Cloudy with a chance of SUNSHINE

BAYLEYS COMMERCIAL BUSINESS LINE LEADERS SHARE THEIR THOUGHTS ON WHAT 2023 MAY OFFER INVESTORS, LANDLORDS AND OCCUPIERS.

Ryan Johnson
National Director, Commercial and Industrial

It's going to be a year of two halves. Most people are expecting a quiet, cautious first quarter of the calendar year as the cost-of-debt and inflation picture starts to become more clear.

The three 'R's with the biggest influence on the market in 2023 will be "re-valuation", "refinancing", and "recession". It is accepted by most that 2023 will be a recessionary year and once the evidence of that starts flowing in through February and March we'll start to see a dramatic shift in valuations and then refinancing.

Many vendors are committed to transacting and can't keep holding off on restructuring their balance sheets.

2022 saw the lowest number of sales since 1991, with wide bid-ask spreads behind a general reluctance to trade. In the second half of this year that will speed up as evidence of recession starts to appear and there is more certainty around both the cost of debt, inflation and pricing.

While caution is still the most prevalent mood in the market, as we get more certainty around pricing, there will be good opportunities for investors. There's still a lot of private equity out there with strong balance sheets looking for the right opportunity.

We'll also see businesses focusing on income with cap rates softening because they won't have that cap rate appreciation that we've seen over the last eight years.

Strong inflation costs and softening cap rates could also see a slowdown in development and a dip in supply.

The other global trend making itself felt here is the ongoing emergence of ESG-driven assets and policies. ESG is a significant, and growing focus, particularly for occupiers, but will be interesting to see how it is prioritised when margins are being squeezed in terms of profitability.

Chris Beasleigh
National Director Retail

With rising interest rates it is likely that many people will have less to spend in 2023, understandably directing income to mortgage repayments and other debt servicing. That, along with some expected uncertainty mid-year that always comes with a general election, means big-ticket purchases will likely be put on hold.

That could add strain for some retailers already struggling and will likely see an uptick in retail businesses going under.

Most businesses are expecting a tough ride through the first six to nine months of the year, with the hope of a bounce-back by the last quarter. That's driven by the hope that increased interest rates will be a short, sharp shock before they start coming back down again.

On the other side of the equation, the borders are open and visitors are coming in with money to spend. There's also some hope that re-opened borders might start to address the staffing shortages that have impacted businesses across the retail sector.

The numbers of potential workers coming in are still low and slow, but they are starting to arrive which may ease one challenge for retail businesses in 2023.

The other interesting point is that as shops come up for lease, they are being picked up by new tenants so while there is churn, that market is fairly stable.

Large-format retail has had a better time than other parts of the sector over the pandemic years. It should remain strong and resilient through 2023, with many of the main players looking to expand, if they're able to navigate construction costs, alongside inflating interest rates and shifting valuations.

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>
> CHRIS BEASLEIGH, NATIONAL DIRECTOR RETAIL

Wayne Keene
National Director Hotels, Tourism and Leisure (HTL)

With favourable exchange rates for many overseas tourists, and rising visitor numbers the HTL sector is looking at a steady 2023.

There will still be challenges, particularly in the first quarter, from rising interest rates. This will mean we are likely to see some businesses come to the market. Rising interest rates on maturing loans will have an effect on profits which ultimately carry through to return on investment. We will see some pressure on operators across the industry however, the Ministry of Social Development continues to prop up a good percentage of the motel sector and with fewer available rooms things should even out.

The good news is that in the event of a market correction, there will be strong interest in those sales as more people see the chance to buy a going-concern business and add value for future capital gain. We are seeing good listings come to market with reasonably strong enquiry, particularly if there is a freehold element. Looking ahead, we're optimistic about sales and believe the year will present more opportunities.

The other big challenge for the HTL sector remains the workforce shortage. We are seeing some large hotels having to operating at only 75-percent occupancy and unable to offer a full service due to a lack of cleaning and hospitality staff. Active measures to fill those jobs will have a very positive impact on the market.

Post-MIQ refurbishment has been on the agenda for many and is largely completed, with tourists flooding back. Hotels are enjoying higher rates as room inventories increase.

That's a harder equation for smaller operators, many of whom have survived the pandemic as emergency accommodation providers for the government. Refurbishment for these properties will be some years away or at least have to wait until operators revert to transient accommodation.

Despite the challenges the overall mood in HTL is positive, boosted by returning tourists and plenty of New Zealanders still travelling locally.

Scott Campbell
National Director Industrial and Logistics

As with most commercial sectors, the industrial investment market paused a little bit through 2022, but we expect it to find its level again within the next six months as the economic landscape becomes a bit more certain.

"WE EXPECT THE INDUSTRIAL INVESTMENT MARKET TO FIND ITS LEVEL AGAIN WITHIN THE NEXT SIX MONTHS AS THE ECONOMIC LANDSCAPE BECOMES A BIT MORE CERTAIN."

SCOTT CAMPBELL, NATIONAL DIRECTOR INDUSTRIAL AND LOGISTICS

The intense demand for logistics space that was a feature of pandemic supply management will again be sought after in 2023 as demand for goods and services remains strong. Goods that were stockpiled to deal with supply chain issues will start to be used and that should also free up warehouse space, but lack of speculative development means the low vacancy environment across New Zealand will continue.

When it comes to industrial new builds and development the big players will continue on with their building programmes, though we could see a bit of a slowdown there until yields and construction costs stabilise through the year. All of the new builds are coming through with carbon-neutral or Green Star ratings.

We are starting to see longer-term leases which is good news for investors, and, for occupiers, rent growth will likely continue but should be at a steadier rate, rather than the huge jumps we've seen over the past couple of years.

As recession hits businesses, it would also be wise for investors to keep an eye on their occupiers' balance sheets to be confident they have enough forward work and income to meet their rent.

Now that we are through the pandemic era we should see an increase in international investment. That's initially from the Australians and Singaporeans coming back into the market but softening yields should start to spark more activity.

Jayson Hayde
National Director Business Sales

Towards the end of 2022 we were seeing a real uptick in business sales.

That is typical when the property cycle starts to turn and those looking for a return choose the 20 percent typical from a business, rather than the seven percent that typically comes from a passive property investment.

With the Reserve Bank signalling there could be another 75 basis point increase early in 2023, confidence in unit-producing cash flow businesses should increase further, particularly in sectors where it's very difficult to replicate the business in areas like manufacturing, infrastructure, or construction.

The things that might hamper that confidence will be the availability of staff, which comes down to whether or not the government further loosens its policies on immigration, along with increased capital costs and supply chain constraints.

Upwards pressure on costs and the difficulty of importing goods will also remain challenging, but New Zealand businesses have clearly demonstrated their adaptability through COVID-19 and I think they will remain nimble in the post-pandemic environment.

Those pressures in some sectors will inevitably see some business owners forced to sell. Hospitality is one, for example, where businesses managed to get through lockdowns and government interventions but in doing so have exhausted their ability to leverage assets and equity.

However, while there will likely be a rise in people having to sell reluctantly, there are also organisations positioned to take advantage of that, particularly for businesses in great locations which adds an intrinsic value to the lease.

Buyers will also look for businesses in sectors that have had an uptick through COVID-19, such as essential services, and can demonstrate the ability to maintain those results in an ongoing, normal trading environment.

Some businesses did extremely well because they were able to keep operating and there was nowhere else for people to go. Buyers will want to see that it is sustainable in a post-pandemic market.

Business owners looking to sell must ensure they have good fundamentals and practices in place and that they're not reliant on things like Resurgence Support Payments (RSP) and Wage Subsidies to keep the doors open.

By working closely with their stakeholders and advisors to ensure the company balance sheet is in very good shape, they will not only be more appealing to buyers, but to financial organisations funding buyers with small business packages that are essentially residential mortgages wrapped up in different packaging.

Lloyd Budd
Executive Director Auckland Commercial and Industrial

When it comes to trend identification in commercial property, the phrase "flight to quality" is at risk of becoming as overused and meaningless as "unprecedented" became in the early days of the pandemic.

That said, the demand from corporates for premium quality spaces that will offer them not just a high-end finish, but with flexible use and lease options in good locations, will be a key feature of the commercial and industrial market in 2023.

"THE MARKET IS SHIFTING SLIGHTLY BACK IN FAVOUR OF OCCUPIERS, AFTER LEANING MORE TOWARD LANDLORDS DURING THE PEAK OF THE PANDEMIC."

LLOYD BUDD, EXECUTIVE DIRECTOR AUCKLAND COMMERCIAL AND INDUSTRIAL

What's changing is that the market is shifting slightly back in favour of occupiers, after leaning more toward landlords during the peak of the pandemic.

This dovetails nicely with what is expected to be the second big trend for 2023 - a massive flow of workers back to the office. There is already anecdotal evidence from overseas of workers heading back to their corporate offices. At Bayleys, we call it Thrive from Work (TFW).

One recent example came from a Western Australian energy company that had been operating with about 30 percent of its workforce on-site daily. When the company announced it would need to downsize due to economic pressures, office attendance immediately rose to over 80 percent.

Large employers in New Zealand are saying they want and need their teams back in the office in 2023 and, now pandemic restrictions and lockdowns appear to be a thing of the past, they are in a better position to entice staff back.

Premium building features, green credentials, office floor plans, and engagement programmes will be key to that but so will economic pressures which may lead to staff "right-sizing" in some organisations and a tightening of the job market in some sectors.

2023, let's Thrive From Work.

David Guy
National Director Building Consultancy

We're going to see property investors, owners and occupiers remain cautious going into 2023.

As the economic conditions change, we've been seeing a lot more tenants instruct us to complete premises condition reports, as they actively seek to reduce their end-of-lease liability and reduce any unwanted expenditure.

But we are also seeing the same instruction from landlords so they can ensure they are minimising unexpected make-good costs and are set up to quickly capitalise on market opportunities.

Hybrid working seems to be decreasing with more staff returning to the office, sometimes at their employers' request but also because the appetite for social engagement is returning. For that to continue successfully employers are moving toward higher quality office fit-outs that appeal to their team.

High net-worth investors from offshore and within New Zealand, will be set up to move quickly in acquiring assets when they see an opportunity, probably among high-leveraged assets. We expect to see a lot of technical due diligence work as they identify those opportunities.

There is an increased appetite for more sustainable buildings with low carbon emissions. As new builds come through, we expect to see increased use of alternative energy systems such as solar, as well as features like natural ventilation and grey-water recycling. These will be key requirements from investment funds who are likely to be far more selective during 2023.