

Master of Property Studies

'Toward the Next Millennium'

What Wellington CBD Office Tenants Will
Require in the Next Decade

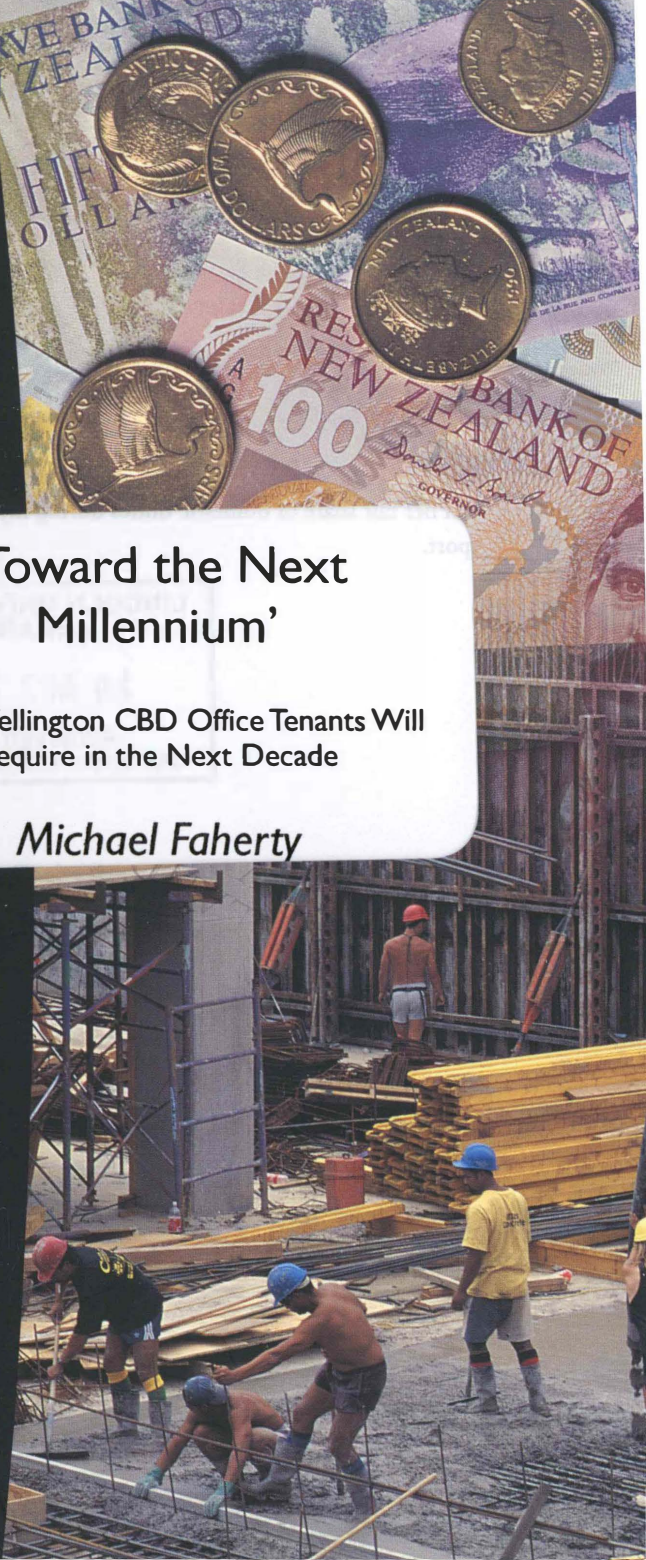
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Te Whare Wānaka, O Aoraki



'Toward the Next Millennium'

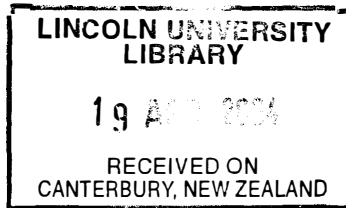
What Wellington CBD Office Tenants Will
Require in the Next Decade

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Executive Summary

- A majority (69 per cent) of survey respondents have lease expiries within the next 3–4 years.
- Almost half (49 per cent) of survey respondents indicated the ‘possibility’ of relocating premises on expiry of their current lease. A further 18 per cent indicated the likelihood of relocation being either ‘probable’ or ‘definite’. This left only 31 per cent indicating a move was unlikely.
- A majority (69 per cent) of survey respondents were expecting to upgrade their quality of space on expiry of their lease.
- A majority (54.5 per cent) of survey respondents expect an improvement in outlook for their business over the next five years, but fewer (38.2 per cent) expect to increase staff numbers and fewer still (32.7 per cent) expect to increase the amount of space required.
- An overwhelming majority of tenants (96.4 per cent) either liked or were generally satisfied with the location of their premises and are unlikely to change from a central business district location.
- The highest ranking factors and features that tenants liked in their current premises (*in relative* order of importance) were firstly location (78 per cent) followed by pleasant internal working environment (74 per cent), fair and equitable lease (56 per cent) and performance of building services (44 per cent).
- The factors and features of less relative importance were large floor plates (64 per cent)—despite the fact that 45 per cent of respondents were in premises over 500m² in size—eye-catching or award-winning external design and spacious entry foyer (47 per cent) and quality of property management (44 per cent), which could possibly be explained by most tenants’ expectations that good (responsive) property management is taken for granted.

- A surprisingly low 16.4 per cent of the survey respondents saw advanced technology and changes in work practices as having an extensive impact on the amount of office space required. Some 25 per cent saw little or no impact in this regard.
- Some 46 per cent of survey respondents foresaw extended hours of office use, and one-third of respondents saw a trend in their businesses toward fewer individual offices, more open-plan, and major changes in internal layout every three years or less.
- The majority of survey respondents (52.7 per cent) pay a rent of \$200 (gross) per square metre per annum, or less. Some 20 per cent pay over \$300 (gross) per square metre per annum plus GST.
- An overwhelming majority (89 per cent) expect rents for average to above-average air-conditioned commercial office premises to increase over the next five years. Some 41 per cent expect an average rental increase of 0–4 per cent per annum, while 43 per cent expect an average increase in the range of 5–9 per cent per annum compound.
- While the majority of tenants intend upgrading the quality of their premises, and most expect moderate rent increases over the next five years, rent affordability may become an issue. Future rent affordability was split roughly one-third to \$200/m², a third to \$300/m² and the balance divided between \$400-plus and the 'don't knows'. It is recognised that respondents' answers to this question may have been somewhat 'guarded' and tended towards the conservative end of the range of 'perceived' affordability.
- Nevertheless, it is likely that a large proportion of demand may well come from tenants who require good quality premises but are either unable or unwilling to pay the level of rent required to construct a new building. This may well herald a growing trend to refurbishment of existing building stock.
- Some 58.2 per cent of survey respondents recognised that a rent in excess of \$400/m² was required by a developer to construct a new commercial office tower.

Introduction

The client, a major (fictitious) Pacific Rim-based property investment and development company, has instructed me to undertake a preliminary investigative study of a random sample of commercial office tenants in Wellington's central business district (CBD) to establish their needs, preferences and priorities in regard to their future office accommodation requirements. Part of this entails finding out what factors and expected future trends are most expected to influence tenants' decision-making processes.

Extensive quantitative research on forecast supply and demand, together with detailed economic feasibility analysis models, have already been completed by the client and further analysis in this regard is not required at this point.

This project is designed to complement the client's earlier research by endeavouring to obtain the outlook, preferences and opinions of tenants to 'fill in the gaps' in the client's knowledge of the market to enable a 'full picture' to be put together prior to deciding whether the time is right to commence development.

The best means by which to undertake such a project and obtain reliable data is to adopt primary research methodology, and to this end the study group undertook a random survey of 118 tenants from which 55 useable responses were obtained.

The survey, made up of 18 questions, explores in some detail the following four areas:

- a broad tenant profile (without specifically identifying the tenant), including such details as general business category, size of tenancy, location, lease expiry, the tenant's likes/dislikes about their current premises and what features they would require of their premises in the future
- future intentions of the tenant in terms of likelihood of relocation, increase in staff numbers, increase in size of tenancy, quality of

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accommodation required, etc.

- those future trends which the tenant predicts as having most impact on their premises requirements, the way they will use their premises, etc.
- the rent the tenant currently pays, the tenant's views on likely future rent increases and what the tenant sees themselves as being able to afford, etc.

Literature Review

A review of the literature reveals the following topics as important trends to be considered in the context of this study:

- the current under-utilisation and over-pricing of most office space
- the effect of developments in communication technology on where people work—working from home, teleworking or ‘hoteling’, for example
- the social needs of people in their working lives.

OFFICE SPACE

Office work now involves about half of the population in western economies and office property is the largest single item in the value of a nation’s asset base. (Kerslake, 1996)

Commercial office space throughout the western world is recognised as being notoriously under-utilised. The cost of office space is widely regarded as the second highest overhead of most organisations, yet historically many exclude the costs of retaining and operating an office from otherwise extensive efforts to control expenses.

There is also debate that the office as we know it is destined for extinction. Consensus is that this may be so, if ‘the office’ in effect means a standard 18 m² for each individual who continues to come to work each day in the time-honoured fashion almost as a way of ‘doing time’ rather than ‘doing work’.

COMMUNICATION TECHNOLOGY

The rapid development of new communication technology will have important repercussions on the world of work and, by extension, on the design of the office as a workplace (Pelegriñ-Genel, 1996).

Advancing technology and the accompanying change in work practices will see less emphasis on job descriptions and inflexible

processes/work practices, and an increased focus on job outcomes. There will be less emphasis on efficiency and more emphasis on effectiveness. We will possibly see the disappearance of the classic one-person office and the development of project rooms where employees will work together for the duration of a project prior to disbanding and regrouping in different specialised groups, in which the most suited individuals are brought together for another task or project. The trend toward employing contractors who can be 'taken on' and 'let go' at will is continuing to grow.

We are already seeing the advent of the 'electronic nomad' (Pelegrin-Genel, 1996), the salesperson who now spends far more time 'in the field' generating sales and is connected to head office by way of mobile phone, laptop computer and modem, and mobile facsimile machine. The salesperson's car has become a 'virtual' office.

Staff in at least 15 of Ernst & Young's US offices operate from outside the traditional parent office for as much as 65 per cent of the time and utilise a desk 'hoteling' system when they need to return to the Ernst & Young office. 'The hoteling system is operated by a concierge or hoteling administrator where the staff member is required to 'book' space with the concierge through a Computer Assisted Facilities Management system'. This concept — together with such other trends as 'teleworking' which is being embraced by large multi-nationals such as Rank Xerox UK — are resulting in huge space reductions and cost savings for the companies involved (Horsley, 1995).

With the cost of installing and operating telecommunications equipment falling below the cost (both direct and indirect) of commuting (Toffler, 1980, from Kerslake, 1996), future work endeavour is more likely to be undertaken outside the traditional office, with concepts such as 'teleworking', 'desk-sharing/hot desking/hoteling', 'just-in-time officing' and the 'virtual office' becoming increasingly used.

SOCIAL NEEDS

On the other hand, 'while it is accepted theory people could work from home, it is noted that in reality business colleagues still want and need a central place to meet each other and clients, and to exchange ideas' (*The Economist*, November 1995, from Kerslake, 1996).

Psychologists estimate that 20–25 per cent of a typical individual's day at the office involves much-needed social contact with others. Working from home, while seen by many as a panacea, has many of its own problems.

SUMMARY

Results from this survey suggest that such emerging overseas trends for work practices and office use are (when it comes to New Zealand) still more apparent than real, and may — as has so eloquently been suggested in the recent past — be more of a 'solution in search of a problem' than anything else at this stage (Smith, 1995, from Kerslake, 1996).

Setting the Scene

So where does all the above lead us?

It has been almost 10 years since a major central business district (CBD) commercial office development was initiated in Wellington, and, from a variety of projected future supply-and-demand forecasts undertaken by various property analysts, it is generally accepted as a 'given' that Wellington will see the commencement of one or possibly two new major office developments in the next five years.

Potential developers will, however, have to give serious consideration to the following two criteria if they are to avoid costly mistakes and avoid going the way of the last generation of developers who met their demise in the late 1980s:

- supply of new office space will have to be demand-driven, at rentals sufficiently high enough to sustain land and building costs and provide a market-related return to the developer/owner as part of any financing package
- the development will have to incorporate sufficient features to attract tenant demand.

It has often been a criticism of developers in the past that they have supplied the product which they *thought* was what the market wanted rather than that which the market actually wanted. A case of the 'tail wagging the dog' rather than the other way around.

The survey which accompanies this report focuses on the tenant to ascertain where they see their future in straight business terms, and in terms of what their future office accommodation needs (both amount of space and special features) might be.

Research Methodology

The survey questionnaire was made up of a series of questions which, I considered, would elicit the most useful primary data available to my client in piecing together the requirements of prospective tenants likely to be seeking commercial office premises in the Wellington CBD over the next five years.

As with most endeavours, the 'kiss' ('keep it simple stupid') principle applied in the formulation of a questionnaire. This retains the respondents interest, facilitates more reliable answers and maximises the response rate.

From the 118 questionnaires sent out, 65 responses were obtained, eight of which were invalid because the randomly selected tenants were in fact owners of their own premises. Two questionnaires were returned unanswered. The 55 valid responses represented a creditable 47 per cent response rate, which in part I attribute to:

- the interest factor the questionnaire generated in the minds of the respondents; some 20 per cent of whom enclosed their business cards for a summary of the survey findings
- the simple 'closed question' nature of the questionnaire
- the fact that stamped, addressed envelopes were included
- the uncoded dispatch of the questionnaires enabled a non-threatening and totally anonymous response to the survey, which in part required the divulging of some commercially sensitive information.

In retrospect, a better response rate might have been achieved if there had been fewer questions to answer. This, however, would have had a trade-off cost, as the survey would then have been much less comprehensive in its scope and ultimately of less use to the client.

The survey was 'pre-tested' by a small number of experienced and

highly regarded property practitioners, and was subsequently modified prior to being dispatched in mailouts on 1–2 October 1996. Responses were received 7–17 October.

The selection criteria for the largely random sample of respondents were as follows:

- 70 per cent were selected alphabetically from bold print insertions of business name in the Wellington telephone directory: the business was not selected if it was located outside the CBD or if it was (in my opinion) likely to employ fewer than 10 people
- 30 per cent were deliberately selected from my personal business-card directory if they fitted the above criteria of being located in the CBD and employing more than 10 people.

Analysis of responses

NATURE OF SAMPLE

The first three questions aimed to give us a clearer understanding of our sample

1 Business Categories

Respondents were divided into business categories as follows:

Government	16.4 per cent
Insurance/Banking/Finance	7.3 per cent
Information/Technology/Communication	9.1 per cent
Transport/Travel	3.6 per cent
Education	1.8 per cent
Business services	56.4 per cent
Other	5.4 per cent

The business service sector made up over half the number of respondents. This sector and IT & Communications are (in common with the rest of the industrialised world) the fastest-growing of all the business sectors using commercial office premises. Respondents in this sector typically included solicitors, patent attorneys, stockbrokers, engineers, advertising and marketing consultants, real estate brokers, etc.

With the exception of the government sector, which is probably slightly under-represented in terms of numbers of respondents, the composition of tenant make-up or mix is fairly representative of the composition of the Wellington CBD commercial office market. Government sector respondents, however, make up more than 33.3 per cent of all respondents currently occupying over 1000/m² of space.

The category entitled 'other' was made up mainly of trade associations and professional bodies and institutes.

2 Current Premises' Size

Representation, by premises size, was as follows:

Under 250/m ² (2,700/ft ²)	20.0 per cent
250–499/m ² (2,700–5,400/ft ²)	34.5 per cent
500–1,000/m ² (5,400–10,800/ft ²)	1.8 per cent
1,000–3,000/m ² (10,800–32,200/ft ²)	18.2 per cent
Over 3,000/m ² (32,200/ft ²)	25.5 per cent

The random selection of tenants for the survey resulted in the '500–1,000/m²' size tenancy category being under-represented, and the 'over 3,000/m²' size tenancy category being somewhat over-represented, when compared to the typical tenant size composition of the Wellington commercial office market.

The survey's relative over-representation of the large tenancies will, however, be very useful to the client in terms of response, as it is the decision-making process and key decision-making factors for the bigger tenants that will trigger the commencement of new commercial office building in central Wellington over the next five years.

3 Lease Expiry

Respondents were asked when their current lease expired:

Short-term notice	5.5 per cent
1996/97	16.4 per cent
1998/99	34.5 per cent
2000/01	12.7 per cent
After 2001	31.0 per cent

This confirms findings from previous, more quantitative-type analyses and the general awareness among professional practitioners in the real estate sector that there is a significant number of commercial office leases due to expire in the late 1990s. This fact, however, is not appreciated by the majority of tenants. The timing of lease expiries is largely attributable to the intersection of two phenomena:

- the end of a long-term lease for many tenants (typically 12-year duration) entered into during the commercial office development 'boom' of the mid-late 1980s
- the end of shorter-term leases for many tenants (typically 3–6-year duration) entered into during the downturn of the early 1990s when business uncertainty and lack of demand dictated a more cautious approach by tenants in making premises lease commitments.

The survey shows that over 55 per cent of tenants have a lease expiry in the next three years, and that potentially there could be a large number of tenants looking for space, with the consequent imbalance of supply and demand resulting in dramatic rental increases ('spikes') over relatively short timeframes.

RELOCATION ISSUES

1 Likelihood of Relocation

Lease expiry is not the full story, however, for where there is a large number of looming lease expiries, there will always be a proportion of tenants who may not choose to relocate.

When asked the likelihood of their organisation moving premises on expiry of its current lease, the answers were:

Definitely will not	3.6 per cent
Probably will not	29.1 per cent
Possibly will	49.1 per cent
Probably will	11.0 per cent
Definitely will	7.3 per cent

Some 67 per cent indicated relocation was at least possible, then. From previous quantitative-type demand analysis undertaken in the property sector in recent years, it is likely that approximately half of that 67 per cent (33 per cent) will in fact relocate to other premises on expiry of their lease.

2 Likelihood of Upgrade

Following are the responses to the likelihood of their wanting to upgrade the quality of their premises:

Yes	11.0 per cent
Yes subject to quantum of rent	16.3 per cent
Yes subject to quantum of rent and other considerations	41.8 per cent
No	29.1 per cent
Not applicable	1.8 per cent

Tenants choose to relocate premises for a variety of reasons, but the single biggest reason is often a requirement for better quality accommodation. Almost 70 per cent of respondents confirmed that, if they did relocate premises, they would want to upgrade the quality of their accommodation, subject of course to qualifying criteria such as rent and other considerations.

The consequence of this is a build-up of demand pressure on more modern and/or better quality commercial office premises, with a resultant upward pressure on the price (rent) of the dwindling supply. The immediate result will be an increase in the number of buildings undergoing refurbishment, followed shortly thereafter by a limited amount of new development to satisfy pent-up demand at the upper end of the market.

3 Changing Needs

Respondents were then asked to rate each of the following categories as being the most applicable future outlook for their organisation, using the same 1–5 scale as in the likelihood of relocation question. The responses 'definitely will not' and 'will not' (1 and 2) have been combined, as have 'will' and 'definitely will' (4 and 5).

	%		
	Will not	Neutral	Will
Improvement in business outlook	7.3	38.2	54.5
Increased staff numbers	27.3	34.5	38.2
Increase office space	36.3	31.0	32.7
Cut overheads below current levels	20.0	40.0	40.0

This question was designed to gauge business confidence, covering a wide range of business and occupations. While over half (55 per cent) saw an improvement in business outlook, significantly fewer (38 per cent) saw a likely increase in staff numbers, and even fewer (33 per cent) had a requirement for an increase (over current levels) in the amount of office space required.

The last of these indicators is possibly explained by one, or a combination, of the following factors:

- staff will occupy a smaller average area
- respondents currently have surplus space into which increased staff numbers can expand
- the advent of new technology and/or change in work practices will reduce the requirement for extra space.

Another indicator that the forecast improvement in business outlook is somewhat cautious is that only 20 per cent of respondents are not looking to reduce overheads below current levels.

PREFERRED FEATURES

1 Current Premises

Respondents were asked to rate which features they liked/disliked about their current premises. The scale was 1 (like very much) through 3 (neutral) to 5 (strongly dislike). Responses 'like very much' and 'like' (1 and 2) have been combined, as have 'dislike' and 'strongly dislike' (4 and 5).

	%			
	Like	Neutral	Dislike	N/A
External design and appearance	43.6	32.7	23.6	0
Internal working environment	61.8	23.6	14.5	0
Location/general accessibility	89.1	7.3	3.6	0
Views/outlook	58.2	20.0	9.1	12.7
Performance of air-conditioning	10.9	20.0	43.6	25.5
Performance of lifts	16.3	47.3	32.7	3.7

<i>cont'd...</i>	%			
	Like	Neutral	Dislike	N/A
Building security/access control	56.3	14.5	27.3	1.9
Quality of property management	49.1	27.3	21.8	1.8
Adequate on-site carparking	30.9	10.9	45.5	12.7
Lease	21.8	43.6	27.3	7.3
Rent	27.3	36.6	34.5	1.6
Flexibility of interior layout	23.6	34.5	41.8	0
Large floor size	25.5	30.9	1.8	41.8
Older character building	14.5	12.7	20.0	52.8
Floor to ceiling heights	36.3	43.6	16.3	3.8
Imposing main entry foyer	21.8	27.3	34.5	16.4

The following significant trends emerged:

- 75 per cent either liked or were generally satisfied with the external design and appearance of the building in which they were currently located
- 84 per cent either liked or were satisfied with their current internal working environment
- an overwhelming 96.4 per cent either liked or were satisfied with their current location, indicating little intention to move outside the CBD
- 10–16 per cent of respondents liked the performance of the air-conditioning system and lifts in their building — while a significant percentage (25.5 per cent) did not currently have air-conditioned premises, 33–44 per cent were dissatisfied or did not like the performance of these two areas of their building services — a trend that *should not be lightly dismissed by commercial office building owners or developers*
- over 75 per cent of respondents either liked or were satisfied with the quality of property management of their premises or building

- a significant portion of respondents (45 per cent) either disliked or strongly disliked the adequacy of on-site carparking facilities — once again a point which should be noted by building developers, although territorial authorities are tending toward limiting (rather than encouraging) the provision of such on-site facilities
- a significant portion of respondents either disliked or strongly disliked their current lease (27.3 per cent) and current level of rent (34.5 per cent), indicating that these will be significant contributors to a tenant's tendency to relocate should their current landlords not take a flexible approach either prior to or at lease expiry.

2 Future Premises

Respondents were asked, assuming their organisation was willing and able to relocate to another building, to rank the following features in order of importance (10 least importance through to 1 greatest importance). Rankings have been summarised into the following three broad categories: very important (1–3), tending neutral importance (4–7), less important (8–10).

	%		
	Most Impt	Neutral	Least Impt
Eye-catching external facade and spacious main foyer	9.1	34.5	47.2
Pleasant internal working environment	74.0	4.0	2.0
Location/general accessibility	78.0	16.0	6.0
Performance of building services (air-conditioning, lifts, etc.)	44.0	48.0	8.0
Quality of property management	14.0	42.0	44.0
Fair and equitable lease	56.0	30.0	14.0
Flexibility of interior layout	26.0	48.0	26.0
Large floor size	6.0	30.0	64.0
Floor-to-ceiling heights	8.0	56.0	36.0
Hi-tech	20.0	44.0	36.0

Given the choice, tenants would normally state most if not all of the above features are of high importance. This question, therefore, was framed in such a way as to force the respondent to carefully select in order of preference those features which were of primary importance, with the result that some clear trends became evident.

Location and a pleasant internal working environment were considered by approximately 75 per cent of respondents to rank as important or highly important considerations. The feature of an internal working environment being an important or highly important consideration was also evident in the survey, with 44 per cent of respondents ranking the performance of building services (air-conditioning and lifts, etc.) as being either important or highly important.

A fair and equitable lease was the third most important feature, being regarded by 56 per cent of respondents as either an important or highly important consideration.

Surprisingly, only 20 per cent of respondents thought high-tech facilities were important or highly important considerations. This point is expanded upon later in this report.

3 Location

Preferred location were:

CBD	87.3 per cent
CBD fringe	9.1 per cent
CBD north	3.6 per cent
Other	0 per cent

As the survey was confined to Wellington CBD tenants, it is hardly surprising that 87 per cent of respondents elected the CBD (core) as the preferred location for their business. Nonetheless, the forecast trend of the mid-late 1980s — that a significant part of future business would become decentralised — is no longer evident.

FUTURE TRENDS

1 *Impact of Technology and Change*

Respondents were asked what degree of impact they thought advancing technology and changes in work practices would have on the amount of office space required in the future:

Extensive impact	16.4 per cent
Moderate impact	58.2 per cent
Little or no impact	25.4 per cent

A surprisingly low 16.4 per cent of respondents saw advancing technology and changes in workplace practices having an extensive impact on the amount of office space being required in the future. It would appear as if overseas trends such as 'teleworking', 'telecommuting', the 'virtual office' and 'hot desking' or 'office hotelling' are still some way off, at least in the minds of New Zealand commercial office tenants. Perhaps there is a parallel here with the 1970s forecast that computers would herald the beginning of the 'paperless' workplace by the turn of the century.

2 *Office Space Trends*

Next, respondents were asked to rate the likelihood of each of the following as being applicable to their organisation in the future:

	%		
	Likely	Neutral	Unlikely
Decentralisation from current location to fringe or beyond	9.1	20.0	71.0
Tendency for more work to be undertaken by staff at home during normal working hours (teleworking)	21.8	45.4	32.7
Increase in 'hot desking'	16.3	41.8	41.8
Extended hours of office use	46.0	25.0	29.0
Fewer individual offices and more open plan	34.5	30.9	34.5
Major changes in interior layout every three years or less	32.7	23.6	43.6
Increase in requirement for on-site staff facilities	27.3	21.8	51.0

The only strongly discernable trend in future commercial office use that can be drawn from this survey is the fact that 46 per cent of respondents foresee an increase in extended hours of office use. A continuation of the current trend for people to work longer and/or more flexible office hours together with some shift work (e.g. secretarial staff in legal firms now often working 2 x 6 hour shifts between 7am and 7pm) necessitating the need for extended hours of building use.

RENT

1 *Current Rent*

Current levels of rent psm per annum (gross) were:

Under \$150	12.7 per cent
Between \$150–200	40.0 per cent
Between \$200–300	16.3 per cent
Between \$300–400	10.9 per cent
Over \$400	9.2 per cent
Don't know	10.9 per cent

Less than 10 per cent of respondents currently pay a rent over \$400/m² per annum, which is the expected minimum level of rent required to make development of a new air-conditioned building economically feasible.

Tenants will face the prospect of either a significant increase in their rent if they wish to move to a new building, or alternatively settle for an existing building at a level of rent commensurate with the quality of space required.

The impact of a large number of tenants all looking for space at the same time will result in the demand-push inflation of rental rates on existing buildings to the point where rents will rapidly escalate to levels where building will become an economically viable option for some tenants looking for better-than-average quality accommodation.

2 *Rent as Percentage of Overheads*

Respondents were asked what percentage of their organisation's overheads is payable in rent. The response was:

0–4%	7.3 per cent
5–9%	21.8 per cent
10–20%	21.8 per cent
>20%	14.5 per cent
Don't know	34.5 per cent

Rent is invariably the second or third highest expense for the majority of businesses, behind labour (and sometimes IT) costs, and tends to lie in the range of 10–15 per cent of total overheads.

All other things being equal and assuming an artificially high (ratcheted) rent is not being paid, a tenant paying a significantly higher proportion than this will not likely be looking to upgrade its quality of premises (or even make a sideways move).

3 Future Expectations

Expected Change

When asked what they expect office rents (for average to above-average air-conditioned space) to do over the next five years, a significant majority of tenants expect rents to increase:

Increase	89.1 per cent
Decrease	0 per cent
Remain the same	10.9 per cent

Level of Increase

Respondents who expected rents to increase were then asked to indicate by how much, on an average per annum (p.a.) basis:

0–4% p.a.	40.9 per cent
5–9% p.a.	42.9 per cent
10–14% p.a.	12.2 per cent
15–19% p.a.	2.0 per cent
Over 20% p.a.	2.0 per cent

Respondents appear to be optimistic, given that informed market commentators and independent property analysts expect the rate of

increase to average around 9 per cent p.a. compound over the next three to five years.

Maximum Affordable Rent

The maximum level of rent (expressed in gross rent or total occupancy cost terms) that organisations could realistically afford and would be willing to pay for centrally-located, average to above-average quality air-conditioned office accommodation was:

\$200/m ²	36.3 per cent
\$300/m ²	34.5 per cent
\$400/m ²	10.9 per cent
\$500/m ²	1.8 per cent
\$600/m ²	0 per cent
Don't know	16.5 per cent

The implications of this response are very interesting. In the previous two questions, a clear majority of respondents had indicated an expectation of market rent increase of between 0–9 per cent per annum compound over the next five years. Over two-thirds of respondents indicated that the maximum level of rent that could realistically be afforded by them was up to \$300/m² (gross) per annum. Some 52.7 per cent of respondents had a rent of \$200/m² per annum or less. Applying the most commonly expected rent increase range of 0–9 per cent to \$200/m² gives an expected rent rate of \$200–\$307/m² per annum, which confirms that this would imply that 50–67 per cent of respondents do not expect or cannot afford to pay a rent over \$300/m² per annum over the next five years.

4 Perceived Viability for Developers

Respondents were asked which rent level they considered a building developer would require to economically undertake a new commercial office tower development of average to above-average quality in a central CBD location. The results were:

\$200/m ²	5.5 per cent
\$300/m ²	18.2 per cent
\$400/m ²	32.7 per cent
\$500/m ²	20.0 per cent
\$600/m ²	5.5 per cent
Don't know	18.2 per cent

Once again, an interesting observation can be made from this question. While over half of the respondents cannot or will not pay a rent of more than \$300/m² gross per annum, over three-quarters recognise that a rent of \$300/m² or more will be required to make a new development economically feasible. Over half of the respondents more accurately recognise that a rent of at least \$400/m² will be required to make a new development economically feasible.

Conclusion and Recommendations

A majority of Wellington CBD commercial office tenants have leases which expire before the end of the decade. Almost 70 per cent of those surveyed expect to upgrade the quality of their space when their current lease expires. Just on 70 per cent will at least consider the possibility of relocating and, as such, have to be considered as potential tenants. It is recommended that the client should (through a proactive leasing broker) commence actively seeking out and targeting those potential tenants for preliminary discussions.

The features most important to those potential tenants are location, a pleasant internal working environment, the performance of building services and a fair and equitable lease. Preliminary discussions with potential tenants should be able to reveal more specific measures on these and other factors which are important to them.

Only 16 per cent of those surveyed saw advanced technology and changes in work practice having an extensive impact on the amount of space required, although improved business outlook was seen by 33 per cent of respondents as leading to an increased space requirement.

It is apparent that, whereas a majority of tenants appreciate that a rent in excess of \$400/m² (gross) per annum plus GST will be required to economically undertake a new CBD commercial office development, the issue of affordability has raised its head. It appears that many tenants want to improve the quality of their premises but are either unwilling or unable to meet the costs involved. I consider that the majority will settle for a compromise of either not relocating on expiry of their current lease or relocating to refurbished premises. There will always be a small minority of tenants who will want to pay for the best, and can afford to do so. In some current cases, a move to better quality accommodation at rentals of in excess of \$400/m² would not be a problem as they have been paying that level of rent under a lease ratchet clause for the past six or seven years. Further investigation will be required to identify those tenants, with a view to obtaining a leasing commitment at the earliest opportunity.

RECOMMENDATIONS

The best course of action for the client to take is to continue with their current work to complete the developed design and obtain the necessary resource consent for their proposed new development, while continuing to secure a substantial leasing precommitment in line with the requirement of their financiers.

While such a strategy will involve not inconsiderable costs, it will ensure that the client will be 'the first cab off the rank' in terms of being able to deliver a well-located, good quality commercial office development within a reasonable timeframe, and so beat off the possibility of competition from other developers.

The strategy for the client to hold its second development option (the proposed refurbishment of a well-located and inherently good but rather dated building) should continue, as it could well prove to be a destination to which second-tier tenants (those who are unable or unwilling to pay new development rents) could be redirected.

References

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