WEALTH AND INVESTING IN NEW ZEALAND

KNIGHT FRANK'S 2022 ISSUE OF *THE WEALTH REPORT* MARKS A VOLATILE POINT IN GLOBAL ECONOMIC HISTORY. HOW DOES NEW ZEALAND STACK UP AGAINST THE GLOBAL TRENDS?

WITH ECONOMIC VOLATILITY at its most intense in almost half a century, data, insights and advice will become crucial tools for investors wanting to seize commercial real estate opportunities at speed.

The 2022 issue of Knight Frank's *The Wealth Report* is one valuable resource when it comes to getting a global view of wealth creation, how that wealth is shaping investment markets and what opportunities and risks are at play.

This 16th edition of Knight Frank's flagship annual report released earlier this year, paints a dramatic picture of an extraordinary moment in economic history. Global easing of pandemic restrictions, combined with inflation and the increasing cost of debt, are creating opportunity and risk in equal measures.

What, then, are the key takeaways and trends for New Zealand?

THE SOURCE OF INVESTMENT

The Wealth Report clearly identifies private capital as the main - and growing - source of global real estate investment. 2021, was a record 12 months for private capital investment into commercial real estate with private investors spending close to US$405 billion; a 52-percent increase on 2020 and 38 percent above the pre-pandemic five-year average. This was well ahead of investment volumes from institutional investors which rose by 29 percent in 2021, just six percent ahead of pre-pandemic levels.

Knight Frank identifies an ultra-high-net-worth individual (UHNWI) as "someone with a net worth of US$30 million or more, including their primary residence."

Globally, private capital now accounts for 35 percent of all investment transactions. With 23 percent of UHNWIs planning to invest in property this year, the report tips office space to be the biggest target, with logistics moving to second place ahead of residential for the first time.

> **"NEW ZEALAND HAS SEPARATED ITSELF FROM THE REST OF THE WORLD IN ITS MONETARY POLICY, SPECIFICALLY THE OFFICIAL CASH RATE, AND WE'VE SEEN THE HIGHEST PERIOD OF INFLATION FOR MORE THAN 30 YEARS."**
>
> RYAN JOHNSON,
> BAYLEYS' NATIONAL DIRECTOR
> COMMERCIAL AND INDUSTRIAL

Bayleys' national director commercial and industrial Ryan Johnson says the same trend has been clearly visible in New Zealand, predominantly from domestic investors with some offshore.

"The last two years of border restrictions have seen private capital investment significantly outweigh any other buyer group in New Zealand."

Johnson adds that in those two years New Zealand has offered close to the highest total returns by MSCI on capital growth and income.

Private investors spent close to $1.4 billion on property in New Zealand in 2021, for transactions greater than 20 million, up 52 percent on 2020. The next largest source of investment here in 2021 was institutional investors which spent $1.04 billion, down 25 percent on 2020. Syndicators showed the second-largest growth in investment year on year between 2021 and 2020, up 17 percent to $664 million.

"What's changing is that New Zealand has separated itself from the rest of the world in its monetary policy, specifically the Official Cash Rate, and we've seen the highest period of inflation for more than 30 years," Johnson says. "Everybody is now looking at what that's going to do to yields, relative to the cost of debt."

While private investment will continue to be a major source of real estate investment into 2023, given real estate's defensive hedge against inflation, Johnson says other sources will start to make more of an impact.

"The trend is certainly going to be continued capital flowing into New Zealand commercial real estate, but probably for the first time, it's going to come from a lot of sources.

"It's going to come from offshore in a significant way, but it's also going to come from Kiwisaver providers. What we'll also see is less investment from syndicators, which have been one of the bigger investor types over the past 24 months."

When it comes to what those investors will be interested in spending their money on, Johnson expects the prime office sector to see renewed interest from offshore institutional investors, private investors will seek out non-discretionary assets, strong cash flow core-plus assets and hotels. Industrial will remain highly sought after across the board.

"The trend that is quite New Zealand-specific will be the ongoing interest in food-related supply chain properties with uses across warehousing and cold stores," Johnson says.

He also predicts investment in life sciences properties such as healthcare and retirement properties will be a notable trend over the next five years.

> **"IT'S THE HIGHEST LEVELS OF VOLATILITY WE'VE HAD IN 50 YEARS, AND IT COMES AFTER A DECADE OF REAL STABILITY AND FAVOURABLE CONDITIONS IN COMMERCIAL PROPERTY."**
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TRENDS TO WATCH

Outside of inflation, *The Wealth Report* identifies growth in cross-border (or offshore) investment, asset rotation and environmental concerns as some of the key investment drivers for the immediate future, and Johnson says the same trends are reflected in the New Zealand commercial property market.

The report found 80 percent of global investors want more ESG (environmental, social and governance) compliant assets to future-proof their portfolios, with a particular emphasis on the 'E'.

"There is an increasing interest from grassroots investors in knowing exactly what they are investing in in terms of environmental and sustainability credentials.

"Ratings like NABERS and Green Star are carrying more weight with investors, and some of the world's biggest global fund managers are mandating that investments be filtered for environmental and sustainability criteria," Johnson says.

With re-opened borders, offshore investment will have a renewed presence as investors look to rebalance portfolios and global companies press ahead with business plans after the pandemic disruption.

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Johnson says investment into New Zealand is likely to come from our traditional mainstays in mainland China, Hong Kong, Singapore, Germany and Australia.

When it comes to asset rotation, many corporates have seen sale and leaseback as an opportunity to leverage the fact that return on equity within the business has been more than 15 to 20-percent EBITDA and yields have been compressed to around five percent.

“The other trend is to restructure leases away from CPI as rates increase. Where previously rents may have gone up on a fixed basis of about 2.5 to three percent, they are now seeing it go up by 5.9 percent to 6.9 percent.”

RISK MANAGEMENT

“There are five factors influencing the New Zealand commercial real estate market where other markets are watching closely: Official Cash Rate rate increases, controlling inflation and the cost of debt, migration resets, digitisation and supply chain disruption. All of them will shape commercial real estate returns for 2022-23,” says Johnson.

Add to that other current global risk factors such as geo-political uncertainty, economic change and international monetary policies, and “I hate to use that word ‘unprecedented’ but it’s looking pretty accurate, right now,” he says.

“You could argue 2022 will experience the highest levels of volatility we’ve had in 50 years, and it comes after a decade of real stability and favourable conditions in commercial property.”

But, Johnson adds, ‘unprecedented’ need not be a bad thing. The key to success for investors of all types is being well-informed so they keep up with the record pace of change and they are able to seize opportunities.

“It will be increasingly important to keep up with the data and trends and lean on insights from companies like Bayleys to inform investment decisions and identify opportunities that arise.”

New Zealand UHNWIs

One of the notable figures in the Knight Frank Wealth report is the prediction that New Zealand will have the world’s highest growth in ultra-high-net-worth individuals (UHNWIs), over the 10 years to 2026.

The report puts the increase at a staggering 270 percent, a figure Johnson puts down to our proximity to Asia, which is becoming the world’s major economic power ahead of the US.

“New Zealand is benefitting from that. Not only because of the financial growth of that region which we are seen as being part of, but also because those ultra-high-net-worth individuals see New Zealand as a safe haven.”

Johnson says those UHNWIs will typically be interested in investing in cash flow businesses such as hotels, tourism businesses and the office sector, with a flow-on effect on luxury, coastal and lifestyle residential property.

By the numbers

Key figures from Knight Frank's 2022 issue of *The Wealth Report* impacting the global commercial property sector.

- 9.3% growth in the global number of UHNWIs 2020-21.
- 28.3% predicted further growth in global UHNWIs by 2026.
- 270% predicted proportional increase in New Zealand’s UHNWIs between 2016-2026; the highest of any country identified in the report.
- 33% predicted growth in UHNWIs in Asia and in Australasia 2021-26.
- 15% of UHNWIs plan to apply for a second passport or new citizenship.
- 6% of those are looking for a better quality of life.
- 52% increase in exposure to real estate investments by private investors in 2021; compared to 29% by institutional investors.
- 23% of global UHNWIs who plan to invest in property this year.
- 80% of investors want more ESG (environmental, social and governance) compliant assets to future-proof their portfolios.