



RODNEY'S RAVINGS take an open-minded and at times irreverent look at topical economic issues. Unlike our pay-to-view reports, that are for the eyes of subscribers only, the **RAVINGS** are free and you may forward them to other people. You can sign up to the **RAVINGS** and the free **Property Insights** reports on our website – www.sra.co.nz – where you will also find information on our pay-to-view reports.

RODNEY'S RAVINGS

Could house prices fall 42%?

EXECUTIVE SUMMARY

I didn't realise that I was predicting that the national median house price would fall 42% in 2009 from the peak level in 2007, but since that is what it says on the front page of the business section of the NZ Herald it must be true (NZ Herald, Tuesday, January 6, 2009). Or NOT! The Herald article appears to be a case of not letting the truth get in the way of an eye-catching headline and there are no hard feelings on my part (although there will be if we receive any letter bombs or anthrax in the mail from disgruntled property owners or real estate agents). But suggesting I am predicting a 42% fall in the national median house price is a sufficiently large misrepresentation of my views to warrant this Raving to set the record straight.

And while I am setting the record straight it is timely to inform people about the blatant misrepresentation of our report on the Mangawhai market that was contained in an advert taken out in the NZ Herald last year by the Mangawhai Business Association, with the seeming purpose of the advert being to discredit the quality or accuracy of our property research. If we get something wrong in our free **Property Insights** reports I am happy to acknowledge that as I did in the case of the Lake Tekapo report. Ironically our mistake in the case of the Tekapo report was to rely on information contained in an article in the Christchurch Press (again, don't always believe what you read in the newspaper!). But if anyone wants to take us to task over our free property reports I ask that they at least read the reports properly first and don't try and discredit them based on misrepresentations or bogus facts.



Rodney Dickens
Managing Director and Chief Research Officer
Strategic Risk Analysis Limited
09 437 6699 (Whangarei) 027 2882209
rodney@sra.co.nz



Any publicity is good publicity, especially if you want to be relegated to the looney fringe

I didn't realise that I was predicting that the national median house price would fall 42% in 2009 from the peak level in 2007, but since that is what it says on the front page of the business section of the NZ Herald it must be true (Tuesday, January 6, 2009). In the first instance I must complement the Herald for using an old photo that takes about 10 years and 10 kgs off the current day me and as my mugshot, one of six, appears next to that of Alan Bollard they have done me another favour (i.e. pride of place but one). But when the prime exposure includes -42% in 11mm high red text, which is presented as my pick for how much house prices will fall in 2009 from the peak level in 2007, I must set the record straight for fear of being considered part of the looney fringe that gets off on predicting outlandish occurrences.

Any publicity is supposed to be good and as a result of the article a number of people have signed up to our free reports (you can do so on www.sra.co.nz), but probably more people, especially property owners and real estate agents will have understandably put my photo on a dart board to extract revenge for my supposed doomsday prediction. But there are no hard feelings (i.e. a correction in tomorrow's Herald would be nice but is certainly not necessary and would be a waste of time unless it appeared in 11mm high red text on the front page of the business section). This is simply a case of not letting the truth get in the way of an eye-catching headline, but it is of sufficient mega-proportions to warrant this Raving to set the record straight. And besides, as long-time readers will be aware the Ravings have only been noticeable by their absence in recent months - a by-product of us being too busy with paid work to focus much on free/marketing reports - so I must further thank the Herald for this opportunity to have a rave.

The version of the article in the NZ Herald loaded on the Herald's website can be viewed using the web-link below, although the web-version of the article doesn't include either the flattering photo or the offending

-42%. http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10550607&pnum=0

In one of life's amusing twists 42 is the answer to the meaning of Life, the Universe and Everything (use the link below if you aren't familiar with insights from the Hitcher's Guide to the Galaxy). But -42% is certainly not my answer for how much the national median house price will fall in 2009 from the peak level in 2007 or over any period (unless "nuclear bombs" start reigning down on Chicken Licken's head!). http://en.wikipedia.org/wiki/The_Answer_to_Life,_the_Universe,_and_Everything#Answer_to_Life.2C_the_Universe.2C_and_Everything_.2842.29

What I really said about house price prospects

Thankfully the Herald article quotes accurately albeit a bit awkwardly what I wrote in one of the **Housing Hell** Ravings (the following link will take you to the part of our website where these and other Ravings are housed - <http://www.sra.co.nz/literacycentre.html>). The following paragraph is what the article by Anne Gibson, the Herald's property editor with whom I get on well (which is another reason for no hard feelings), attributes to me:

One economist went much further. "Housing hell", wrote Rodney Dickens looking at 2009 and beyond. "The average rental income will have to increase 71 per cent or the median house price will have to fall 42 per cent," he said, if historical average rental yields of 7.7 per cent on residential property were to apply. "Or, more likely some combination of the two will unfold."

"Or, more likely some combination of the two will unfold" means just that (i.e. the yawning gap between rental incomes and house prices will be closed partly by rising rents and partly by falling house prices, but it will not be closed by either a 71% increase in rents or by a 42% fall in house prices!!!). So maybe I protest too much, but anyone glancing at the article would be completely within their rights to assume I am predicting a 42% fall in house prices and if I was I should be consigned to the looney fringe. After the paragraph above Anne gave a pleasant little plug for our business but thankfully without giving out our mail address because we don't have either letter-bomb or anthrax handling facilities (not yet anyway!).

The earlier **Housing Hell** Ravings, which are well worth a look if you haven't already read them, focus on what happens to real or inflation adjusted house prices after mega-booms in prices of the sorts often only experienced once or twice in a lifetime (i.e. of the sort experienced between 2002 and 2007 during which the national median house price increased by 108% while the average employee's income increased only 24%). People in general, including from our experience some property professionals, aren't well placed to appreciate what can happen when housing bubbles of the sort that brewed between 2002 and 2007 burst.

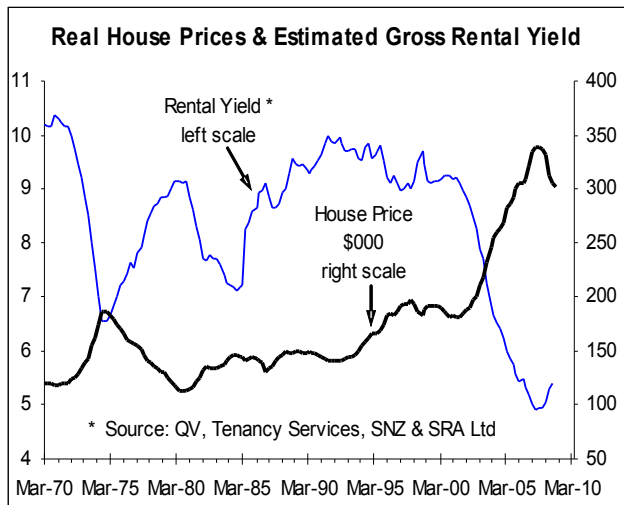
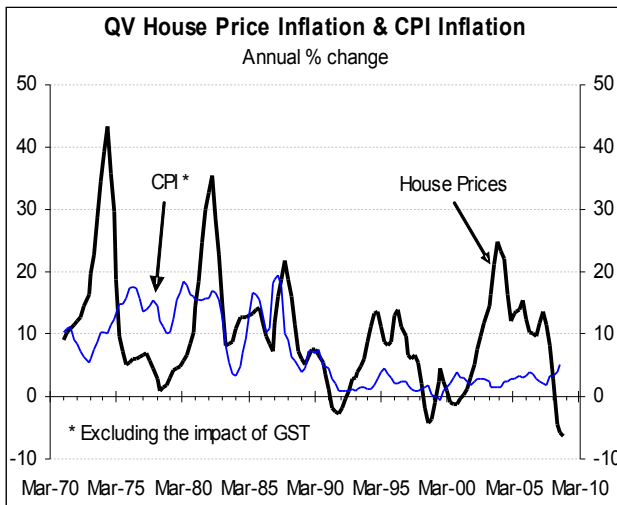
While Strategic Risk Analysis Limited will use all reasonable endeavours in producing reports to ensure the information is as accurate as practicable, Strategic Risk Analysis Limited, its employees and shareholders shall not be liable (whether in contract, tort (including negligence), equity or any other basis) for any loss or damage sustained by any person relying on such work whatever the cause of such loss or damage.



This is because it is normal for people to use recent experience, like the last couple of housing cycles (or the last couple of years for the more myopic), as a basis for picking what will happen during the next downturn. But when the cycle we are in is a once or twice in a lifetime type of cycle then by definition recent experience will be as useful as greased dunny paper (which doesn't explain why greased dunny paper was so popular for so many years in public toilets, but that is digressing).

First it is useful to understand why investors should focus on prospects for real or inflation adjusted house prices. The end-game for investing in housing for many people will be to generate wealth increases that can be used either directly by spending the accumulated capital or via the income stream the capital generates (i.e. rents, dividends or interest) to sustain themselves in retirement. When viewed in this context or from the perspective of building up a large legacy to pass on to future generations the objective should be to achieve increases in wealth greater than the increase in prices in general. In this context housing is only a good investment if house prices increase more than the prices of the goods and services people will buy in retirement (e.g. food and healthcare prices, and the prices of treats for grandchildren for those so afflicted).

The left chart shows what has happened to annual house price inflation relative to annual inflation in prices in general, the latter measured by inflation in the Consumer Price Index (CPI), since 1970. On average annual house price inflation (10.1%) has outstripped annual CPI inflation (7.2%), but by much less than is probably perceived to have been the case by many people, while there has been one previous period on the fringes of my living memory when house price inflation ran well below CPI inflation. After increasing by 140% between March 1970 and December 1974 the annual increase in the national median house price averaged 4.9% during 1975-79 while CPI inflation averaged 14.4% (i.e. relative to prices in general the national median house price fell 9.5% per annum for five years). In real or inflation-adjusted terms the national median house price fell a cumulative 40% between December 1974 and December 1980 (see the black line in the right chart which adjusts the national median house price for CPI inflation).



The mega-boom in house prices between 1970 and 1974 got well ahead of the increases in rents and resulted in our estimate of the gross rental yield on rental properties falling from over 10% in the early-1970s to 6.5% by December 1974 (see the blue line in the right chart). But the rental yield was restored to a reasonable level by 1980, although this was achieved by rents (and incomes and prices in general as measured by the CPI) increasing much more than house prices. During the latest mega-boom or speculative bubble our estimate of the gross rental yield has fallen from around 9% to under 5%, with the latter only being sustainable if mass lunacy remains the order of the day. Sanity is reasserting itself, with the national median house price having already fallen 6.8% since December 2007 based on the QV data while the average rental income has increased almost 3% since December 2007 based on the rental component of the CPI (i.e. relative to rents house prices have fallen almost 10%). As I argued in the **Housing Hell** Ravings, part of the adjustment back to a sane rental yield will come via falling house prices and some through rising rents (and rising incomes and prices in general). In our **Housing Prospects** reports, a must read for anyone serious about understanding housing and section market prospects (visit our website for information on these reports), we try and quantify the extent to which the adjustment will come via falling house prices versus rising rents and the likely timeframe for these adjustments.



The challenge as the current speculative bubble unravels is in one respect tougher than that faced after the 1970s bubble. The potential is now much lower for increases in rents, incomes and general prices to wash away the excesses in house prices and the associated increase in debt levels by home owners and investors. This implies that a significant amount of the adjustment will have to come via falling house prices, but we still expect more than half of the adjustment to come via rents and incomes rising relative to house prices, although this will to be a drawn out process over several years or more, just as was the case during the fall in real house prices in the 1970s. And until this adjustment has occurred we will be warning investors that housing is not a quality investment. But a day will come, which readers of our **Housing Prospects** reports will be the first to hear about, when housing again represents a good investment. And consistent with our aim of helping clients both avoid disaster during downturns and prosper during upturns we will be singing the praises of housing when a combination of lower interest rates and an upturn in net migration is about to underwrite the next golden era in the housing and section markets. While house and section prices will follow a winding road even during the protracted adjustment period we expect, including episodes of rising prices which we will be warning clients about in advance.

Time to wipe the slate clean with respect to misrepresentations

Last year I was effectively accused of being part of the looney fringe by the Mangawhai Business Association (MBA) in an advert they took out in the NZ Herald, so I'd also like to thank the Herald's misrepresentation of my views on house price prospects to address the attempt by the MBA to tar our good name. A number of clients and many of our contacts in Whangarei read the advert and realised that it was a case of sour grapes which is why I have overlooked the issue up until now, but the accusations by the MBA are sufficiently substantial to warrant a brief comment.

In the advert the MBA asserted that in our August 2008 report on Mangawhai (use the following link to assess this and our other **Property Insights** reports - <http://www.sra.co.nz/free.html>) we claimed that there were 450 "sections available for sale in the Mangawhai area". The MBA advert says that this is double the number actually available for sale and largely on the basis of that difference goes on to label our report "economic sabotage" (i.e. crap analysis). If the members of the MBA had taken the time to read our report before blowing off steam, even just the first paragraph of the report, they would have realised that the 450 number we refer to in the report relates to vacant sections available to be built on not sections for sale. There is a major difference between vacant sections available to build on and sections advertised for sale, a distinction we made in the report but one which the MBA either overlooked by accident or by design in their desire to discredit our report.

I don't expect the MBA to put an advert in the Herald correcting the blatant misrepresentation of the our Mangawhai report contained in the ad they took out last year, I can even appreciate why they don't like someone from outside critiquing the local property market. But if anyone wants to take us to task over our free property reports I ask that they at least read the reports properly first and don't try and discredit them using misrepresentations and/or bogus facts/analysis.