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PROPERTY INSIGHTS

Taking Stock of the Housing and Section Hotspots

EXECUTIVE SUMMARY

Christmas can be a good time to take stock of things. In many retail stores around the country petty thieves and some staff will be taking free samples of stock home for Christmas. On farms in some parts of the country uninvited locals will be absconding with stock of the livestock variety to put on the Christmas barbeque.

Christmas brings with it the holiday season and to us at Strategic Risk Analysis holidays are synonymous with property research. So it is timely that this Raving takes stock of the housing and section markets, including a look at some of the coastal and resort hotspots. Our research shows that in some places there is an avalanche of stock sitting on the market in search of buyers. Maybe next year or the year after retailers will be tempting Christmas shoppers with the offer of a free section in the Far North or in the Queenstown-Lakes District with every purchase over \$500.



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TAKING STOCK OF THE REGIONAL HOUSE AND SECTION MARKETS

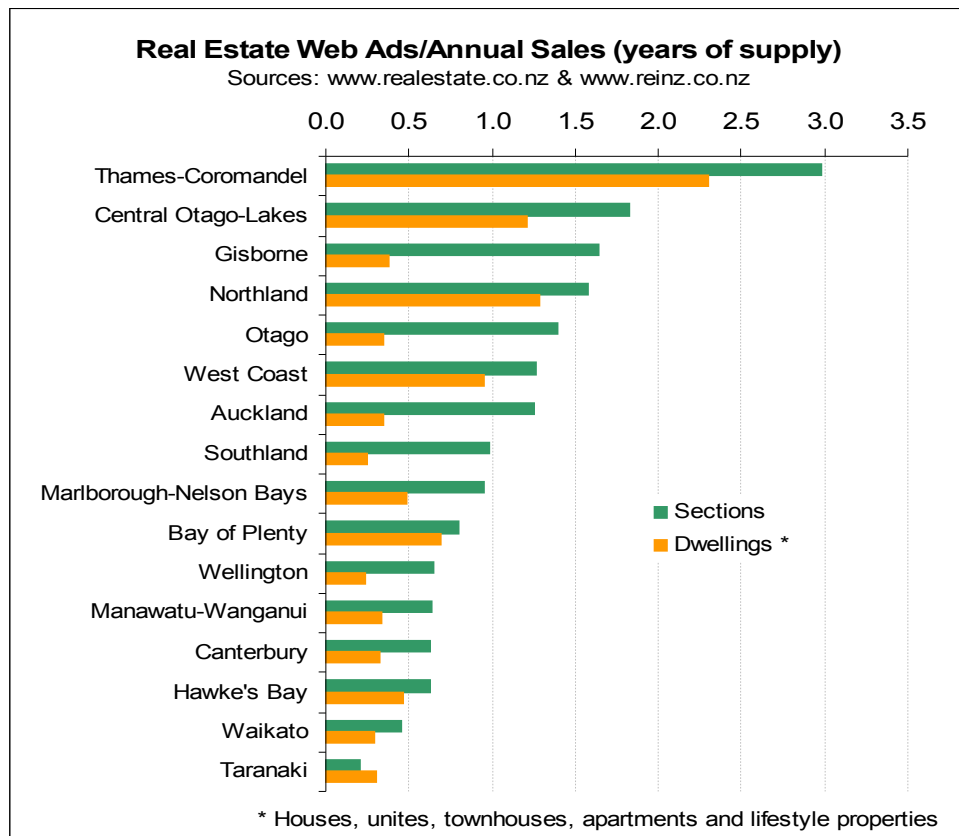
The stock/sales ratio is an important gauge in some industries (e.g. total retail sector stocks according to Statistics NZ run around \$5bn compared to annual retail sales of \$60bn, meaning stock levels turnover around 12x per year or every month). So we thought a look at the stock/sales ratio in the regional house and section markets might prove enlightening. And it did, even if our findings will leave some feeling like they have been enlightened by being hit by a bolt of lightning.

We used the REINZ's website (www.realestate.co.nz) to assess the number of sections and dwellings (houses, units, townhouses, lifestyle properties and apartments) advertised for sale as at Friday 15 December. The number of for sale adverts is used as a proxy for the stock of property on the market. We then used REINZ's other website (www.reinz.co.nz) for actual sales numbers.

The chart below reports for each region the number of years it will take to sell the existing stock of sections and dwellings advertised for sale, assuming sales continue at the same rate as the last year. For example, in the Thames-Coromandel pseudo-region there were 701 section-for-sale ads compared to 235 section sales over the last year, which gives a stock/sales ratio of almost three (i.e. it will take almost three years to sell the current stock of sections provided sales run at the same level as over the last year).

Having not assessed stock/sales ratios in past years it is hard to say what reflects oversupply versus undersupply. However, we suspect that having more than a year's sales currently being advertised reflects material oversupply, while having more than two year's sales currently on the market represents an avalanche of supply.

There are technical issues: some properties may be advertised more than once (not so common because of the prevalence of sole agencies); some real estate agents may be slow to remove sold properties from the website; some ads can cover more than one property, particularly in the case of section ads but also to some extent for apartment ads; many sections and some dwellings are not sold via real estate agents; while it was not always possible to get perfect regional matches between www.realestate.co.nz and www.reinz.co.nz. However, these technical issues are probably overshadowed by our assumption that sales levels will remain around the same as the last year. The risk in some places is that demand or sales will run below last year's level, which implies that it will take even longer to clear current stock levels.



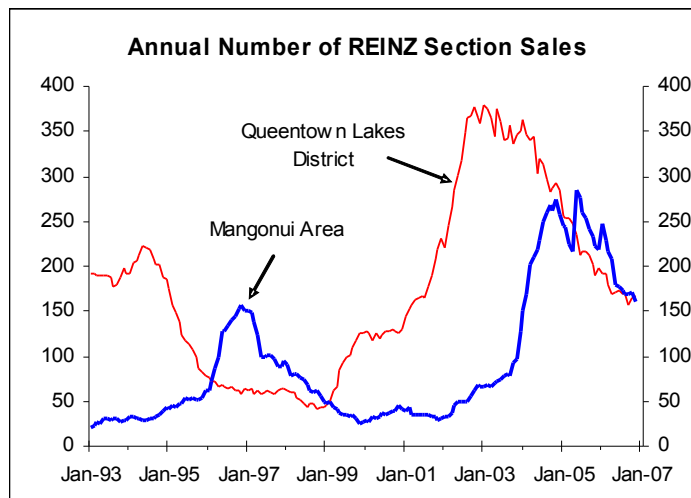
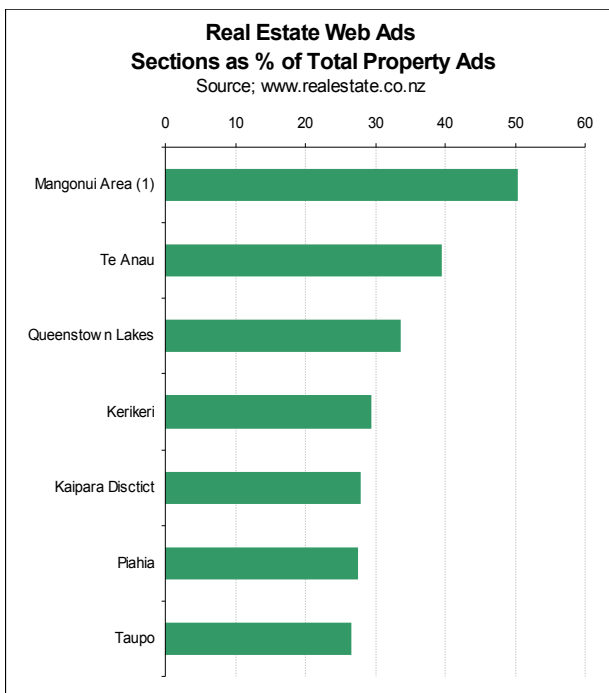
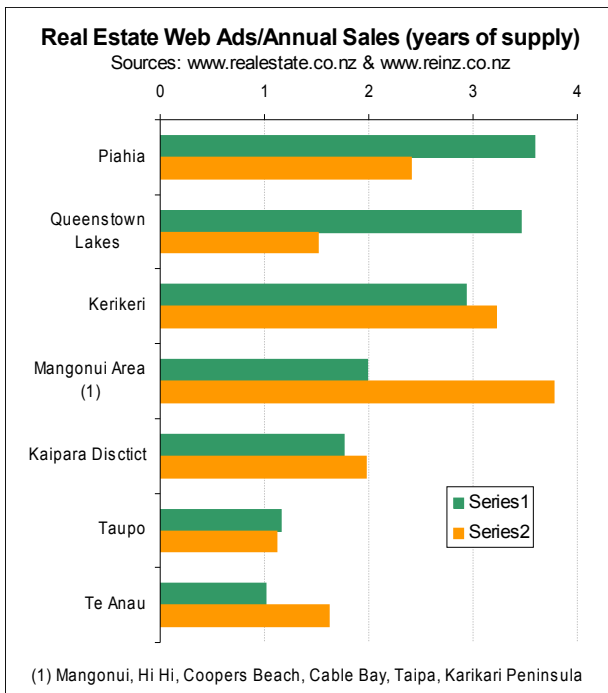
Many regions are experiencing a level of subdivision activity seldom if ever seen before. In some regions the subdivision activity is largely supported by demand from locals and/or immigrants who want to build

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dream new homes (e.g. Taranaki and to a lesser extent the Waikato, Hawke’s Bay, Canterbury and the other regions in the bottom 40% of the chart above). However, in some regions/places investors have driven demand for sections as much if not more than demand from end-holders/users. In these places the high stock/sales ratios in part reflect investors trying to extract themselves, as well as developers trying to sell sections in new subdivisions and individuals trying to sell sections cut off existing properties.

The left chart below shows a selection of hotspots, all of which have at least one year of sales currently being advertised for both sections and dwellings. The right chart below shows the number of section ads as a % of combined section and dwelling ads for these places (e.g. in the Mangonui Area 50% of all ads are for sections). We guesstimate that in a normal mature market around 10% of all property ads should be for sections, which reflects the preference of the majority of people to buy existing properties rather than experience the trials and tribulations of building a house, although this will be higher in developing holiday areas which lacked supply of existing properties. However, to us the right chart below rings warning bells in terms of the supply of sections relative to existing houses. A section in an idyllic spot in the far north with fantastic sea views or in parts of the alpine south with spectacular mountain and lake views may seem like “location, location, location”, but investors need to realise that demand/sales in some of these places can fall dramatically during weak markets and stay low for a number of years (e.g. see bottom chart).

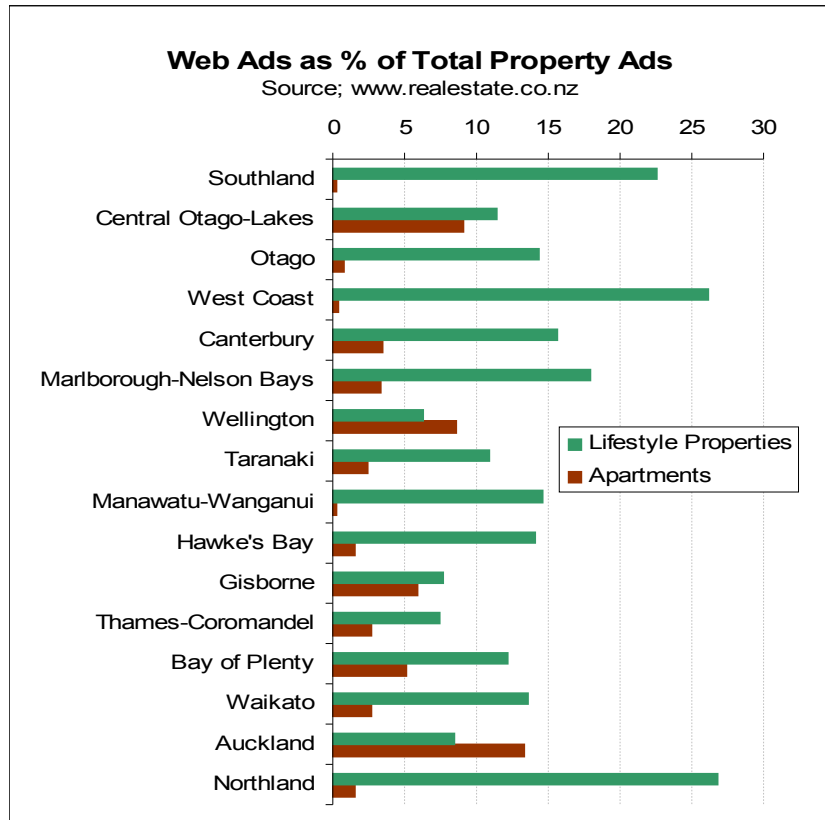


A look at for sale ads for apartments and lifestyle properties provides some interesting insights, with the chart below showing ads for these categories as a % of total property ads on the REINZ’s website.



Northland is the lifestyle capital of the world based on lifestyle property ads as a % of total ads, narrowly piping the West Coast for gold, while Southland comfortably takes the bronze. Northland is also numero uno in numbers of lifestyle ads at 1,365, swamping the West Coast, at 240; Auckland takes the silver at 1,145 lifestyle ads, Canterbury the bronze at 865 and the Bay of Plenty is outside the medals at 603.

Not surprisingly, Auckland takes gold in the apartment stakes, both on the basis of apartment ads as a % of total ads and based on the number of ads (1,819). The real battle was for the silver, which Central Otago-Queenstown Lakes won in % terms, but in numbers Wellington (259) beat the Bay of Plenty (258) in a photo finish, with Central Otago-Queenstown Lakes also in the photo but a neck behind (251).



So what is the overriding conclusion we draw from having taken stock of the section and house markets, but especially the section market? In a number regions and hotspots portrayed in the charts above it appears that realty has been suspended temporarily thanks to our old friends avarice and blissful-ignorance, which gives the impression that prices can walk on water. However, ultimately prices will be determined by the balance between end-user demand (as distinction from investor demand) and supply.

In many places demand is still being bolstered by ill-informed investors and is well above levels justified by end-holder demand, while we see downside risk to end-user demand based on our view on interest rate prospects (subscribers to **INTERESTING TIMES** are privy to our views on interest rates). Secondary market supply coming from investors trying to quit their holdings will in many places compete with supply from developers. So we see the fundamentals of demand and supply being a bit like a truckload of TNT but with a long and winding fuse (i.e. an explosion – or, more aptly, an implosion – is inevitable, but the timing of the event is hard to predict and will vary from place to place).

In some places, like Kinloch (49 section ads), the proverbial is already hitting the fan (e.g. “Our mission is to find a buyer prepared to make a ridiculous offer on our vendor's lovely section”, source www.realestate.co.nz). Opotiki - one of my favourite places in Godzone, where life is still as idyllic as it once was in many parts of the country, with horses more often seen on the main street than real estate agents - does not warrant a mention because it is too insignificant to waste time on.