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PROPERTY INSIGHTS

The lifestyle property market

EXECUTIVE SUMMARY

Many people harbour a desire to live on a lifestyle property and this has helped fuel a major increase in the number of lifestyle properties in recent years. But paralleling the residential section markets in various parts of the country and most coastal and resort markets, supply increases in the lifestyle section market have run ahead of demand increases. Consequently a significant supply overhang has developed in the lifestyle market in numerous regions of the country. And like the urban dwelling and residential section markets, prices in the lifestyle market are now well out of line with fundamentals like affordability. While the lifestyle market reacts slower than the dwelling market to the changes in the demand-supply balance, we assess that it faces at least as much downside risk on the price front as the urban dwelling market.



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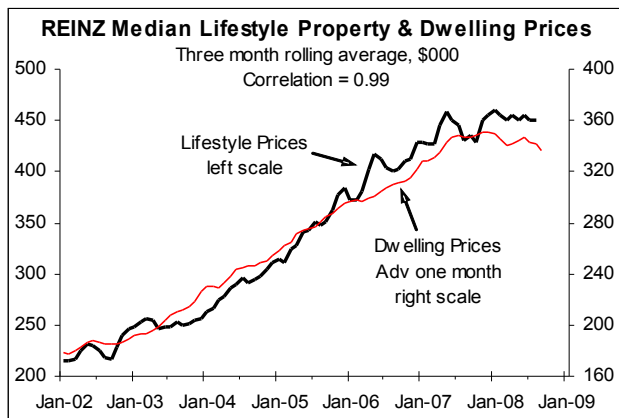
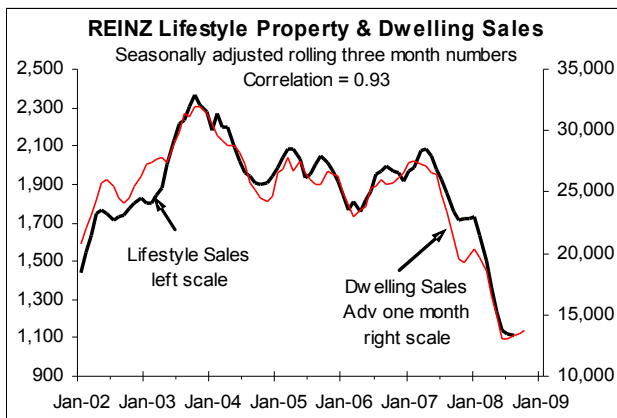


Where the urban housing market goes the lifestyle market follows

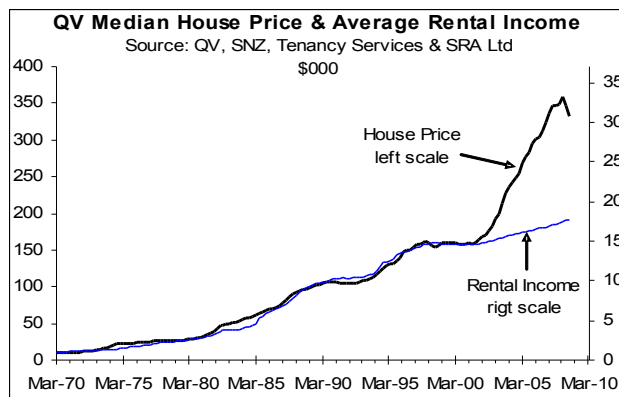
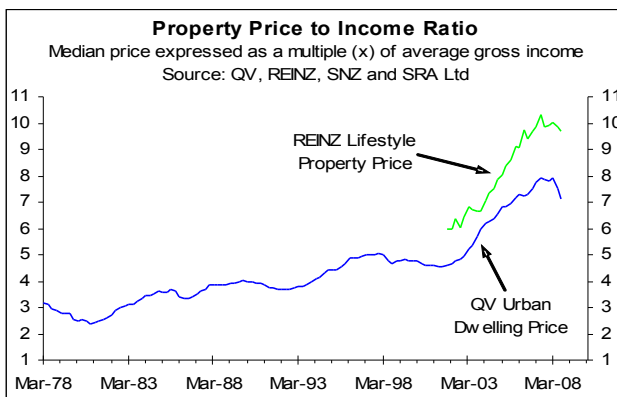
In the year to August 2008 there were 5,707 lifestyle property sales versus 64,703 urban or non-lifestyle dwelling sales based on the REINZ numbers. The lifestyle market is a significant niche of the overall residential property market and it behaves much like the urban residential market.

The left chart shows that the cycles in the number of lifestyle property sales (the black line) largely follow the cycles in urban dwelling sales (the red line). The best fit in the left chart is with the dwelling sales line advanced or shifted to the right by one month. This suggests that on average buyers of lifestyle properties take around a month longer to respond to the drivers of demand, like interest rates, than do urbanites. This may just reflect that more issues need to be considered when buying a lifestyle property and the less homogenous nature of properties, although maybe country folk are just more laidback than urbanites.

The best fit is also with urban dwelling prices leading lifestyle property prices by one month (see the right chart below), although only when we see a full cycle in prices will it be possible to say categorically that changes in lifestyle property prices lag changes in urban dwelling prices by around a month. Although our research on the lifestyle property market around Hamilton this year supports the idea that lifestyle property prices lag urban dwelling prices.



It would be nice to have data over a longer period than just from 2002, but based on the two charts above it seems reasonable to conclude that the analysis of prospects for the national housing and section markets contained in our pay-to-view **Housing Prospects** reports can be applied almost verbatim to the national lifestyle market. On the positive front this suggests demand for lifestyle property is about to rebound moderately fuelled by the fall in mortgage interest rates since April (although this is provided the world doesn't end in the meantime because of the US-international banking crisis, as covered in our **Special Client Report** of 9 October). But by association lifestyle property prices are in cloud cuckoo land, like urban house and section prices. See the Raving titled **Housing Hell Revisited** for our most recent – outside our regular client reports – views on the sanity of house prices at the peak levels reached earlier this year (accessible from this link - <http://www.sra.co.nz/pdf/housinghellrevisited.pdf>).



The left chart above shows how out of line with historical norms the national median dwelling price is relative to the gross annual income of the average employee (the blue line). But while the national median dwelling price peaked at around 8x the average income, the national median lifestyle property price peaked at over 10x (green line). The right chart above shows how the national median house prices has got hugely

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out of line with the average annual income from rental properties, which is evidence that the housing market has experienced a speculative bubble that is just starting to unravel. We don't have rental data for the lifestyle market, but as well as being sky high relative to incomes it is likely that lifestyle property prices are at least as much out of line with the fundamentals used to assess value, like rental income, as are residential property prices. There is a time bomb and the clock is ticking, but we don't know whether there will be one big explosion, like that unfolding in the US housing market, or a series of smaller explosions drawn out over the next few years.

The balance between demand and supply is not flattering

At its worst in the US housing market there have been enough houses advertised for sale at any one time to satisfy around eleven months of sales/demand, with this being a good measure of the balance between demand and supply (a balance that will ultimately dictate what will happen to property prices). When we look at the stock of lifestyle properties advertised for sale on the REINZ website www.realestate.co.nz for the 14 regions covered in the table below we find that there is enough stock in most regions to satisfy well over eleven months of sales based on the average annual sales rates experienced since 2001. In Hawkes' Bay for example, which tops the table, the 524 for sale ads equate to around 22 months of sales. Both the ads and the sales numbers used in the table include developed and undeveloped lifestyle properties.

The table assumes each ad equates to one property for sale, which will not be the case because some properties are advertised by more than one agent, although when it comes to lifestyle sections/blocks some ads are for more than one property. There may also be some distortions caused by the regional definitions used for the ads not quite lining up with the definitions used for the sales data, but as much as allowable we have lined to two up. Even with these qualifications we are confident that the table is correct in signalling that numerous regions have a demand-supply balance that is worse than the US housing market. However, most of the people who bought NZ lifestyle properties in the last couple of years should be under much less financial stress than many of the people in the US who bought houses in the last few years using the likes of low documentation and no documentation loan agreements. Property prices only tumble when there are lots of forced sellers. The lending scam in the US has meant there have been a sizeable number of forced sales. Forced sales should be much less frequent in NZ, although they will still play a part in depressing local prices. Financial catastrophe aside we don't expect NZ lifestyle property prices to tumble in the near-term as much US house prices have, but a significant near-term fall followed by a protracted grind lower, certainly in real or inflation-adjusted terms if not in actual dollar terms, seems likely.

In the **Housing Prospects** reports, which are produced eleven months each year, we look at the same measure of the demand-supply balance for housing in 24 cities/districts and for sections in 17 regions/sub-regions. To put the lifestyle market in perspective, in general it has a materially worse demand-supply balance than the housing market but a somewhat less worrying balance than the section market.

Lifestyle Property For Sales Ads

	Number of Ads ⁽¹⁾	Months to Sell ⁽²⁾
Hawke's Bay	524	22.3
Otago	632	20.0
West Coast	168	19.1
Northland	1,153	18.6
Auckland	2,145	18.1
Bay of Plenty	865	17.6
Waikato	1,055	14.2
Wellington	455	13.9
Nelson/Marlborough	393	12.6
Manawatu/Wanganui	526	11.2
Gisborne	69	11.0
Southland	231	10.1
Canterbury	898	9.5
Taranaki	149	8.0
New Zealand	9,263	14.9

As is the case in most coastal and resort markets, many of the lifestyle markets around the country have experienced an unprecedented level of subdivision activity over the last several years, resulting in supply now being well above demand. The demand-supply balances identified in the table, especially for the regions at the top end of the table, portray a ticking time bomb.

Many Kiwis and a number of immigrants harbour a deep-seated desire to live in the country, but in numerous cases the joy of country living fades when the vagaries of grass growth (and lawn mowing), noisy neighbourhood dogs and birds, and constant trips to town to take the kids to sports, cultural events or friends, become the reality of country living.

⁽¹⁾ Sampled on 7 October 2008 from www.realestate.co.nz

⁽²⁾ Based on REINZ annual average sales since January 2001



This year we have twice had a reasonably in-depth look at the lifestyle property market around Hamilton. Our first visit was in Easter during which we assessed that the local market was living on borrowed time, with would-be vendors still after top dollar even after house prices were already reported to be falling in the Hamilton market by some experienced local agents. When we visited again several weeks ago we found a number of the more over-priced properties we inspected at Easter still on the market and not selling in part because some vendors were slow to recognise the new reality sweeping the countryside. In general we found that properties that would have been listed for \$700-800k in March were now asking around \$100k less. Reasonably priced properties were selling, although sales volumes were down materially, but it appeared that the lifestyle section/block market was still trying to defy gravity and as a result sales volumes appeared to have almost dried up.

Deep pocketed developers might try and sit it out and wait for demand to recovery, but in our assessment this will be a long and lonely route. The section market is where the largest increase in supply has been and as covered in our monthly **Building Barometer** reports in the context of demand for new dwellings and residential sections, a major challenge the lifestyle section/block market faces is that developed property prices are falling, making the option of buying a section and building much less financially attractive. A couple of the real estate agents we meet in Hamilton had caught on to this and were using it as a means of promoting the merits of developed properties over buying undeveloped sites and building.

The analysis of the behaviour of dwelling prices relative to section prices in the urban residential market contained in our **Housing Prospects** reports is probably applicable to the lifestyle market. We find that urban dwelling prices lead residential section prices by several months. So just as the prices of developed lifestyle properties have started to reflect the new and much less favourable demand-supply balance, the same reality should be starting to come to bear on lifestyle section/block prices. But it will prove to be a long road to hoe and in some parts of the country it will be decades rather than years before the recent increase in supply is soaked up.

Location NOT, location NOT, location NOT

The lifestyle section market, possibly even more so than the Auckland apartment market, has a huge diversity of quality ranging from “I’d kill for this one” to “I’d die if I had to live here”. This issue was canvassed in our West Coast lifestyle report (<http://www.sra.co.nz/pdf/WestCoastlifestyle.pdf>), while the Kerikeri, Paihia and Russell report - <http://www.sra.co.nz/pdf/KerikeriPaihiaRussell.pdf> - also presented pictorially some of the mutton dressed up as lamb in the local lifestyle section market. Below is a small selection of the photos from these reports of potential Location NOT lifestyle blocks/subdivisions.



In some cases farmers have carved off one-off lifestyle blocks or mini lifestyle subdivisions in places that even hermits might consider undesirable (e.g. corner sites on main roads with limited views other than the bush, in shady gullies, or far from where most people would want a lifestyle block). And just as problematic, some of these Location NOT properties have been asking silly prices.

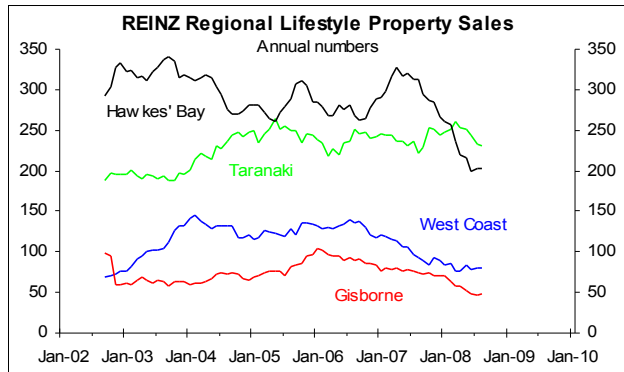
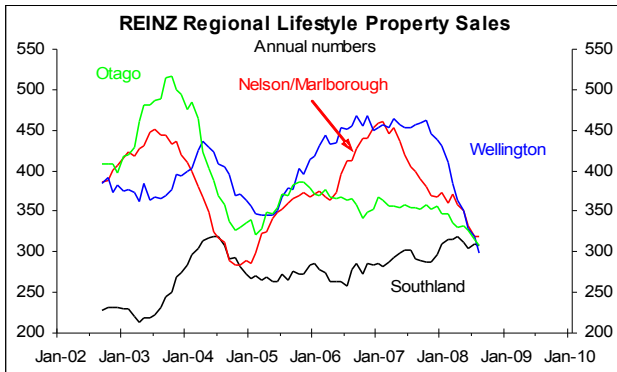
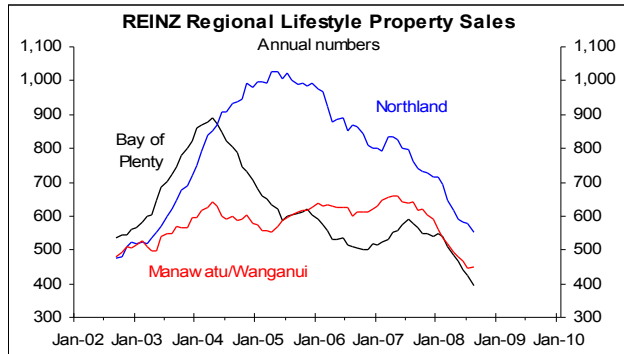
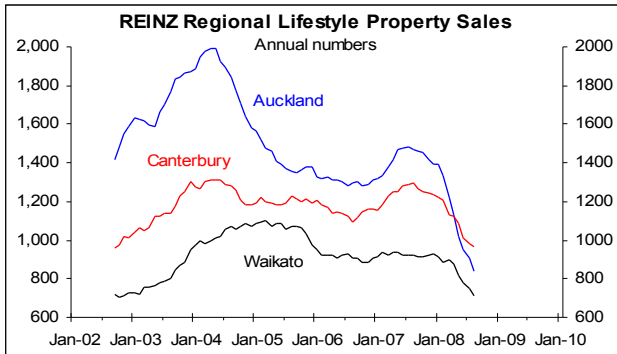
The quality properties were the price setters during the boom, which dragged up prices of the good but unspectacular properties, which in turn boosted prices of the lesser quality properties. But on the way down the rolls will be reversed. The dogs won't sell at any price, the prices of lesser quality properties will get marked down severely which will make good properties look expensive on a relative basis, while as the prices of the good properties fall it will start to make quality property look expensive. And the myth that they ain't making any more land, which was rife in the coastal market, gets exposed. Land supply in total hasn't changed but the amount of it that has been carved up into lifestyle subdivisions over the last few years means the supply of lifestyle blocks has got well ahead of current and near-term demand, and in some case it has grown well above medium-term demand. This is the same process as is unfolding in the coastal section market with sections well back from the beach dragging down prices of sections just back from the beach, which will impact on absolute beachfront prices even though they ain't making much more of it.

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A graphical look at the regions

The four charts below, which show the rolling annual number of lifestyle property sales for 14 regions, identify that there has been major regional differences. The regional differences in lifestyle property sales are much more marked than the differences in regional house sales. This will in part reflect different attitudes by local councils to permitting lifestyle subdivision, noting that the sales data include both developed and undeveloped lifestyle properties.

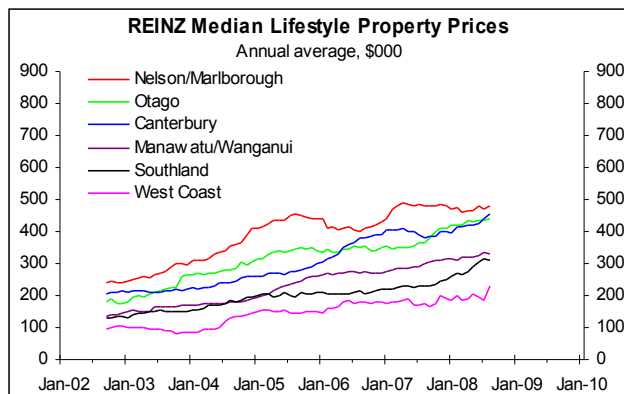
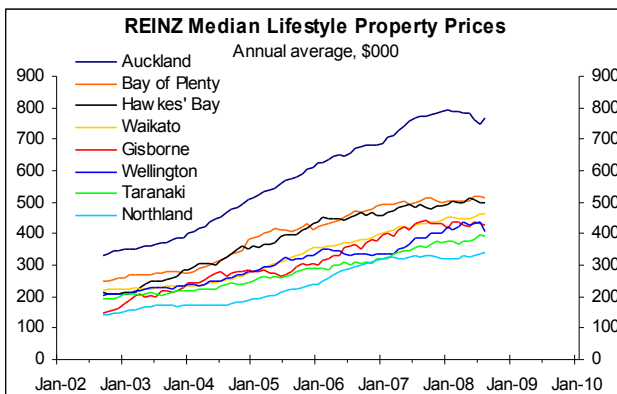


REINZ Median Lifestyle Property Prices
\$000, average for year to August 2008

Auckland	\$768	Gisborne	\$427
Bay of Plenty	\$515	Wellington	\$406
Hawkes' Bay	\$498	Taranaki	\$393
Nelson/Marlborough	\$478	Northland	\$342
Waikato	\$461	Manawatu/Wanganui	\$332
Canterbury	\$456	Southland	\$310
Otago	\$438	West Coast	\$230

As the table shows, there are also major differences in lifestyle property prices around the country. As you would expect, regions a long way from major urban populations are the cheapest (e.g. West Coast and Southland), while Auckland is by far the most expensive. As well as proximity to major urban areas affecting prices, the quality or value of the land for agricultural use and whether it has sea/water views will also play a significant part. The high prices in the Bay of Plenty will reflect a combination of these factors as well as population.

But while sales volumes have varied hugely in different regions, prices have been more correlated (see the charts below). This is because local urban dwelling and residential section prices, which have reasonably high correlations between regions, will be benchmarks for local lifestyle property prices.



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