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focus



Interview with
Precinct Properties'
CEO Scott Pritchard:
Laying Foundations
for Future Growth

Many people's first thought of Precinct Properties is as the owner of prime office buildings. Office, as a sector, has had its challenges, particularly through COVID. What is the state of the office market today, and how are things like working from home impacting your business?

There's definitely a two-tiered market in both Auckland and Wellington. What we've seen since COVID is a real flight to quality. Businesses have recognised that in order to optimise their workforce's productivity, they are better off having their workers in the office the majority of the time.

In order for those businesses to attract workers back into the office, they are seeking prime grade, high quality offices. We've been a beneficiary of that. We've seen really strong demand for our office portfolio.

Office buildings which are C grade or D grade, and not in the preferred locations, are finding that maintaining occupancy is challenging. Businesses are looking to leave those spaces, because they can't get their workers back into the office. Prime grade office is doing well, while lower quality office is not.

While office is still core to Precinct, the company has evolved over recent years. Can you take us through what's changed?

We've evolved a lot in the last decade. Ten or more years ago we were very passive. We didn't do a lot of development. We owned and managed our real estate. In many respects, we just heavily relied on the quality of our real estate portfolio.

We've made a bunch of changes over the last 10 to 12 years. First, we adopted a service mentality, engaging with our occupiers and treating them as clients, rather than as tenants.

We've established a strong development capability, which has enabled us to develop new world-class real estate, and to continue to attract the best quality clients in the country. By developing the Commercial Bays, the Bowen Campuses, and the Wynyard Quarters, it means we can constantly put new office product in front of our clients and extending our offering.

We have also moved into mixed use. Through Commercial Bay, in particular, we've moved into adjacencies to office. That's city centre retail, hospitality, and more recently hotels. The amenities we're now providing ties back to attracting people back into the office.

As we've become more experienced with mixed use, we've started to think about other options. The most obvious one for us is residential.

Moving into the residential space really captures that live, work, and play element. We are looking to leverage the capability and learnings of our team into residential development.

If you look at most global cities, there's going to be greater demand for high density living over time, including in New Zealand. Auckland will likely see a much greater proportion of its population living in the city centre. It's really underrepresented when compared to other large cities at the moment. We believe the skills that we have can be utilised in that space.

If I think about our business over the last 10 years, we have evolved a lot. But every time we've done it, it has been iterative, and we've looked for adjacencies. We see the move into residential as being iterative, and adjacent to the things that we're doing already. So it's an exciting phase for our business.

A fair criticism of some property companies over recent decades has been that they're more focused on collecting assets, rather than creating shareholder value. The capital required and risks across your different activities are quite varied. How do you think about right sizing each activity, and how they'll add value for shareholders?

Since 2021, when we internalised our management function, we've moved to establish a third-party capital strategy: attracting capital partners, generally large institutional investors to co-invest alongside us, either in new developments or assets we already own.

The reason for this strategy was that we wanted to diversify our activities and income streams, and enhance the return we make on our capital. It also means that we're not continually going back to the share market to raise equity. Bringing in outside capital allows us to leverage our capability and to be remunerated for the services that we provide, while at the same time allowing us to directly invest in all the things we're doing. Through those moves we feel like we are focussing and lifting the return on the capital we have, rather than constantly issuing new capital. That's been the focus over the past three years.

The establishment of our residential or living business allows us to further extend the opportunities for capital partners. It gives us a better position to be able to attract capital.

Overall I think we've made good progress. We have a strict focus around how we use our capital, and we've put in place good disciplines to ensure that we grow returns to shareholders.



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Precinct is a big developer in Auckland. As you mentioned, the company has built Commercial Bay and a good chunk of Wynyard Quarter so far. How much appetite does Precinct have for future development? How do you manage development risks?

We view development as a way to continually improve the quality of our portfolio, and to set the benchmark, in terms of high quality real estate, in the markets in which we operate.

We adopt a whole range of approaches to mitigate risk. We look for pre-leasing, or pre-sales in the case of residential, before we start construction. We engage with high-quality construction companies, and try to secure fixed price contracts where we can. If we can't get a fixed price construction contract, we intensively manage and control the design risk. We have good relationships with our lenders, and we don't put too much debt into our projects. So there's a whole bunch of things that we do to manage risk.

We have a group of people within the business who have been here for a very long time. We've learned a lot through developing close

to \$3 billion worth of real estate over the last 10 years. We're really leveraging off those skills and experiences, and we have a whole bunch of management practices in place to ensure oversight and that decisions are made appropriately. There's no doubt that development carries higher risk, but if you put in place the appropriate mitigants it can offer really good returns for that risk.

There has been considerable construction cost inflation over recent years. How do you think that impacts the replacement cost and book value of the assets you're holding today?

Construction cost escalation has been enormous. In the last six or seven years construction costs have almost doubled. What that means is that replacement costs are probably 20% higher than market values. That means you're unlikely to see a whole lot of new development taking place. That should generally underpin valuations of existing stock, and also support rental income. That's the market at the moment - because construction cost escalation has been so high there'll be very limited supply in the near term. That's good if you already own real estate.

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It's been an unusual few years, COVID closed the borders, inflation soared, and now it's coming back down, interest rates jumped and are now trending down, we are in recession. Can you tell us what you've learned from the current cycle?

The biggest lesson I've learned is that you've got to have the ability to adapt. You've got to think about what could go wrong, and have good practices in place to be able to manage risks, so that when something unexpected happens you're able to handle it and adapt. When we committed to develop Commercial Bay we never had a pandemic on our risk register. Sometimes things hit you that you don't see coming. Having the ability to adapt and manage is the key learning for us over the past five or six years.

What new opportunities have you seen emerge from this volatility? Are there any trends, when you look globally, that you think might find their way to New Zealand?

Student accommodation is something we see as emerging in other markets, and something we're interested in. There's good demand and not a great deal of supply. Whenever you're looking for opportunities, that demand supply and balance is really important.

Also, residential living within the city centre is something that I'd love to see more of, particularly in Auckland. There's already a good

level in Wellington. But if you look at cities like Vancouver, for example, you've got around 10% of the population living in the city centre, and the city centre is a community. It's walkable, it has trees, and it's a beautiful place to be. I think Auckland has that opportunity. We've only got 40,000 people that live in the city centre. If you compare that on a proportionate basis to Sydney or Melbourne, we should have more like 100,000 people living in our city centre. I think that's a real opportunity over the next 10 years, as we continue to face a housing shortage.

You've been the CEO for 14 or so years. What keeps you motivated? What's left for you to achieve in the role? What does success look like for the next five to ten years?

I can't believe it's been 14 years. It honestly feels like five or six. We've had so much happening in the last 14 years, and the business has changed so much. We've had some really material, strategic, transformational changes. It's those changes that have kept me engaged. I could have thought at the end of Commercial Bay it was the time to finish up, but then we had the opportunity to internalise our management. Since internalising our management, we've moved into third party capital, and then, more recently, into living. As we evolve the business, and explore exciting new opportunities, that's really what keeps me engaged. I'm loving it.



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We're having a great time at Precinct. We've got a terrific team. Success, I think, looks like a business with a dominant position in the market, and growing and leveraging the Precinct brand, so that when we move into the living space there's much greater public recognition of our reputation. That's something that I'm focused on over the next two to three years.

Are there any final thoughts or comments you'd like to leave with our investors?

I think the listed property sector has learned a lot over the last decade. If I look back to where the sector was 10 or 15 years ago, you had a sector that was largely externally managed and more focused on growing assets under management. You perhaps didn't have the alignment of interests between the companies and shareholders that we have today.

In general the sector has managed the recent high inflation environment and elevated interest rates really well. There hasn't been a

lot of dilutive equity raisings, people have been disciplined. I think the property sector is growing up, which is great because investors love to invest in property, and it's all about managers like us delivering for shareholders.

We know that property is cyclical. We know that it's heavily impacted by interest rates. From our experience, whenever we're in a declining interest rate environment property performs well. We haven't had a huge amount of new supply in office in the last few years, so I think we're going to see values well supported. Generally, at this stage of the cycle, it's a good place to be. We've got lots of exciting opportunities in front of us, and we think that the cycle is going to be supportive over the next four to five years. To those investors that have been with us for a long time, thank you, we're continuing to do our best to try and grow returns, and we're grateful for the support.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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