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PROPERTY - *the facts*

Newsletter November 2011

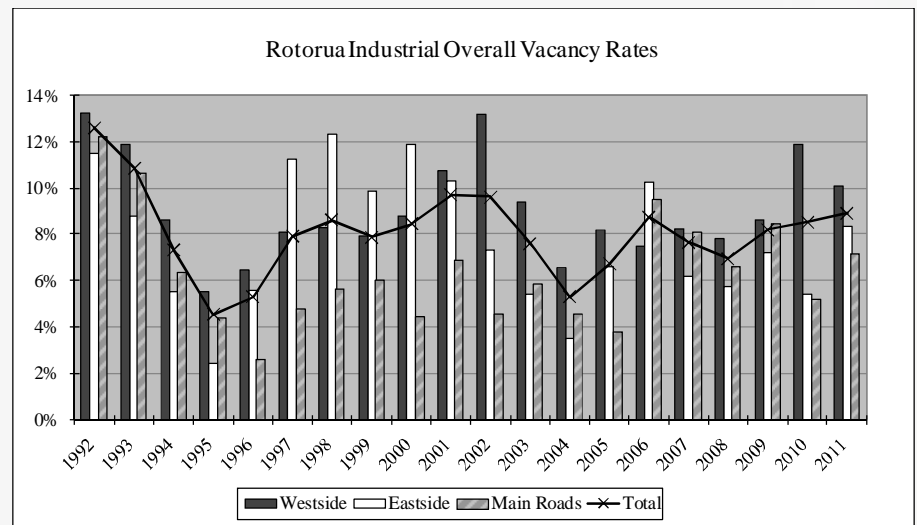
Rotorua Industrial Vacancy Survey 2011

In general, the industrial leasing market has eased again in 2011 with vacancy levels in Rotorua having increased for the third year in a row. We have seen a number of businesses downsizing into smaller buildings. Some businesses have relocated to less prominent locations on the Westside and away from more expensive positions on the Eastside and Main Roads.

The general lack of demand for industrial properties to lease has caused a drop in market rent levels, discounted rents to existing tenants and rent holidays for new tenants have continued.

Unless there is a change in demand, we expect vacancy rates will increase further at the next survey in 2012.

The locational trends can be seen on the graph.



Reid & Reynolds Limited carries out an annual survey of vacant industrial accommodation in Rotorua. The latest survey was completed in August 2011.



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Season's Greetings

Once again it has been a challenging year for most sectors of the economy and the property sector has been no different. The whole country was buoyed by the winning of the Rugby World Cup and the hosting of the international visitors to our country. Now is a time to reflect on the year and look forward positively to 2012. We would like to wish you, your families and your staff the very best wishes for the festive season and look forward to working with you in 2012.

Reid & Reynolds is about to announce some exciting changes for 2012 with alignment with the nationally recognised valuation group of Telfer Young. Full details will be released early in the New Year.

Watch this space.



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Rotorua Lakes Overview

The Lakes market is typically made up of non-local purchasers more often than not spending discretionary income in the purchase of a holiday home, and also local purchasers with the ability to service the costs involved with living outside of Rotorua (primarily being fuel). Since 2008 the global credit crisis and resulting international and domestic recession together with increases in fuel and other everyday commodities, and a tightening in bank lending policy has meant discretionary household spending has reduced markedly. As a flow on effect we have seen significantly lower numbers of sales than normal and falling value levels for lake properties. Having said this we still tend to see the odd sale which is in excess of our expectations of market value and this is the reality of this type of the 'top-end' market.

The non-lakefront properties tend to be the hardest hit in terms of value reductions with lake edge properties generally tending to hold their value slightly better. This year to date, at Okareka and Tarawera (which tend to be the most popular lakes), there have been 14 sales. Of these sales four have been lake edge

properties and one a larger lifestyle block. We have tried to analyse those recent sales which also sold in the 2007 period in order to show the percentage of price reduction over the period. Due to the low volume of data, there is no clear trend. However we estimate that values have fallen by at least 10%.

Given the uncertainty in the national and international economies at present, we believe investor confidence will remain low for some time yet. The financial spinoffs from the rebuilding of Christchurch after the earthquakes is likely to increase confidence in the next couple of years, at which time we should start to see market activity return to normal levels and values strengthen.



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Top End of Rotorua Residential Market

The top end of the residential property market is typically defined as properties over \$500,000 and includes properties on sections without lakefront influence within the sought after suburbs such as Matipo Heights, Tihi-O-Tonga, Springfield, Glenholme, Lynmore and Kawaha Point.

This is only a small portion of the market, with the number of sales over \$500,000 comprising approximately 3.3% of the total number of improved sales for the year to date.

Our records show there were 27 market sales over \$500,000 in 2010 while there have been 21 sales in this price range for 2011 to date, so activity is relatively static but definitely down on the more buoyant years of 2005-2007.

There are a fewer number of buyers who can afford to purchase in this price range. They tend to be a more discerning buyer. While there are some special

exceptions, the upper level for residential homes without lakefront influence appears to be around \$700,000 with only one market sale over \$700,000 recorded this year. By comparison, when I first started valuing in Rotorua some 11 years ago, this upper level was only \$500,000. Above this level the residential market actively competes with lifestyle properties and properties at the lake settlements.

The top end of the market has not been immune to the downturn in the property market which has occurred over the past three to four years. It has experienced the same trends as the rest of the residential market, with low sales volumes and values below those recorded through 2005-2007.

Until some certainty returns to the market place we expect that this market will continue to remain relatively quiet at least into early 2012.



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Forestry Market Overview

Over the first decade of the millennium, limited transactions and declining tree plantings were the principle signs of a difficult period for New Zealand forestry. Log prices, both domestically and for export, experienced fluctuation with a downwards trend. At the same time, harvest and transport costs escalated. As a result, forestry returns have generally been in decline. The decline in forestry land area reflects harvest output over the decade, being relatively constant around 20 million m³ however new plantings have consistently declined, from around 30,000 hectares in 2000 to less than 4,000 hectares in 2007.

In the last 18 to 24 months there has been a noticeable shift in the status of forestry in New Zealand. Two significant factors have created some stimulus to the sector.

Firstly, on 1 January 2008 forestry entered the Emissions Trading Scheme (ETS). Foresters are now able to participate in carbon farming on post 1989 land. That is, carbon units are earned as a forest grows.

These carbon units are tradable. Forest investors have realised that the Emissions Trading Scheme (ETS) provides further options to the growing of trees other than timber production.

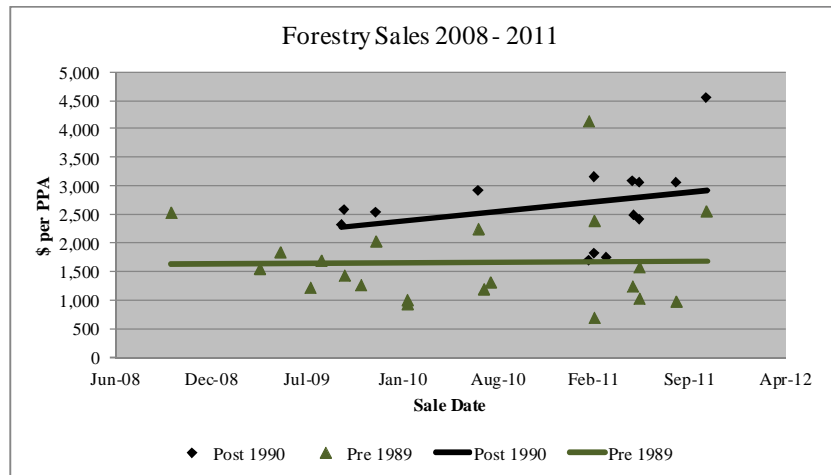
Investors appear attracted to the lower risk profile which post 1989 forest land offers over and above pre-1990 forest land (land planted prior to 31 December 1989 and not deforested prior to 1 January 2008).

Post 1989 forest land creates several management options:

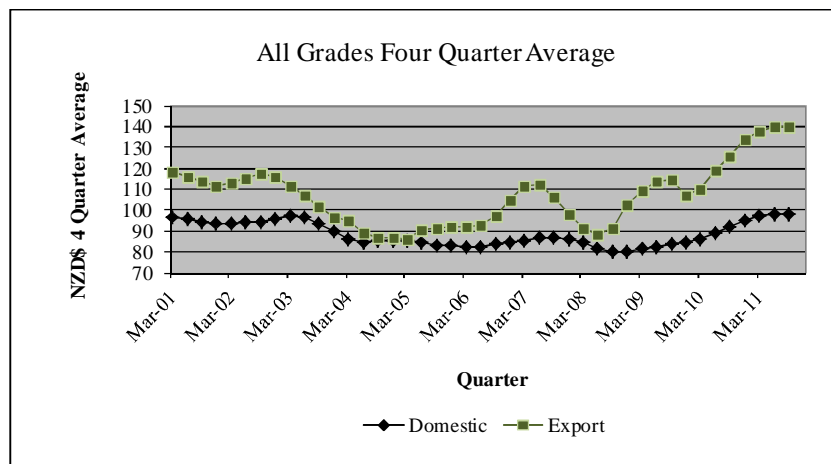
1. Timber production
2. Carbon farming (trading in carbon units – NZUs)
3. Alternative land use options (pre-1990 land has deforestation liabilities restricting alternative land use potential)

Over the past three years the majority of forestry land transactions have been for post 1989 land. The graph below plots analysed forestry land sales over this period. It is noticeable that there is an increasing divergence in forest land values.

The evidence indicates a \$1,000-\$1,500 per hectare differential between pre-1990 and post 1989 forest land.



Secondly, the industry has experienced a log price spike. Through 2010 log prices rose considerably, largely underpinned by Chinese demand plus demand from India and other Asian countries. These economies do not yet appear to be impacted by the global financial crisis. China accounts for 59.6% of total log export volumes (June 2011 quarter - source MAF). Export log prices in 2010 were an average of 25% higher than in 2009.



The prognosis of continued economic growth in Asia and India together with New Zealand's commitment to the ETS are viewed as positives for the short and medium term future of New Zealand forestry.



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Insurance in the Commercial Property Market

In the wake of the tragic Christchurch earthquakes, over the past 12 months, there have been a number of questions posed as to what impact they will have on the commercial property market.

While the market is still dealing with the Christchurch earthquakes, key factors already apparent are:

- increased insurance costs and the uncertainty as to whether this can be passed on to tenants
- the age of the building and date of construction/completion is now critical for insurers - buildings built pre-1935 could well be difficult to insure without earthquake strengthening and premiums are likely to be higher for buildings built pre-1935 and those built between 1935 and 1976, which was prior to the new building codes
- seismic upgrading needs to be clearly identified and this will have an impact on the level of cover and premiums paid
- inflationary and demolition provisions may need to be higher due to unforeseen widespread catastrophic events such as the Christchurch earthquake.

More changes are expected as the Christchurch claims are worked through and the new valuation standards recently issued are adopted.

In the aftermath of Christchurch, local authorities are being directed to revisit their earthquake prone building policies. At present a number of local authorities, including the Rotorua District Council, have not completed a full audit and review of buildings and have preferred to review earthquake proofing on the application for a change of use or a building consent.

A district wide review of all buildings will identify those buildings requiring upgrading. This data will be held on the public record. Once this is determined it is highly likely to have a major impact on the leasing potential and resale potential. At present, evidence from other regional centres where the district wide review has taken place suggests a heightened awareness of these factors. The potential costs of upgrades and risk of changing policies are both factors that are starting to be allowed for by lessees and purchasers.

In summary, this is highly likely to place potential downward pressure on rentals and value levels. Alternatively this could also offer redevelopment opportunities and excellent opportunities for knowledgeable investors.



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Keeping in Touch ... “Dear Valued Tenant ...”

The best thing you can do to preserve the value of your tenanted commercial property is know and understand your tenants. If you are in regular contact with your tenants and develop a working relationship with them, the changes that occur to their business may present some opportunities to you. To illustrate, they may need a refurbishment due to increases or decreases in staff numbers, and this may be something you could assist in funding in exchange for an increase in rental. Arrangements such as these are good options in times of low market rental growth and often occur outside of the usual cycle of reviews and renewals or can be incorporated into these processes.

There are other benefits to keeping communication open with your tenant. Once you are nearing renewal, you may find the communication is more restricted and akin to a poker game. However if you have

already had a conversation with them about the pros and cons of your building to their business, it will make the negotiation at this time easier for you as you will already understand these essentials. And of course Christmas is the perfect time to ensure they know you appreciate them as tenants and don't take them for granted.

Feel free to contact the team at Property Strategies if you need any assistance in how to approach any lease dates and processes, we will be happy to help.




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