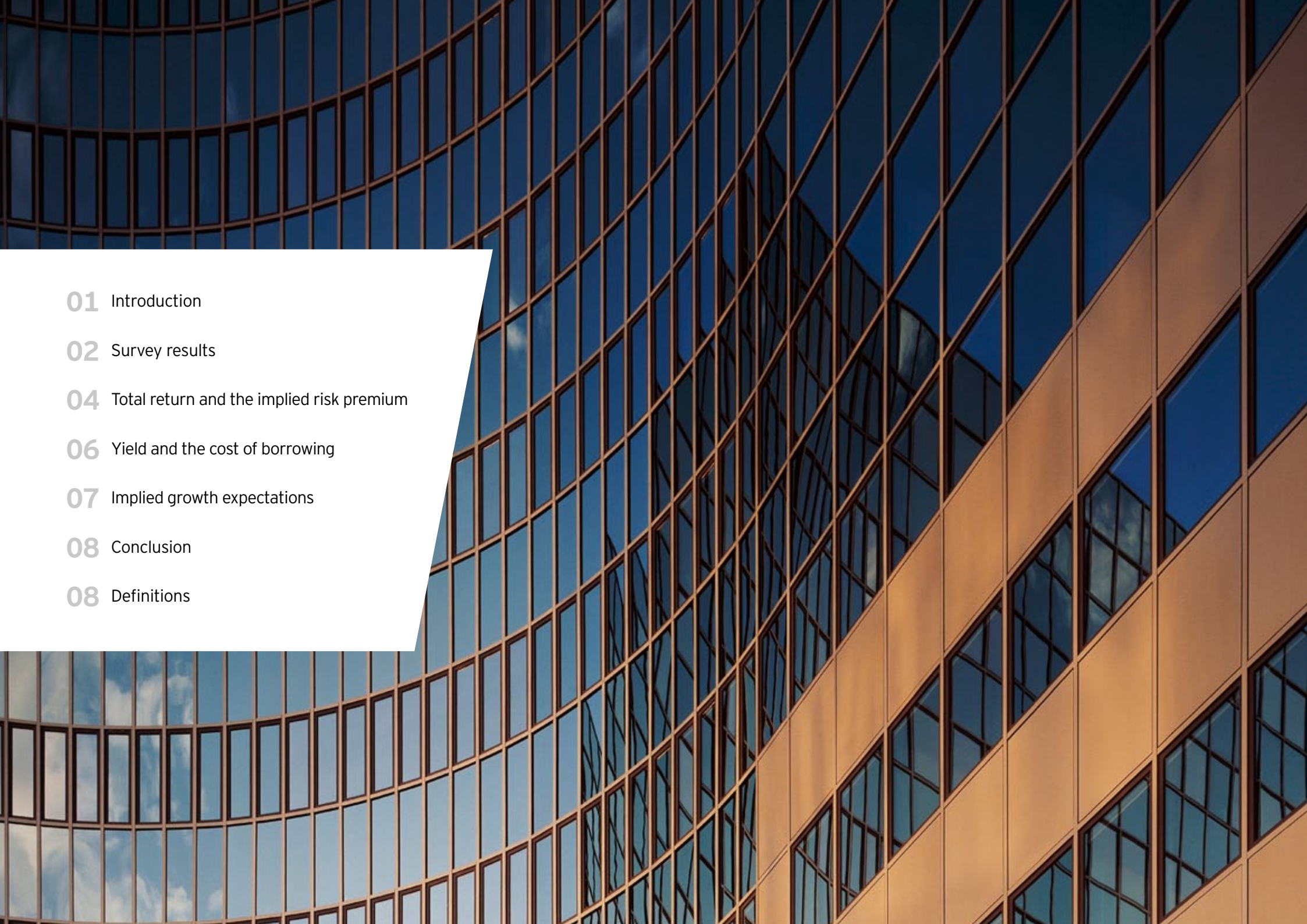




Real Estate Investor Survey

Investor return expectations
New Zealand – March 2010

 **ERNST & YOUNG**
Quality In Everything We Do



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Introduction

The New Zealand economy appears to be performing relatively well. The recent decline in unemployment (from 7.1% to 6.0%) certainly stunned economists. Australia has also recovered strongly on the back of its resource exports. However, non residential building consents remain circa 20% down on levels a year earlier and investors are conscious of the tax changes announced in this year's Budget. Over this period global share markets have also taken a hammering amid concerns about the Greek debt situation.

Market uncertainty seems to continue to be the only certainty. This survey is a forward looking measure that provides insight into market participant expectations. Where economic data fails to provide any clarity, we think it is worthwhile getting it from the horse's mouth.

Ernst & Young's real estate investor survey asks key investors within New Zealand's commercial real estate markets to indicate their current return expectations for New Zealand's major office, industrial and retail markets. Specifically, respondents were asked to indicate their initial yield and their total return (internal rate of return (IRR)) expectation. This was to be given as a point estimate for sectors in which they held investments or planned to invest over the next year.

The following investment characteristics were to be assumed by respondents:

- Rents at or near market levels
- Vacancies minimal
- Lease length medium to long-term
- Anticipated capital expenditure minimal over the short- to medium-term

The survey was completed by 28 prominent investors, including some of the foremost institutional investors within the New Zealand market. Combined, the respondents hold a substantial proportion of New Zealand's property stock.

Survey results



The table opposite provides a summary of the survey results across the three geographic regions on which investors were asked to comment.

Overall, the survey results suggest limited movement in yield expectations but a reduction in total return expectations (circa 0.5% to 1.0%) over the last six months, reflecting or implying lower growth expectations in the medium-term.

		Yield expectation					Total return expectation					
		Median Mar10	Mean Mar10	Low Mar10	High Mar10	SD Mar10	Median Mar10	Mean Mar10	Low Mar10	High Mar10	Range Sept 10	SD Mar10
Auckland office	CBD Prime	7.75%	7.79%	6.75%	9.00%	0.54%	9.50%	9.57%	8.50%	10.50%	2.00%	0.54%
	CBD Secondary	8.50%	8.68%	7.25%	11.00%	0.84%	10.25%	10.38%	9.50%	11.50%	2.00%	0.65%
	Suburban	9.00%	9.22%	8.00%	11.00%	0.86%	11.00%	10.98%	9.50%	12.75%	3.25%	0.96%
Wellington office	CBD Prime	8.00%	7.98%	7.00%	8.50%	0.42%	10.00%	9.83%	8.50%	10.75%	2.25%	0.57%
	CBD Secondary	8.75%	8.78%	7.75%	10.00%	0.61%	10.75%	10.69%	9.75%	12.00%	2.25%	0.76%
	Suburban	9.50%	9.63%	8.00%	11.00%	0.81%	11.50%	11.44%	10.25%	12.75%	2.50%	0.81%
Christchurch office	CBD Prime	8.50%	8.51%	7.25%	10.00%	0.73%	10.25%	10.17%	9.25%	11.00%	1.75%	0.48%
	CBD Secondary	9.50%	9.51%	8.00%	11.00%	0.87%	11.25%	11.19%	9.75%	12.50%	2.75%	0.90%
Auckland industrial	CBD Prime	8.25%	8.38%	7.50%	11.00%	0.66%	10.38%	10.36%	9.00%	12.50%	3.50%	0.85%
	CBD Secondary	9.50%	9.54%	8.75%	11.00%	0.59%	11.50%	11.41%	9.75%	12.75%	3.00%	0.81%
Wellington industrial	CBD Prime	8.88%	8.64%	7.50%	9.50%	0.58%	10.25%	10.42%	9.75%	11.50%	1.75%	0.59%
	CBD Secondary	9.88%	9.85%	8.75%	11.00%	0.62%	11.50%	11.60%	10.25%	12.50%	2.25%	0.76%
Christchurch industrial	CBD Prime	9.00%	8.88%	8.00%	10.00%	0.48%	10.75%	10.62%	9.75%	12.00%	2.25%	0.63%
	CBD Secondary	10.00%	9.98%	8.50%	11.00%	0.75%	12.00%	11.65%	10.25%	12.75%	2.50%	0.83%
Retail	Regional	7.50%	7.51%	6.50%	8.00%	0.48%	9.75%	9.79%	8.50%	11.75%	3.25%	0.78%
	District	8.75%	8.76%	7.50%	10.25%	0.69%	11.00%	11.08%	10.00%	13.00%	3.00%	1.00%

SD: Standard deviation

Source: Ernst & Young Real Estate Investor Survey - March 2010

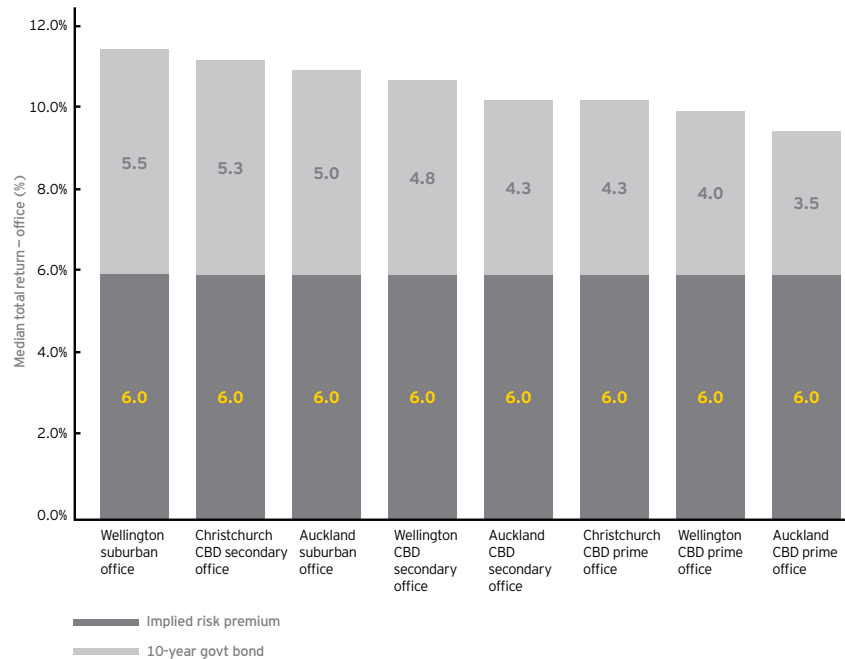
Total return and the implied risk premium

The three charts below present the mean total return expected for each asset class and the risk premium property investors are therefore seeking over the current 10-year bond rate (which at the time of the survey was in the order of 6.00%).

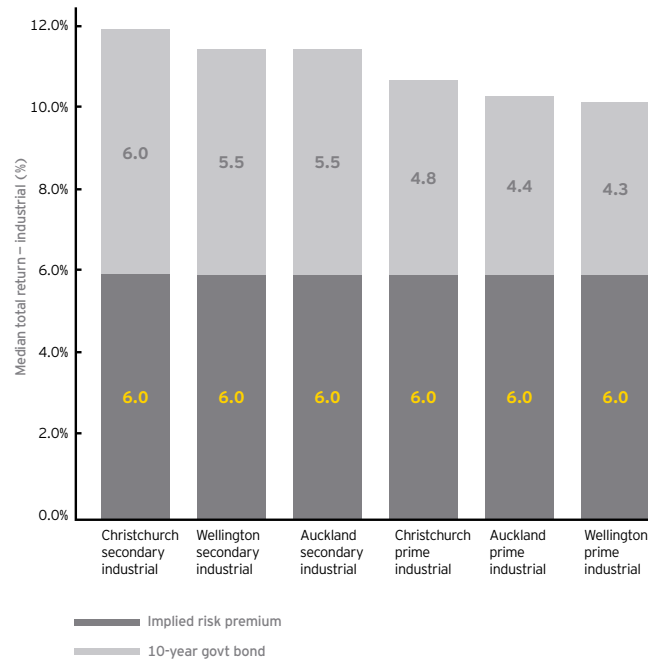
The 10-year bond rate has traditionally been used as a benchmark for commercial property, because it can be considered a proxy for the risk free asset and has an investment duration similar to that of institutional grade real estate.

The survey results suggest that investors require a risk premium of between 3.50% and 6.00% in the current market environment, down from 4.60% to 6.60% in September 2009 and 5.75% to 7.90% in March 2009. To the extent that property investors do benchmark their return expectations against long-term bond rates, this may suggest continued reduction in market volatility.

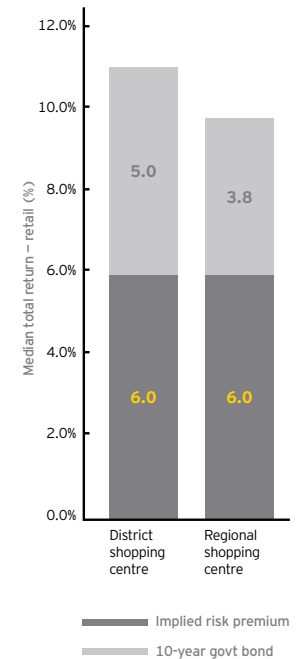
Total return expectations – office property




Total return expectations – industrial



Total return expectations – retail



Source: Ernst & Young Real Estate Investor Survey - March 2010

A low-angle, upward-looking photograph of several modern skyscrapers. The buildings are made of glass and steel, with their facades reflecting the sky. The perspective creates a sense of height and scale. The sky is a clear, pale blue. A white text box is overlaid on the right side of the image.

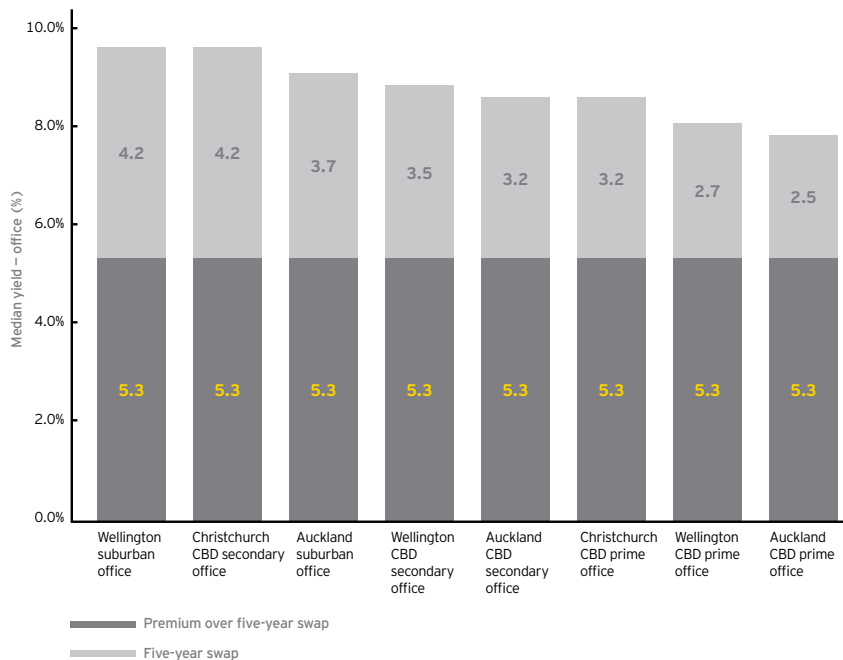
The survey indicates that investors' required risk premium has reduced since September 2009, representing a further reduction from March 2009

Yield and the cost of borrowing

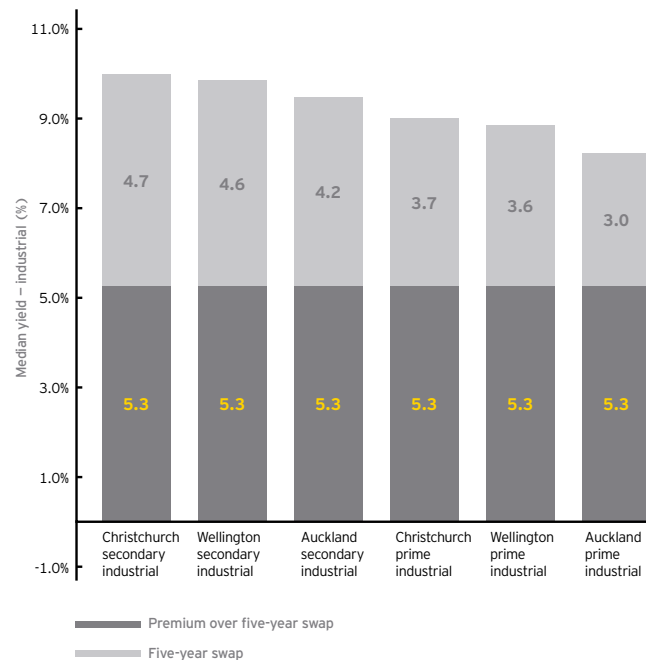
The following three charts present the median yield expectation for each asset class and the premium this represents over the five-year swap rate (which at the time of the survey was in the order of 5.3% down from 5.5% in September 2009). Against this, credit spreads have declined slightly. Overall, the margin over borrowing costs is expected to remain relatively static. However, interest rates increased post the recent announcement of a large reduction in unemployment (post collection of the survey results).

The expected margin over borrowing costs has remained relatively static since September 2009

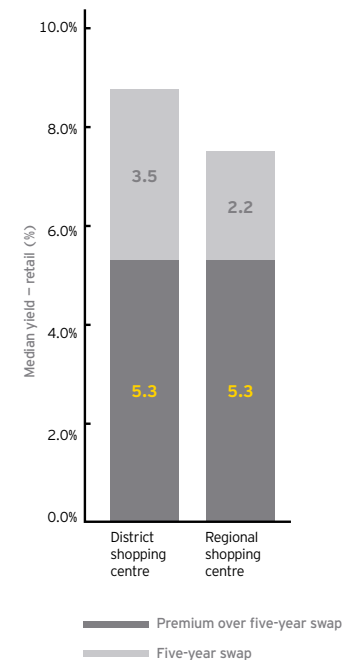
Yield expectations – office property



Yield expectations – industrial



Yield expectations – retail



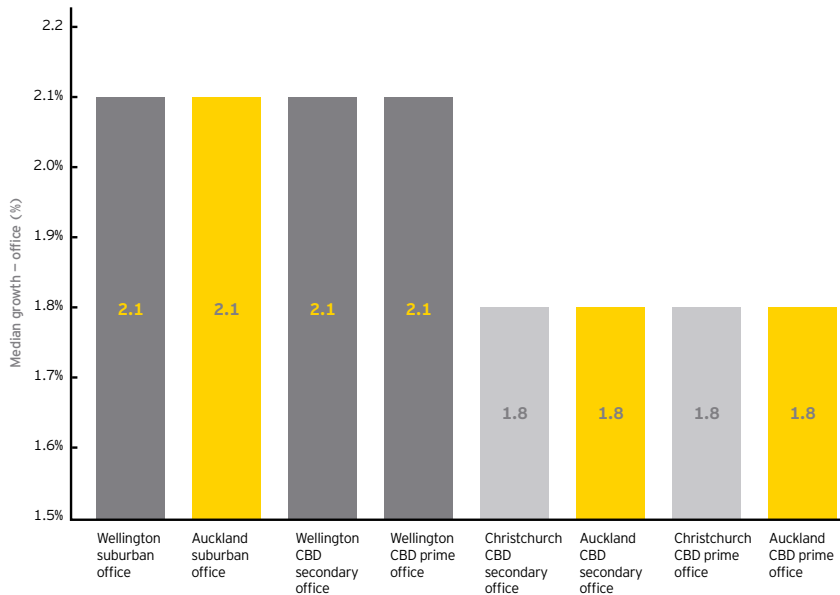
Source: Ernst & Young Real Estate Investor Survey - March 2010

Implied growth expectations

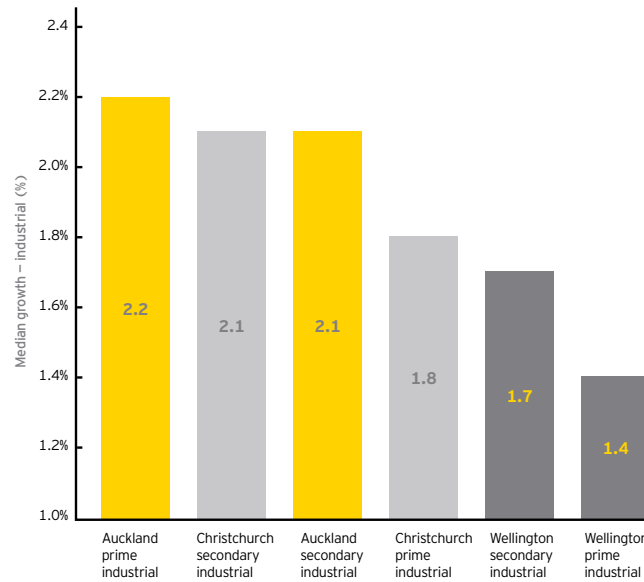
The Gordon Periodic Growth Model¹ has been used to establish the implied growth expectations of investors. This involves the comparison of their total required return (IRR) and yield expectations. The consensus of the survey respondents appears to be that growth will likely be in the order of 1.4% to 2.3% per annum in the short-to medium-term. This is a significant reduction from what was expected six months ago where growth ranged between 2.1% and 3.1%. In our view this is likely to reflect the declining occupancy market, with increasing vacancies and declining rentals, particularly in the office sector.

Investors' growth expectations have declined, likely reflecting the declining occupancy market

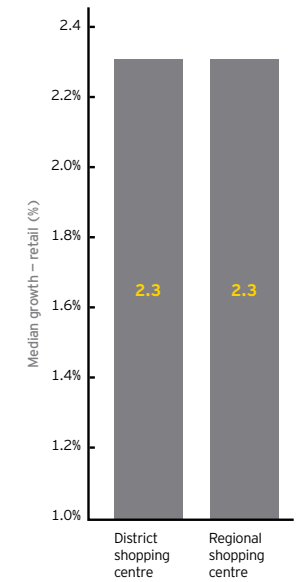
Growth expectations – office property



Growth expectations – industrial



Growth expectations – retail



Source: Ernst & Young Real Estate Investor Survey - March 2010

¹M. J. Gordon, "Dividends, Earnings, and Stock Prices," The Review of Economics and Statistics, Vol. 41, No. 2, Part 1 (May, 1959), pp. 99-105, The MIT Press

Conclusion

- Generally, yield expectations across all sectors have remained steady over the past six months, as have interest rates, implying that risk as perceived by investors has not changed materially.
- Total return expectations have reduced, suggesting reduced volatility. Coupled with stable yields, this implies lower growth expectations in the short-to medium-term. In our view, this likely reflects deterioration in occupancy and rental growth expectations.
- The survey data did exhibit greater volatility with respect to parts of the Auckland (CBD and suburban) and Christchurch (Prime and secondary) office markets, which may suggest investors are most uncertain in these sub-markets.

Definitions

Required initial yield

If rents are at or near market levels, if vacancies are minimal, lease length medium-to long-term and anticipated Capex minimal over the short-medium term, what would your required yield be?

Total return

If rents are at or near market levels, if vacancies are minimal, lease length medium-to long-term and anticipated Capex minimal over the short-medium term, what (annualised) return would you require over a ten-year holding period? Total return is also commonly referred to as internal rate of return, or IRR.

Auckland office

1. CBD prime: (examples: Vero Centre, PwC Centre, Deloitte Tower, Lumley Centre, 21 Queen Street)

2. CBD secondary: (examples: HSBC Tower, AXA Centre, IAG Building, Forsyth Barr Tower)

3. Suburban: (examples: Takapuna, Newmarket, Parnell, Newton, Greenland etc B/C grade office buildings <10 years old, >2,500sqm)

Wellington office

CBD prime: (examples: Mobil on the Park, Majestic Centre, Bowen House, Trustbank Centre, Lambton Tower)

CBD secondary: (examples: Open Networks House, Sun Micro Systems House, NCR House)

Suburban: (examples: Lower Hutt and Porirua. B/C grade office buildings <10 years old, >2,500 sqm)

Christchurch office

CBD prime: (examples: Forsyth Barr Building, PwC, Clarendon Tower and Cardinal Building)

CBD secondary: (examples: Anthony Harper Building, HSBC House, Langwood House, Landsborough House, BNZ House)



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SCORE Retrieval no. NZ00000209

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