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Outlook for the Wellington office market

Wellington, NZ (25 September 2008)

Commentators are predicting a looming glut of C and B grade office space in the Wellington market over the next 18 to 36 months.

Whilst on the face of it this is true, many other factors need to be considered to understand where the office leasing market is heading in the next few years suggests David Fisher, Director Office Services, CB Richard Ellis (CBRE).

A number of larger corporates, state-owned enterprises and government departments have now confirmed their alternative locations. Additionally, many tenants have recently decided to renew their existing leases.

Analysing these facts provides some startling figures. Some 15 new developments have been completed, are under construction or have just been announced in the last 18 months. These developments total just over 200,000sqm, or approximately 15% of Wellington's entire office stock.

"From this it is clear that many tenants are upgrading their accommodation," says Fisher.

"Given that the majority of these buildings have been constructed incorporating Environmentally Sustainable Design (ESD) features, the overall quality of our office stock is improving."

Over the next six months there is very little substantial office space available for lease in Wellington. Existing buildings are able to offer up only one or two reasonable quality opportunities of over 2,000sqm. This space is currently being considered by tenants.

There will be more opportunities on offer, beyond the middle of 2009, as a number of tenants relocate into completed developments, lease expiries come about, mergers take place and natural growth occurs.

CBRE is monitoring over 190 significant lease expiries over the next five years, with approximately 250,000sqm of office space potentially due to expire in this time frame. Whilst there will be opportunities for developers to secure some of this potential requirement, CBRE suggests that the bulk of take-up will be through renewals or leasing of the available stock in the B and C grade markets.

"Owners of many of these existing buildings are already considering their options on the presumption that a lease expiry could mean potentially vacant space," says Fisher.

"Usually a lease with renewals states that an existing tenant is not required to confirm their departure until three or six months prior to their lease expiry. This provides a landlord with uncertainty, which good business sense dictates they should cover by assuming the tenant will be departing. Well in advance of expiries many landlords are therefore planning major upgrades of their buildings, giving themselves an advantage in what will become a competitive market."

CBRE is marketing two such buildings, which although not available until 2011, will provide tenants with two very different quality offerings. The IRD building at 15-27 Manners Street comprises approximately 9,000sqm of good B grade space with naming rights, excellent parking and a great outlook. The other building located at 110 Featherston Street may provide over 8,500sqm. Well located near the Government Centre, this building boasts large floors and offers naming rights opportunities.

Both of these buildings will provide good quality office space for 30-40% less than a new development cost.

"Office rents are currently at historical highs, but have some way to go in real terms to reach the mid to high \$500 gross levels achieved in the late 1980s," says Fisher.

"We believe that rents will continue to increase over time, albeit at a decreasing rate. What will probably occur is a two-tiered market. The rental gap between new developments and the few real A grade buildings that Wellington has and the city's existing stock will widen. This factor may contribute to a reduced number of potential new developments and the existing 'better value' refurbished buildings being leased as a more practical alternative. "

The state of the financial markets and the risk of business contraction will have a flow on effect on the office market should the current recession continue, says Fisher. Some organisations may reduce in size, placing more stock on the market or putting off planned growth. They would then logically be less inclined to consider new developments in lieu of reviewing alternative options within existing Wellington office stock.

"Any change in government policy targeting the likes of departmental mergers, staffing sinking lids and reductions on spending will slow growth in our markets," says Fisher.

"Nevertheless new development with tenant pre-commitment is still very viable. Developers need to be more aware than ever of tenant's requirements and be prepared to work closer with them to secure agreement. It's fair to say that the current crop of developers are extremely professional and are well supported by cautious financiers and shareholders. "

CBRE expects one to two new developments to be announced in the next six months.

Whilst there is a large amount of B and C grade stock expiring in the medium term, those landlords who have given due consideration to their potential vacancy and acted on the markets requirements will be well placed.

"We have no doubt that there will be stock in the medium term that will be difficult to lease," Fisher says.

"In the past the apartment conversion developers, language schools and education facilities moved in to take up the slack in the poorer stock. We do not see this occurring this time around, so quite where the space fillers will come from for this space we can not say. "

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