TRANSITIONING TO A NEW GROOVE

SELLERS AND BUYERS ARE FACING OFF OVER VALUE PERCEPTIONS IN THE CHANGED COMMERCIAL AND INDUSTRIAL MARKETPLACE.

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AMERICAN ECONOMIST BENJAMIN Graham said, "the intelligent investor is a realist who sells to optimists and buys from pessimists" – which implies that everyone has a different take on what constitutes a "good opportunity".

As we observe the hands of the commercial and industrial property cycle clock moving in response to the higher cost of debt, recessionary talk, changing dynamics across asset classes and lingering uncertainties in COVID-19's wake, we are seeing real change in the market.

Deal volumes are down around 30 percent on this time last year and historically, a drop in the number of sales can be an early indicator of some stress in property markets as prices are usually somewhat slower to respond.

Some transactions are being done off-market, and the all-equity deals we've transacted on behalf of well-resourced entities are helping to keep average prices firm for now, but this is not a true reflection of the overall market.

The cycle started to change in mid-March and four months on, we're seeing volatility in the lending sector which is a clear sign that there's been some structural change.

Sellers, buyers, valuers and lenders are all waiting for the new market equilibrium around pricing fundamentals to be set, with an emerging disconnect between vendors and buyers over the perception of value.

Vendor expectations haven't moved much, but for purchasers requiring debt – and that's a large chunk of the pool – yield expectations have changed and risk is being priced in more significantly now.

We're witnessing a standoff as the new landscape hits home, with neither side wanting to forego any ground.

It all reminds me of 2007-2009 when New Zealand, like the rest of the world, faced the fallout of the U.S. housing bubble burst and the ensuing global financial crisis.

The big question today is how long the current transition cycle will last.

Long-hold owners of quality assets who have plenty of equity and good tenant covenants will generally be able to manage their way through any downturn, while many investors are sitting on large amounts of cash putting them in a strong position to acquire.

Deep-pocketed buyers, those with access to very cheap debt, and those with well-positioned balance sheets have the upper hand in the market.

Real estate has historically been a natural hedge to inflation, but there are always people who need to sell – in any cycle, at any given time – and for them, it's tricky to try and second guess the market.

Do you transact now or in six to nine months' time? All things being equal, the advice would seem to be – sell now.

When things get tough in the macroeconomic space, the bid-ask spread widens.

Banks have started to shrink liquidity, and the approach to risk is changing.

As the country's bellwether, the Auckland market was the first to see market changes but feedback from our team across both islands suggests the regions are following suit.

However, and there's some cautious optimism here – at the time of writing, international wholesale rates were dropping and in New Zealand, two-year swap rates have come back a bit from June's level.

Some of the main trading banks have revised their residential lend rates downwards and this is a good sign.

While we're still noting positives in the broader commercial sector – certainly for prime A-grade space – it's important to remember that each asset class is different and is responding in different ways to changing market conditions.

Industrial remains strong, the office sector is softening a bit, retail is a mixed bag but across classes, rental growth is the big thing to watch – particularly where rents are linked to CPI reviews.

Rental returns are expected to continue to improve over the next few years – albeit to different thresholds dependent on asset type.

In this edition of *Total Property*, we have 75 new commercial and industrial property opportunities for you to weigh up.

In our insights pieces we look at the capital crunch and how this is playing out in the property sector, discuss what impact inflation is having on commercial property projects at the feasibility stage, and consider the dynamics of ski resort towns when it comes to property expectations and investment.

Pessimist or optimist, it takes all types to keep property wheels turning so speak to us for a transparent take on the current market.