



Cautious optimism in response to changed market forces



Emergence of sub-lease or shadow space



Vacancy rises to 9.94%



Occupiers looking for strategic partners



Capital gains are decelerating

Shadow (sub-lease) space emerges

As office occupiers reassess their current and future space needs amid changing expectations around what workplace environments should look like and adjusted bottom-line budget realities, there's been some notable corresponding changes in office property market fundamentals around New Zealand.

Shadow space is being released to the market as occupiers become pragmatic about their space requirements and look to reduce their occupancy costs.

By on-leasing some of their office property footprint, the occupier can recover a portion of leasing outgoings without the inconvenience and associated costs of exiting a lease or relocating to smaller premises.

In the face of changing work models – largely-driven by improvements in technology and reflecting global best practice – large tracts of office space consolidated in one central location are increasingly being reviewed.

Some occupiers are adopting a core + flex model with a more-condensed centralised hub supplemented with satellite space elsewhere, while others are actively looking to sub-lease excess space to allow business continuity.

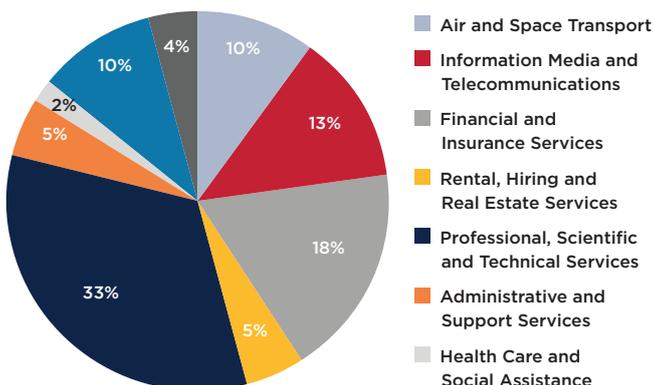
When combined with recently-completed office space and a relatively-large pipeline of supply soon to come to the market, this shadow space is putting downward pressure on rents.

The emergent sub-lease space in the Auckland CBD market is coming from various business sectors – particularly those that have been able to quickly and seamlessly switch to more-remote working models, or those that have faced significant restructuring and the subsequent reduced headcount.

Some large occupiers are taking a long-lens view on space requirements and are yet to decide whether to downscale on pre-COVID office space commitments, while many smaller occupiers are also tentatively riding the wave by embracing shorter-term solutions before making any hard-and-fast longer term commitments.

Also notable in this evolving shadow space narrative is more proactive communication between landlord and occupier as workable solutions are sought for all parties.

Known source of sub-lease space, by industry (Auckland CBD)



Source: Bayleys Research



Vacancy is on the rise

Vacancy rates (both direct and shadow space) in the Auckland CBD office market have increased in the fallout from COVID-19, and this is notable across all precincts according to the latest Bayleys Research vacancy survey conducted in December 2020.

Since the start of 2020, overall vacancy increased by 4.54% to 9.94%.

Vacancy has increased for various reasons – from increased office stock levels through the completion of new developments, occupiers going out of business, downsizing, or staff moving to remote or satellite working models.

The high levels of leasing activity that were evident at the start of 2020 softened as the year progressed, as businesses reassessed their space requirements and monitored their occupancy costs.

The increased vacancy in the Midtown precinct was due in part to the completion of a refurbishment project at 246 Queen Street which added circa-8,000sqm of A-grade office space to the office leasing market.

The Midtown precinct also saw large occupier DLA Piper vacate around 3,000sqm at 205 Queen Street with a move to the new PwC Tower at Commercial Bay.

The established education precinct along the Symonds Street Ridge has experienced a big increase in vacancy due to the sudden drop of international students as a result of New Zealand's closed border.

Vacancy along that Ridge rose from 5.28% to 17.57% but is expected to gradually rebound as international students return to these shores in-line with government directives around border management within this sector.

Secondary-quality stock will inevitably face a challenge over the coming months with downward pressure on rents expected as occupiers consider higher quality space with better amenities for staff, and businesses continue to evolve their operating models in response to a changed marketplace.

Vacant space in prime quality buildings should normalise over the course of 2021.

Precinct	Jan 2020	Dec 2020	Change
Anzac Avenue	3.42%	6.58%	↑
Britomart	1.61%	5.49%	↑
Downtown	7.61%	11.37%	↑
Midtown	9.09%	18.90%	↑
Peripheral and Upper Queen	5.31%	5.96%	↑
Quay Park	7.33%	15.64%	↑
Symond Street Ridge	5.28%	17.57%	↑
Viaduct Harbour	0.52%	4.04%	↑
Victoria Quarter	3.41%	4.06%	↑
Western Peripheral	5.18%	14.42%	↑
Wynyard Quarter	0.0%	1.13%	↑
TOTAL	5.40%	9.94%	↑

Source: Bayleys Research

Source: Bayleys Research



New phase for development activity

Vacancy levels reached historically-low levels in the five years pre-COVID-19, going as low as 4.92% in mid-2018.

In response, developers upped construction activity trying to meet demand and some of those developments have now come – or will soon be coming – to the market offering new office space.

Notable completions of 2020 include the iconic PwC Tower at Commercial Bay which added 39,000sqm of premium quality office space to the CBD inventory, and the recently-completed 15,000sqm One55 Fanshawe Street which comprises seven levels of prime office space.

Auckland CBD has also seen significant refurbishment of older office stock, with retrofitting to meet occupier expectations for collaborative spaces, breakout rooms, more natural light and end-of-trip facilities.

One current example is 8,500sqm at 131 Queen Street, which is being refurbished to mark co-working operator WeWork's entrance into the New Zealand market.

Some existing office stock has also been removed from the CBD office market – such as the recently-completed QT Hotel in the Viaduct Harbour, where circa 7,000sqm of office footprint has been absorbed into the accommodation sector.

Given the uncertainties of 2020, plans for the future supply pipeline of new office stock is understandably being revisited by development entities.

A new development at 1 Queen Street is currently being reviewed by Precinct Properties as they balance the office/hotel mix and further analyse fundamental demand drivers.

However, like other cities globally, there is expected to be continued demand for high-quality CBD office spaces that can offer large floor plates, abundant natural light, end-of-trip facilities and other sustainability benefits.

Development pipeline

Precinct	Development	Area (sqm)	Type	Stage	Estimated Completion	Developer
Downtown	Commercial Bay	39,000	New	Complete	Q2 2020	Precinct Properties
Midtown	246 Queen Street	6,000	Refurb.	Complete	Q4 2020	Wilshire Group
Wynyard Quarter	One55 Fanshawe Street	15,534	New	Complete	Q4 2020	Mansons TCLM
Wynyard Quarter	10 Madden Street	8,181	New	Under Construction	Q4 2020	Precinct Properties
Viaduct	136-142 Fanshawe Street	12,500 - 16,675	New	Under Construction	Q3 2021	Mansons TCLM
Downtown	131 Queen Street	8,462	Refurb.	Under Construction	Q4 2021	Krukziener Properties
Wynyard Quarter	Site 18, 164 Beaumont Street, Orams Marine	3,500	New	Planned	Q4 2022	Orams
Wynyard Quarter	Innovation Precinct	10,000* +	New	Mooted	2022+	Precinct Properties
Wynyard Quarter	124 Halsey Street	9,782	New	Planned	Q4 2023	Precinct Properties
Wynyard Quarter	117 Pakenham Street	8,730	New	Planned	Q4 2023	Precinct Properties
Victoria Quarter	35 Graham Street	15,000	Refurb.	Mooted	2024+	Augusta
Downtown	46 Albert Street	30,000	New	Mooted	n/a	Mansons TCLM
Downtown	28 Shortland Street	30,000*	New	Mooted	n/a	Heng Chuang Investment Group
Wynyard Quarter	VXV Wynyard - future projects	up to 30,000*	New	Mooted	n/a	Goodman/TRAMCO
Downtown	1 Queen Street	8,700	Refurb.	Planned	n/a	Precinct Properties

*Bayleys Research estimate

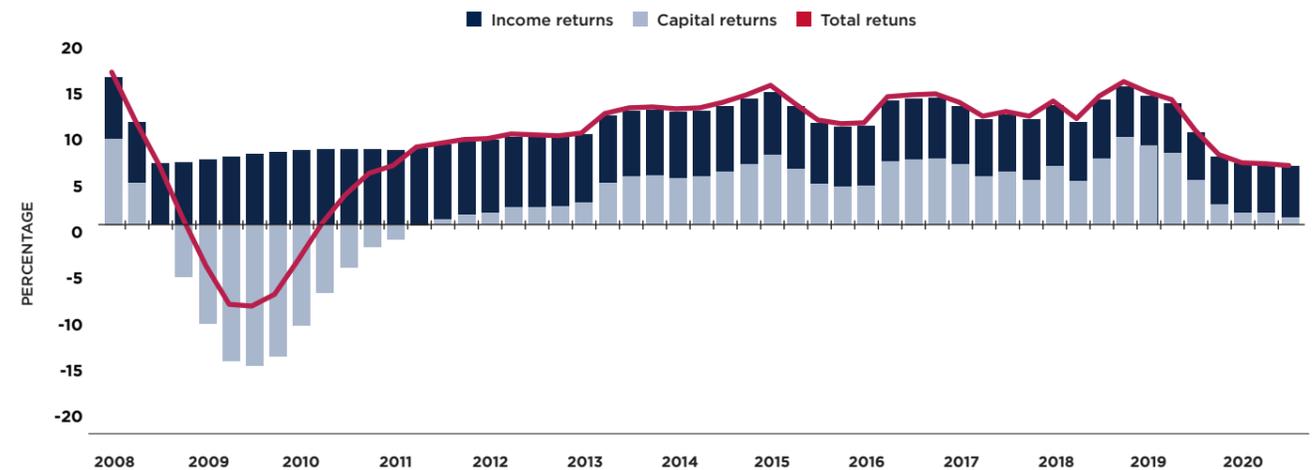
Source: Bayleys Research

Income returns sustain overall returns

- MSCI figures show a total return of 6.4% over the 12 months to September 2020.
- Income was sustained at 5.5% over the 12 months to September 2020 while capital gains have dropped off to 0.8% over the same period.
- 3-year and 5-year returns remain above 10%, making the office sector highly attractive for investors.
- There was significant yield compression for investment grade assets during Q4 across all geographies and sectors as the sheer quantum of capital made its way to commercial real estate. There is now circa \$19.4bn of term deposit outflows (RBNZ) which is seeking income on a risk/return adjusted basis.
- There was more certainty in the market for investors, with strong transactional activity across all tiers of value rapidly escalating through Q3 to Q4 2020.

- The lack of opportunistic buying has led to firming in core yields. The low yield environment looks set to continue into 2021.
- In absence of foreign investors due to border restrictions, there has been significant local demand from listed property trusts, syndicators, ultra-high-net-worth-individuals, and other trusts.
- Significant recovery in investor appetite for commercial real estate, led by industrial and logistics, large format retail and healthcare.
- The office sector is seeing cautious interest return, albeit capital mandates are still seeing how the occupier side will play out.
- Strong demand for alternatives such as healthcare and data centres; but a shortage of these assets.

Investment returns Auckland CBD office



Source: MSCI, Bayleys Research

Auckland CBD commercial office leasing trends 2H 2020

Precinct	Leasing market		Net rent (\$/sqm) low - high	Rental forecast 12 months	Outgoings (\$/sqm) low - high	Car parks \$pcpw
	Demand	Supply				
Viaduct Harbour*						
Prime quality	Steady	Shortage	300 - 600	→	110 - 300	100 - 130
Secondary quality	Steady	Shortage	200 - 300	→	95 - 250	
Upper Queen Street and Peripheral						
Prime quality	Weak	Sufficient	250 - 375	→	80 - 100	65 - 85
Secondary quality	Weak	Sufficient	180 - 250	↓	70 - 90	
Midtown						
Prime quality	Soft	Sufficient	300 - 450	↓	80 - 120	100 - 130
Secondary quality	Soft	Sufficient	180 - 250	↓	75 - 100	
Symonds Street Ridge						
Secondary quality	Soft	Sufficient	180 - 350	↓	75 - 85	
Downtown						
Premium quality	Steady	Shortage	500 - 900	→	140 - 180	120 - 170
A-Grade quality	Steady	Shortage	350 - 600	→	110 - 130	
Secondary quality	Steady	Shortage	250 - 350	↓	70 - 110	
Anzac Avenue						
Secondary quality	Weak	Shortage	170 - 350	→	65 - 100	55 - 100
Britomart						
Prime quality	Strong	Shortage	450 - 650	→	110 - 140	120 - 170
Secondary quality	Strong	Shortage	300 - 450	→	100 - 140	
Western CBD						
Prime quality	Steady	Sufficient	400 - 550	→	100 - 150	90 - 140
Secondary quality	Steady	Sufficient	250 - 350	→	80 - 110	
Quay Park						
Prime quality	Soft	Sufficient	300 - 500	→	100 - 150	70 - 100
Secondary quality	Soft	Sufficient	250 - 320	→	80 - 120	
Wynyard Quarter*						
Prime quality	Steady	Sufficient**	450 - 795	→	100 - 150	100 - 130
Secondary quality	Steady	Sufficient	300 - 450	→	90 - 150	
Victoria Quarter						
Prime quality	Steady	Sufficient	450 - 650	→	100 - 130	90 - 130
Secondary quality	Steady	Sufficient	300 - 425	→	80 - 100	

NB: Net face rental rates exclude GST and car parking costs. Outgoings inclusive of rates and ground rent where applicable.
 Prime quality = Premium and A-Grade accommodation. Secondary quality = B and C Grade accommodation,
 pcpw = per car per week. *net rental generally includes ground rent in this precinct, outgoings vary if ground rental not absorbed.
 All rates as at December 2020.

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