LOOKING FORWARD, LOOKING BACK

THERE HAVE BEEN COVID-19 HIGHS AND LOWS BUT BAYLEYS' EXPERTS ARE OPTIMISTIC NEXT YEAR WILL BE A GOOD ONE.

WHILE THIS HIGHLY UNUSUAL YEAR got off to a nervous start, strong deals across the commercial, industrial and retail sectors have taken Bayleys' experts somewhat by surprise, meanwhile COVID-19 has also exposed risk in some areas that were previously looked beyond.

With essential services booming, the company has achieved a fantastic $173 million of retail sales to a mix of New Zealand and overseas parties across large format retail and supermarkets sectors.

Syndication has also been a big winner, with $11 billion of withdrawn funds from the term deposit market now looking for a new home, however, COVID has disrupted total returns in the office and retail sectors which are likely to decrease next year for the first time in many years.

We spoke to Bayleys' business line leaders about how the year has gone and what lies ahead.

ON TRACK BUT WITH RISK

RYAN JOHNSON

National Director Commercial

The economic and property markets have recovered very well but I think equally they've heightened areas of risk that were probably masked over the last couple of years. Those risks are factored in by the spread between prime and secondary yields, which had previously got very close, although secondary yields have now really started to separate. Cap rates have started to soften in some sectors and we're seeing evidence of the return to a two-tiered market, whereby prime assets yields represent a stark contrast to secondary yields, where investors are now starting to price in risk whereas pre-COVID they weren't. That risk includes consideration to the type of occupiers, the quality of tenant covenants and location of assets, so while there's been a really strong recovery in a lot of sectors COVID has also exposed completely the uncertainty in some sectors such as office which have been impacted by new trends such as remote working.

COVID has also put a downward pressure on supply in some sectors with many speculative development projects now being placed on hold. Downward pressure on rents in most sectors has also been observed, together with increased rental incentives as landlords seek to preserve the 'face rents' that they are achieving. Those fundamentals have been exposed in the office sector, to the extent that for the first time in a number of years we expect to see decreasing total returns in 2021. Total returns across all

"TOTAL RETURNS HAVE BEEN STRONG FOR A LONG TIME BUT COVID HAS DISRUPTED ALL THAT."

RYAN JOHNSON
NATIONAL DIRECTOR COMMERCIAL

sectors have been strong for a long time but COVID has disrupted all that, with the exception of large format retail, which in 2021 I foresee a yield with a three percent in front of it being achieved.

On the upside, the $173 million in sales conducted by Bayleys is an endorsement of the resilience of the large format retail sector and supermarkets. That's been one of the highlights of 2020 and will continue to be in 2021. MaxCap's funding for Ramada Wellington, its first New Zealand loan, is also important given the four major Australian banks are reducing their exposure to commercial and business lending. MaxCap Group is one of Australasia's biggest non-bank lenders and Bayleys owns 25 percent of MaxCap NZ and Forsyth Barr owns 25 percent, so we have an equity stake in the sector and can assist clients with lending.

The other big story of 2020 has been the syndication market. As the return investors receive from term deposits rolls over from around 3.5 percent to 1.25 percent investors are now looking elsewhere for yield and income and in the last 10 months $11 billion of deposits have been withdrawn from the term deposit market which is now being put on call, before being invested into residential, syndication or equity dividend and shares.

THERE'S STILL PLENTY OF CONFIDENCE OUT THERE

STEPHEN RENDALL

National Director Real Estate Advisory

The highlight for me has been the opportunity to work alongside some of our fantastic internal teams – particularly capital markets (led by Ryan Johnson), South Auckland industrial (led by Scott Campbell), and our land development and residential projects teams (Suzie Wigglesworth and Gerald Rundle).

These three teams have been particularly active for a variety of reasons, including (in the immediate wake of COVID) because of a need to structurally re-position assets and portfolios (for example, through sale and leaseback transactions or through site consolidation exercises). More recently the industrial and residential investment and development markets have been booming, and there has been a real demand for expert deal and development advisory expertise to work alongside our real estate agency teams.

There has also been a noticeable demand for structured syndication investment product, both through traditional sources and through more informal clubbed investment schemes, where a handful of investors with equity partner together to take on an investment or development project. This is driven by non-existent returns on bank deposit – investors with cash are looking at increasingly more innovative ways to generate return on investment.

An initial consequence of the COVID-19 pandemic was a dramatic fall in investment and development activity and revenue, particularly in the hotel, tourism and hospitality sector, and in street level retail. There was a general nervousness and fear regarding economic prospects that completely undermined confidence – the sky was falling in, so you had this almost immediate cessation of activity, and a few panicked deals done. Since then, a number of sectors have experienced genuine hardship, but we've had a massive rebound in confidence, too, most noticeably in the residential markets where owner-occupiers, developers and investors are now all chasing product, and in the industrial sector which continues to move from strength to strength.

"THERE HAS BEEN A REAL DEMAND FOR EXPERT DEAL AND DEVELOPMENT ADVISORY EXPERTISE."

STEPHEN RENDALL NATIONAL DIRECTOR REAL ESTATE ADVISORY

Clearly, extraordinarily low interest rates and the Government's wage subsidy and other stimulus packages have had an impact, and there hasn't been anything like the widespread corporate hardship and distress that had been anticipated. At least not yet – and the Government can't keep spending money the way it has indefinitely. 2021 will be very interesting to watch unfold.

AMAZING RESILIENCE

LLOYD BUDD

Director Auckland Commercial and Industrial

To see the way our people and the whole industry have responded to two lockdowns in Auckland shows the resilience of the market. There have been fantastic stories of landlords and tenants working together to achieve joint outcomes and the industry has been well-prepared with the level of professionalism across it to deal with a surprise even such as this.

The market has demonstrated proof of tried and true property values. During the last few years the difference between an A Grade and B Grade property value was being blended, and I now think people are going back to what is proven over a long period of time to create real value and that is good covenants from tenants, long leases in place and well-located properties; that holy trinity of real estate.

An impact of COVID has been people adapting to technology faster than ever before, leading to better productivity and efficiency in the way we work. Looking ahead, the low interest rate environment will have a direct impact on yields and A Grade property prices will go up. I think the market will continue to show the same resilience it has so far and that will grow for quality product. I also think we are going to see some long-term change in property trends, such as perhaps more of a move to the fringes and with the need to be in the city impacted we may see more core and flex come into play.

"THE MARKET HAS DEMONSTRATED PROOF OF TRIED AND TRUE PROPERTY VALUES."

LLOYD BUDD
DIRECTOR AUCKLAND COMMERCIAL AND INDUSTRIAL

I would say the mood is one of cautious optimism. There's still money out there that needs a home and that's driving the activity. Hundreds of millions of dollars of offers are being put forward on A Grade campaigns. Syndication product has also had a comeback - Augusta took the Anglesea Medical Centre back to market and over $38m was subscribed in a matter of days. The message is a positive one – we're heading into a strong year.

INDUSTRIAL IS BOOMING

SCOTT CAMPBELL

National Director Industrial

From an extremely buoyant 2019, 2020 started in a positively strong territory. The lockdown from COVID provided a small speed bump which resumed strongly since level 2. We're still transacting high volumes of deals with the industrial asset class becoming more highly sought after. Investors are keen to get their hands on industrial product, be it large scale tenanted investment or vacant stock that owner-occupiers can take advantage of in the low interest rate environment. There's a wall of capital looking to be put into the industrial sector from both on and off-shore investors.

On the leasing front, vacancy levels have continued to decline which can be attributed to some retailers who have closed their retail shops and have opened up warehousing with everything going online. We're also seeing a rise in micro industrial with lots of activity in the 30sqm to 60sqm unit developments which are flying out the door for between $250,000 and $400,000. These small industrial lockups are like garages on steroids for small businesses, with a coffee grinder, mechanic or plumber, moving in.

This is a global shift, if you look at any trends from around the world, in terms of industrial warehousing and logistics space, every major city is going through an industrial boom.

"INVESTORS ARE KEEN TO GET THEIR HANDS ON INDUSTRIAL PRODUCT."

SCOTT CAMPBELL
NATIONAL DIRECTOR INDUSTRIAL

PEOPLE ARE TAKING CONTROL

JAYSON HAYDE

National Director Business Sales

Activity has remained high, which surprised me but equally on reflection going into the first lockdown we had a lot of good solid business opportunities on our books and a lot of enquiry as people looked to investigate what opportunities might be available to them with so much time on their hands. At the time I believe many in the market looking to buy a business thought there may be significant discounts available to them given the situation and the uncertainty. As we emerged from the initial lockdown we found this wasn't the case, many sectors remained strong, and bank term interest rates began to fall further. People had had time to consider all the variables and many made good decisions quickly securing great business opportunities, these businesses now thriving under new ownership.

Good examples of this were larger companies acquiring competitors or complementary businesses, enabling them to use their existing infrastructure and strengthen up their balance sheets with additional revenue streams to help more quickly with their recovery. We also spoke

"MY OVERALL VIEW IS THAT THE MARKET REMAINS STRONG FOR GOOD SOLID BUSINESSES."

JAYSON HAYDE
NATIONAL DIRECTOR BUSINESS SALES

to many individuals who became newly redundant who just wanted to secure their futures in very uncertain times.

International enquiry has also remained strong with expats returning to New Zealand. There have been leadership transition opportunities, these deals were mainly to expats who were highly skilled buying into companies enabling a structured transition over time with a business owner not quite ready to retire, but who could see the opportunity to release some cash from their businesses and at the same time bring in a breadth of experience from an overseas market. We concluded a few hospitality transactions where people just wanted a change of lifestyle, there were multiple deals on childcare centres, a packaging company, a very large business in the motor vehicle industry, and a fantastic result for our vendors at Bracu Estate.

Fast forward to our current portfolio of work, and you will find it includes activity in the Kiwifruit sector which is in significant growth mode, data security and technology, construction and infrastructure, food manufacturing, and franchising. We have some outstanding talent in our Business Sales Team and nationally we are continuing to grow this talent pool.

My overall view is that the market remains strong for good solid businesses, smart and savvy investors will do very well through this period and I think we're seeing decisions that may have been made in five years being pulled forward and being made now.

ROLLER COASTER RIDE IN RETAIL

CHRIS BEASLEIGH
National Director Retail

Retail has probably been through the biggest roller coaster but we are surprisingly still doing a lot of deals. We've worked out what retailers need in terms of COVID clauses and the like and who is doing well and who is still expanding. It's been an interesting year. Hardest hit were those in tourist-related markets but there has been a rebound with internal travel. Another area hit hard was the CBD with no tourists and a limited number of office workers back. A lot of the big corporates are now working on a different strategy with fewer people in the office and more flexi time with people working from home which has meant fewer people in the CBD but growth of suburban.

Supermarkets have done really well and we're seeing service retail rebound strongly, such as physios, beauty, barbers, hairdressers – all those things you can't buy on the internet. There's also a strong demand from a lot of the large format retailers looking at click and collect and dark stores, and the drive-through and fast foodies are doing well in this kind of market. I can't say next year is going to be great for some, but there are others who will come out of it really well.

"RETAIL HAS PROBABLY BEEN THROUGH THE BIGGEST ROLLER COASTER."

CHRIS BEASLEIGH
NATIONAL DIRECTOR RETAIL

"THE MARKET HAS REACTED POSITIVELY LOOKING TO SECURE BETTER RETURNS THAN WHAT'S AVAILABLE FROM BANKS."

WAYNE KEENE, NATIONAL DIRECTOR
HOTELS, TOURISM & LEISURE

A SECOND SUMMER FOR SOME

WAYNE KEENE
National Director Hotels, Tourism & Leisure

The year has been rocky for some and not so for others with a number of large hotels struggling but motels taking advantage of domestic tourism. There are a lot of non-accommodation tourism operators who have been affected in more international destinations like Queenstown, and the larger hotels - unless they are one of the 30 isolation hotels around the country – will be finding things pretty tough.

In the small to medium size properties two things have been happening. On one hand the Government has taken rooms out of available inventory for emergency housing and as a result of less rooms in the market, along with domestic being up, has seen properties trading really well compared to the same period last year.

Looking back now at our first level 4 lockdown, I really thought that we would be seeing less people in the market prepared to buy. As it happens, the market has reacted positively looking to secure better returns than what's available from banks.

Destinations like Taupo and the Bay of Islands who always have reasonable winter trading are enjoying increased revenue along with other hot spot holiday areas.