Question and Answer

Craig Tyson

Craig Tyson, OnePath. The last we heard with PwC in Christchurch, you were uncertain of the future of that building. And that in your statement today, you do say that it did sustain significant damage. What kind of things have you seen that actually give you concern that now the building is actually in a worse state perhaps than you originally thought? And is there a possibility that potentially, the building can be knocked down and you get your original valuation rather than the current valuation?

Chris W. Gudgeon
Former Chief Executive Officer

Well, the Christchurch earthquake is a new event for everybody. We've never experienced anything like it before and our initial reaction was one of relief, I suppose. The building, the structural integrity was such that the building held up well and all occupants were vacated safely. The original, the initial view of the building was that the damage was possibly not particularly significant. But now that we've been able to get back into the building with our engineers and really go through top to bottom, I think it's fair to say that there has been significant damage. And what we've also learned in post-earthquake analysis is that the actual earthquake shake itself was very severe. So in terms of the damage we can see, you see cracks in beams, adjacent to columns, which is where they're supposed to crack in an earthquake event, you see some cracking in topping slabs, on the office floors. We've seen some cracking in the basement slab, which is of concern, and we've seen differential settlement in the ground surrounding the building. So we've only in recent weeks been able to properly get into the building with our engineers and with the insurers' engineers. And we're under way with a full structural assessment and geotechnical assessment. It will be 1 month or 2 before the results are out. But I think it's fair to say that the uncertainty remains. We don't know what the eventual outcome will be. And we can't rule out any scenario, including the one you mentioned of potential demolition. And in that event, you're right, the insurance policy stand good, and we get indemnity value. Well indemnity value relates to both premarket -- sorry, pre-event market value, and it also has some reference to replacement value. So we're obviously keenly interested in the outcome, but uncertainty remains.

Jeremy Andrew Simpson
Forsyth Barr Group Ltd., Research Division

Jeremy Simpson, Forsyth Barr. Firstly, given -- what's the effective tax rate you think for your FY '12? And how does that compare what you might have been thinking this time last year after the budget?

Chris W. Gudgeon
Former Chief Executive Officer

As I mentioned, the effective tax rate that we're projecting is approximately 16% for FY '12, the bulk of which is the impact of the depreciation effect, and that's broadly in line with what we were expecting this time last year.

Jeremy Andrew Simpson
Forsyth Barr Group Ltd., Research Division

So you haven't been able to sort of play around with that and seems to have reclassify things and being more aggressive in the way you're accounting for things to improve that outcome?

Chris W. Gudgeon
Former Chief Executive Officer

I would never suggest we're more aggressive with tax. But we're obviously very focused on taking the deductions that we're entitled to take up front.

Jeremy Andrew Simpson

Forsyth Barr Group Ltd., Research Division

And just on the outlook for Wellington office, you sort of gave us some -- a view from the market from one of your consulting firms. What's your view on the Wellington office market and how your assets are positioned over the next few years?

Chris W. Gudgeon
Former Chief Executive Officer

Well our observation is that the Wellington market has moved into the correction phase after Auckland. Auckland was much earlier in and the recovery in Auckland appears to be happening prior to that, that's forecast for Wellington. That's consistent with our experience. The Wellington now, we do have the government's fiscal austerity program affecting demand, and it will avoid a situation of government triggering new builds, which are unwanted. But in theory, we're going to see possibly some contraction in the government. So they affect both the demand and the supply side of the equation, but they are still a very stabilizing influence in Wellington. And our vacancy is less than 2% in our assets there. They do cater to government, and we take nothing for granted. But we're reasonably comfortable with our exposure there. Obviously now, everyone's focused on buildings' performances in earthquakes and government tenants are looking for buildings that will perform to around 70% of current codes, so our buildings sit comfortably in that respect.

Jeremy Andrew Simpson
Forsyth Barr Group Ltd., Research Division

Just one more. What's your view on having NTA will track in the next couple of years? I mean we're seeing signs that market is stabilizing in Auckland, like you mentioned. Wellington is still a bit soft. They came back obviously last for a number of factors. So when are we going to start to see that flatten out? And do you think your PEP's harshly down while you revals[revaluations] some questions given you were the first who came for the rent doing revaluations in a very uncertain time?

Chris W. Gudgeon
Former Chief Executive Officer

Well, if you look at CB Richard Ellis' forecast for cap rates over the next 3 to 4 years, they're looking at cap rate compression of around 80 basis points. So they're looking to significant firming cap rates, which will flow through the valuations and which will flow through the NTA. We think, we'd really like to believe we're at -- firmly at the bottom of the cycle in terms of asset values. And the analysis indicates that, that should be the case. And the last part of your question was ...

Jeremy Andrew Simpson
Forsyth Barr Group Ltd., Research Division

Christchurch revals.

Chris W. Gudgeon
Former Chief Executive Officer

Yes, Christchurch revals. We think that in our asking a valuer in the middle of March to revise a valuation post the February earthquake event was quite a tough thing to ask the valuer to do but we put pressure on, and he had to do it, and we're required by the accounting standards to do it. He, with Northlands just for the uncertainty factor, out of 100 basis points of our cap rate, and had a massive impact. And he's got a role as an independent valuer, he had to take a view and he did. I think we had been harshly hit, however. And I absolutely would expect Northlands' value to come back, to recover in the forthcoming revaluation rounds. So the trading performance, up trading performance both March and April over 30% up on the prior month of last year, on the same month last year.

Craig Brown

Craig Brown from OnePath. Chris, I just noticed the trust deed gearing of 35.9%, getting close to the requirements of being under 40%. Just being interested in your thoughts on how comfortable you are at those sorts of levels? And then I guess, if your PEPs aren't as comfortable, what your sort of thoughts are at this stage about how you manage that level of gearing.

Chris W. Gudgeon
Former Chief Executive Officer

If we look at net debt to total assets, it's a more comfortable figure at 32.7%. We just made that point. Because we do take into account cash on deposit when we look through the real gearing position. But your point, I think, is still valid. If you look ahead to our development program on ASB, gearing will increase. And we are heading towards the limit of our comfort zone. So over the next few years, we will have to address it one way or the other. And we do -- how we do anticipate in coming years an improved market. And we do anticipate obviously to recycle assets, and there are some assets that we would comfortably sell to address our gearing outlook so.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

Marcus Curley from Goldman Sachs. Just wondered if you can give a little perspective about what sort of rental growth you're expecting in the current year? And how much of the over-renting are you expecting to turn up in the portfolio?

Gavin Edward Parker
Former General Management of Funds Management & Capital Markets

Yes, so if we go back to those over-renting statistics, which the valuers produced asset by asset, and they did it for as of 31 March '11. So it's a good reference point. So the retail portfolio their assessment 1% over-rented, and we'd have to conclude with that, we think we're essentially at market on retail rents. We've, I mentioned the renewals program at Northlands around 90 renewals; and at North City, around 70. So those specialty leases, if you like, have been corrected to market. If you look at particular assets like Sylvia where we're still driving rental growth of 7% approximately, that's clearly -- in this market, that's clearly a very positive sign for the year and 2 years ahead as we see a recovery in sales. If you look at sales statistics, our March and April sales are quite encouraging across our portfolio. Last quarter of 2010 was not good, and we saw that across the broader economy. But perhaps we're seeing the first signs of some positive sales numbers in the retail world. So on the retail front, I think we are firmly at market, and the prospects are that for us to drive rental increases in line with sales growth. On the office side, the value is the same. We're still, on the ground, 7% over-rented. And you have to bear in mind that when you look at that statistics, that rents are not, if you like, on a floating rate. In the office world, they occur at 3-year intervals. So there's always a smoothing effect by virtue of that 3-year interval and there's also a smoothing effect by virtue of ratchet clauses. So I think we'll see some continuing softening in the office outlook in terms of net income performance, but not to the extent of 7%. It will be somewhere between 0% and 7%. And overall, we're looking to drive a positive position for the total portfolio in terms of rental growth, retail outweighing office and retail prospects being better than office.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

So does that suggest you're looking at total rental growth for 2012?

Chris W. Gudgeon
Former Chief Executive Officer

Yes, we are not looking for anything particularly significant on that front, we're targeting rental growth.

Operator

[Operator Instructions] First question comes from the line of Jason Lindsay of First New Zealand Capital.

Jason Lindsay
Jarden Limited, Research Division

Chris, much of my questions have been asked but I'm -- just follow up to Craig Brown's question about gearing. Is there any consideration to looking to change the bank covenant? I guess 36% in itself, probably not much of a problem, it's just the level of headroom to that covenant. And talking about recycling assets would possibly be one that you're able to recycle given the new improved Wellington lease structure feature?

Chris W. Gudgeon
Former Chief Executive Officer

Well, I'd just point out, Gavin might add to this. But our bank covenants are already at 45%, so the trustee is at 40%. Our bank covenant's at 45%. And I'm sorry, I didn't hear your second part of your question probably, Jason?

Jason Lindsay
Jarden Limited, Research Division

Just with regard to your comment about recycling assets with perhaps, Straight V [ph] -- one of those that you'd consider, given the lease restructure in the long Wellington property now.

Chris W. Gudgeon
Former Chief Executive Officer

Yes is the answer.

Jason Lindsay
Jarden Limited, Research Division

And can you -- are you sort of comfortable now with the 1/3 office, 2/3 retail split? Or still looking to make some refinement to that?

Chris W. Gudgeon
Former Chief Executive Officer

Well, I think we've always said that we pride ourselves on being retail specialists. And we think the retail sector over the long-term provides better returns with low volatility. At the same time, we absolutely respect the value we offer as a diversified vehicle and it's important to maintain scale and market capital liquidity. But looking ahead, we would be comfortable with gradually increasing our retail weighting over time, no particular compelling reason to do anything as a matter of urgency. But over time, I would not at all be -- I wouldn't be at all surprised to see our retail weighting gradually climb.

Jason Lindsay
Jarden Limited, Research Division

Just one last question. Have you disclosed your WALT covenant before with the bank or is there a WALT...

Gavin Edward Parker
Former General Management of Funds Management & Capital Markets

Our WALT covenant, Jason, is minimum of 3x.

Operator

Your next question comes from the line of Lance Reynolds of UBS.

Lance Reynolds
UBS Investment Bank, Research Division

Just a couple of questions, most of them have been covered off in relation to your gearing. I noticed you've pulled the historical gearing chart out of the presentation, and just touching on that 36%, I mean I'm more interested on the -- they call the acquisition potential pipeline. Have you looked at the number of deals? Are there reasons why you haven't taken any of those on? What are you seeing out there in terms of acquisition opportunity, particularly in retail? So that we could say that retail mix head upwards?

Chris W. Gudgeon
Former Chief Executive Officer

Well, we're always alert to opportunities to make good investments and we're not idle on that front. We are completely grounded in our approach, however, and that we realize if we're going to make an acquisition, it's got to make a sense for unit holders. And clearly, we'd like to -- we want to drive accretion and distributions. How do we fund acquisitions? If something compelling comes across, comes along, well there's a range of opportunities. We can raise our capital, we could raise equity if around a particular acquisition, if it was sufficiently compelling, we can partially debt and equity fund an opportunity if we felt that the return outcome justified the cost. So yes, all opportunities are available to us. And I think there are opportunities that will come to market in the next 2 years. We just got to be fussy, and it's all got to make very good sense for unit holders before we move.

Operator

There are no further question, I'll now pass the call back to the speakers.

Gavin Edward Parker
Former General Management of Funds Management & Capital Markets

Marcus?

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

Marcus Curley, just one follow-up. Obviously, a recent amount of talk in the industry about internalization. Could you give your views relative to Kiwi?

Chris W. Gudgeon
Former Chief Executive Officer

Well, we're obviously part of the industry that has the external manager arrangement. As an external manager, our owners are always concerned to ensure that we are competitive in terms of the fees we charge. The recent analysis we've seen post and particularly, post the office rearrangements suggest that we are competitive and the research suggests that our fees are around average. And in fact, the management fee structures at A&O and Goodman are more onerous than ours. So we're not uncomfortable in terms of our competitiveness, in terms on what we charge on management fees. The whole internalization versus external manager debate is one that I can't really contribute to. It's a shareholder issue. I think participants in the market would say there's room for both models. It all comes down to performance and performance in terms of unit holder returns. So one is, internal management, the other thing is the panacea. There are other factors. Ongoing debate, I imagine, Marcus.
Okay. Thank you, everybody, for coming today. We're looking forward to beating many of you on a one on one, and getting down to Wellington, seeing you, Jason. And so thanks for coming.