

INVESTMENT MARKET IN NEW ZEALAND

The Reserve Bank of New Zealand (RBNZ) held the official cash rate (OCR) at 2.5% at their April 2010 monetary policy review. The RBNZ continues to support the expanding but fragile New Zealand economy, following a series of large reductions throughout 2008 and 2009, equating to an overall reduction of 5.75 percentage points.

Reserve Bank Governor Alan Bollard said "The New Zealand economy is recovering broadly as expected and growth is predicted to pick up further through 2010.

"Trading partner activity has recovered more quickly than we expected. Growth in Asia has been particularly strong. Consistent with this, export commodity prices have increased close to their 2008 peak. At the same time, risks to the global outlook remain elevated.

"Notwithstanding the impact of stronger than expected export earnings, New Zealand households remain cautious, with the housing market and household credit growth subdued. Similarly, business spending is weak and firms continue to reduce debt.

"On balance, we continue to expect the New Zealand economy to recover in line with or slightly faster than our March Statement projection. Annual CPI inflation, which has been close to 2 percent for the past year, is expected to track within the target range over the medium term.

"As previously indicated, we expect to begin removing policy stimulus over the coming months, provided the economy continues to evolve as projected.

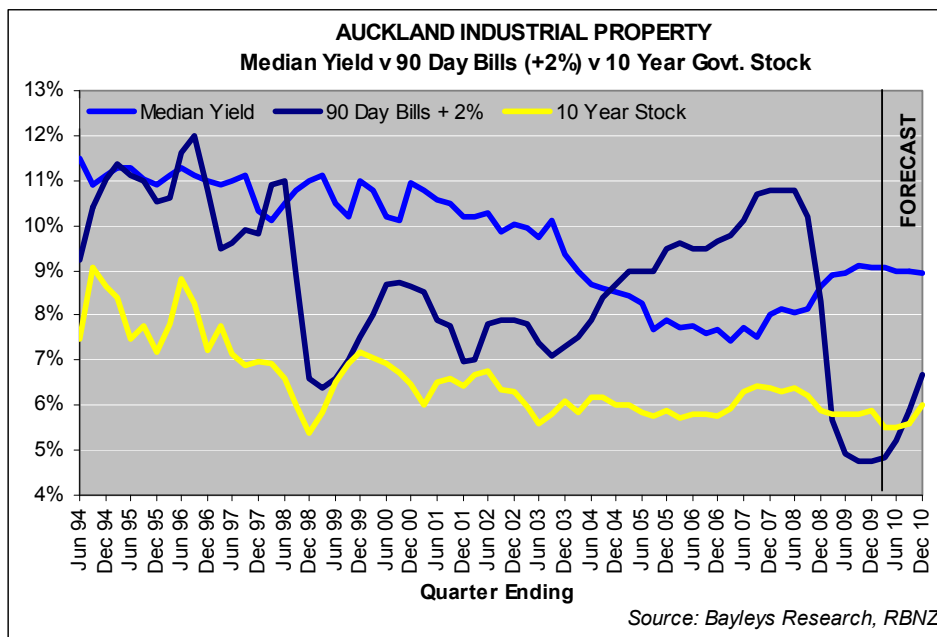
"The increased wedge between the OCR and lending rates, as well as a steeply positive-sloped interest rate curve, is expected to make OCR increases more effective than in the past. Accordingly, these factors should reduce the extent to which the OCR will need to be increased relative to previous cycles."

From Alan Bollard's comments, it seems clear that we have seen the bulk of monetary policy easing and that, subject to unforeseen shocks to the financial system, there will be no further OCR reductions during this cycle. The question now is how soon the Reserve Bank will begin the tightening cycle.

The global economy is growing also, with some of New Zealand's major trading partners showing good growth. In this light, the Reserve Bank affirmed their previous statement that, provided New Zealand's economy continues to grow in line with their forecasts, then a mid-2010 start date for the tightening cycle is likely. It seems from its latest statement, however

that at this stage the RBNZ believes that any increases in the OCR are likely to be limited in the short term future.

While the latest quarterly result shows a firming in the median yield, the volatility of which is due to limited sales volumes, *Bayleys Research* forecasts this to soften further overall, as a result of upward pressure on secondary yields while prime yields have stabilised. There is a greater level of investment interest in commercial and industrial markets at present, but these investors are looking closely and the tenant and the security of the property's cash flow. There is increased demand for prime investments, which hold a strong tenant covenant, however beyond that there remains subdued interest in secondary property.



The median investment property yield is compared with movements in borrowing rates in the graph above. It shows the indicative median yield on industrial investment property, based on sales completed in the June 2009 quarter, stood at 8.46% representing a yield gap of 3.4% for industrial property. This widened yield gap has evolved following the sharp reduction in lending interest rates and softened yields, as property investors continue to seek low risk investments. With the current level of interest rates and the marginally softening yields, this positive gap should continue to increase throughout the early part of 2010.

| NEW ZEALAND INTEREST RATE FORECASTS | | | |
|-------------------------------------|-------------------|------------------|----------------------------------|
| QUARTER | 90-DAY BANK BILLS | 10 YR GOVT STOCK | FIRST MORTGAGE (4 largest banks) |
| December 2007 | 8.77% | 6.38% | 10.55% |
| December 2008 | 6.30% | 5.49% | 8.86% |
| December 2009 | 2.79% | 5.90% | 6.04% |
| December 2010 (f) | 4.39% | 6.11% | 6.78% |
| December 2011 (f) | 5.85% | 6.21% | 7.98% |
| December 2012 (f) | 5.67% | 6.35% | 7.71% |

Source: NZIER, Bayleys Research

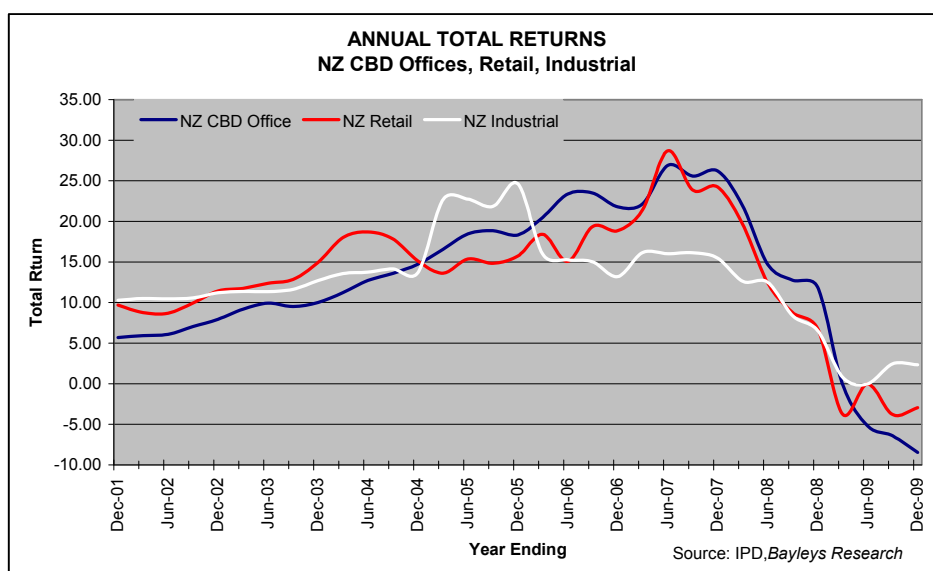
| INTERNATIONAL INTEREST RATES | | | | | | | | | | |
|---|------|------|------|------|------|--------|--------|--------|--------|--------|
| End of March year | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 f | 2011 f | 2012 f | 2013 f | 2014 f |
| Short-term rates | | | | | | | | | | |
| USA | 4.9 | 3.3 | 0.1 | 0.1 | 0.2 | 1.2 | 1.7 | 2.2 | 1.9 | 1.7 |
| Japan | 0.5 | 0.8 | 0.8 | 0.8 | 0.7 | 0.7 | 0.8 | 1.0 | 1.1 | 1.1 |
| Euro zone | 2.8 | 3.9 | 4.7 | 0.7 | 0.8 | 1.6 | 2.2 | 2.7 | 2.7 | 2.7 |
| UK | 5.3 | 6.0 | 2.6 | 0.7 | 0.8 | 1.5 | 2.0 | 2.6 | 2.7 | 2.7 |
| Australia | 6.4 | 7.2 | 4.1 | 4.2 | 4.3 | 5.1 | 5.2 | 5.2 | 5.1 | 5.0 |
| GDP weighted average | 3.7 | 3.5 | 2.0 | 0.5 | 0.6 | 1.4 | 1.8 | 2.3 | 2.2 | 2.1 |
| Long-term rates | | | | | | | | | | |
| USA | 4.5 | 4.6 | 3.8 | 4.0 | 4.3 | 4.5 | 4.6 | 4.9 | 5.2 | 5.4 |
| Japan | 1.6 | 1.7 | 1.4 | 1.4 | 1.5 | 1.5 | 1.6 | 2.1 | 2.4 | 2.5 |
| Germany | 3.5 | 4.1 | 4.0 | 3.5 | 3.7 | 3.9 | 4.0 | 4.4 | 4.3 | 4.3 |
| UK | 4.3 | 4.7 | 4.2 | 4.1 | 4.3 | 4.4 | 4.5 | 4.9 | 4.9 | 4.8 |
| Australia | 5.3 | 5.8 | 5.7 | 5.7 | 5.8 | 5.9 | 5.9 | 6.0 | 6.0 | 5.8 |
| GDP weighted average | 3.8 | 4.1 | 3.6 | 3.5 | 3.8 | 3.9 | 4.0 | 4.4 | 4.5 | 4.6 |
| Notes: (1) Short-term rates are for: US (3 month Treasury bill), Japan (3 month certificate of deposit), Euro zone (3 month Euro rate), UK (3 month interbank rate), Australia (90 day bank bill) | | | | | | | | | | |
| (2) Long-term rates are for 10 year government bond yields | | | | | | | | | | |
| (3) The Euro zone consists of 15 Member States: Belgium, Germany, Ireland, Greece, Spain, Cyprus, Malta, France, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Slovenia | | | | | | | | | | |

Source: Consensus Forecasts, NZIER estimates and forecasts

Investment Performance Index – Property Council of New Zealand

The latest release of figures by the Property Council of New Zealand show the returns for retail property have plateaued over the last two quarters. The industrial sector is the only one traced to have provided a positive annual return in the year to December 2009 while the decline in CBD office returns has continued.

The total returns, which combine the return on income and capital growth, have improved slightly at -2.94% for retail property returns in New Zealand for the 12 months to the end of December. Over the same period returns stood at 2.34% for industrial property, up from 0.82% nine month earlier. Total returns on New Zealand CBD offices have continued to decline. Returns for the 12 months to September 09 were -8.45%, down from the September 2009 recording of -6.41%.



Across all sectors, the return on income provided has remained fairly consistent. It has therefore been falling capital values, apparent over the last year, which has been responsible for driving down the total returns.

In the industrial sector, capital returns peaked in December 2005 at over 14% and by the year to March 2009 this figure had slipped to nearly -7% in the face of falling rents and softening yields.

New Zealand retail and CBD office sectors have been more dramatic in their declines, with capital gains peaking for both sectors at nearly 20% in the year to June 2007 before sliding to below -10% returns in the latest results.

It is likely that, across the sectors, total returns will remain subdued over the short term future. Although, further softening of yields is likely to be marginal, rental levels will remain under pressure until such a time as vacancy levels begin to fall again.

| INVESTMENT PERFORMANCE INDEX | | | |
|--|-------------------|--------------------|------------------|
| RETURN SUMMARY TWELVE MONTHS ENDING DECEMBER 2009 | | | |
| | Income (%) | Capital (%) | Total (%) |
| New Zealand Industrial | 8.50 | -5.72 | 2.34 |
| Auckland Industrial | 8.53 | -5.77 | 2.30 |
| New Zealand Other Retail | 8.44 | -7.03 | 0.87 |
| New Zealand Retail | 7.60 | -9.85 | -2.94 |
| New Zealand Shopping Centres | 7.45 | -9.98 | -3.22 |
| Wellington CBD Office | 7.82 | -12.13 | -5.19 |
| New Zealand CBD Office | 7.77 | -15.13 | -8.45 |
| Auckland CBD Office | 7.70 | -18.31 | -11.91 |

Source :PCNZ, Bayleys Research