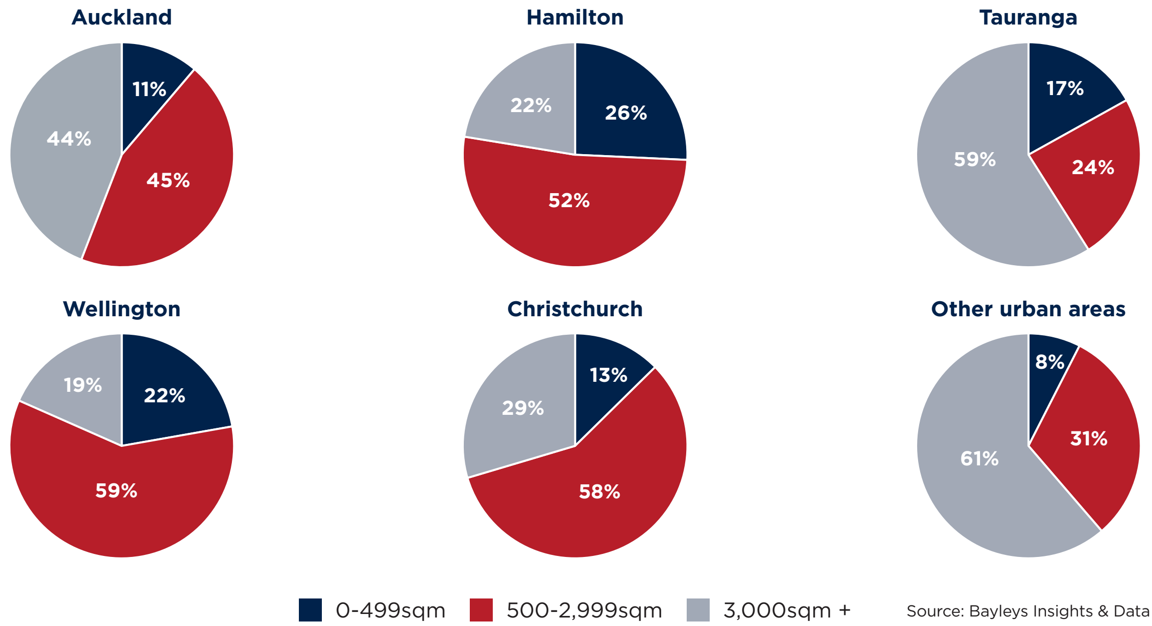
"We've seen more sub-lease opportunities in the last few months as occupiers rationalise underutilised or redundant space – but not just for purely financial reasons.

"Some are due to business acquisition, retiring business owners, a desire to be more efficient, or to be more socially responsible around carbon footprint."

Another trend in the wider Christchurch area is a more active owner-occupier market, with financiers looking favourably on businesses with strong and proven capital flows.

"On the other hand, some tenants are opting for sale-and-leaseback arrangements because while the location works well for them, they need to release capital to plough back into their business."

TOTAL VACANT FLOOR AREA BY VACANCY SIZE



Source: Bayleys Insights & Data