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PROPERTY INSIGHTS

Tauranga City, including Mt Maunganui and Papamoa

EXECUTIVE SUMMARY

The climate in Tauranga City/District, which includes Mt Maunganui and Papamoa, has been a magnet for population growth, with the local population growing 55% between 1991 and 2006 versus national population growth of 19%. But while the climate is still a major positive for the local housing market, on our recent fact finding visit we detected a malaise, which was confirmed by the REINZ data. This questions whether the area is currently experiencing its normal strong population growth.

Our research points to The Mt-Papamoa area having priced itself out of the market for a number of would-be residents, especially for sections. This appears to be true to a lesser extent for Tauranga "township". In the last couple of years Hamilton City has offered much cheaper house and section options, which will have been working against demand in Tauranga District. Slow progress with the plans for major new subdivision activity at Papamoa East, where we assume sections will be priced more affordably, will be a factor in the malaise we observed.

We assess that there is more than enough sections available or in the pipeline to meet near-term demand, especially because higher interest rates are in the process of suppressing demand and high section prices are also hurting sales levels. But unlike some of the areas we have researched, there is not a major oversupply of sections relative to medium-term demand prospects. There is one massive residential subdivision, The Lakes at Tauriko on the western outskirts of Tauranga, but it is being released in stages.

Consistent with the malaise in section sales and potentially sub-par population growth, consents for building new houses are running below the national performance, although this may in part be explained by existing house prices offering a more attractive option than buying a section and building. There appeared to be a moderate but not excessive amount of spec building.

Like apartment markets in many parts of the country, investors have played a major roll in funding a large increase in supply of apartments, especially at Mt Maunganui but also to a lesser extent in Tauranga and Papamoa. While it was not possible to get decisive information or data, it looks to us like the apartment market is facing indigestion problems.

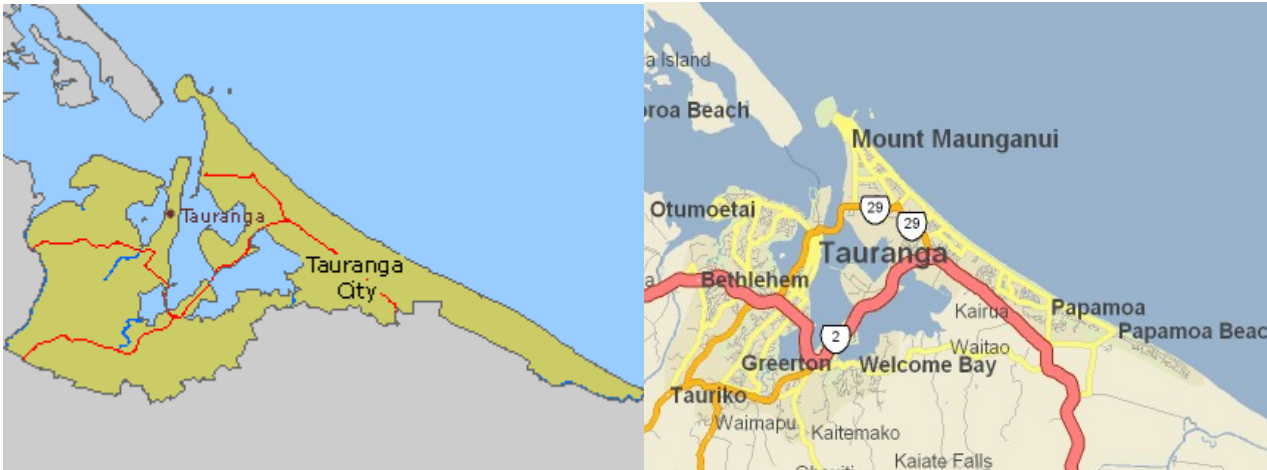


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Tauranga City/District and some background information

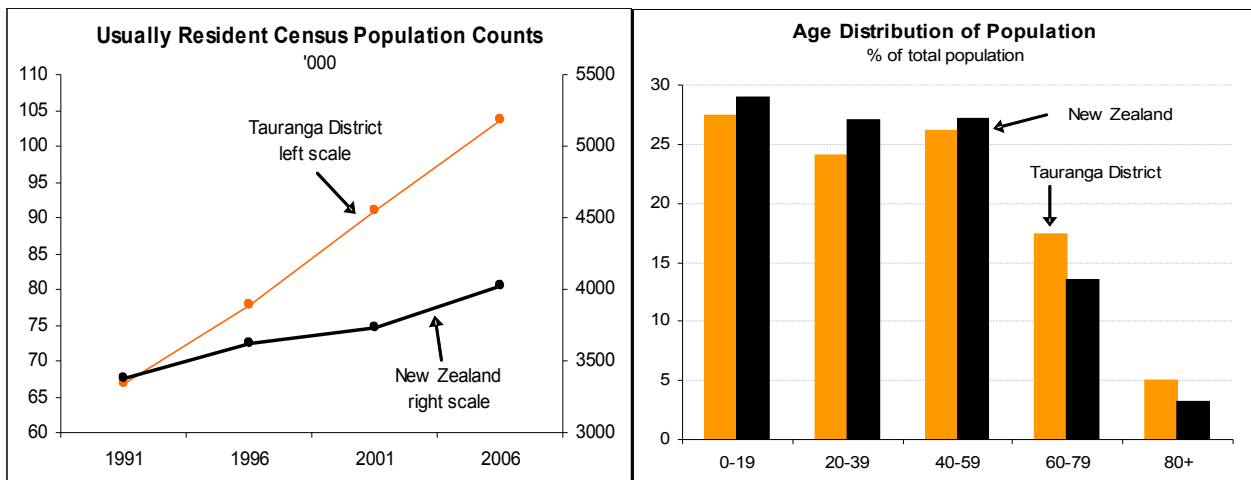
The left map below shows the official boundary of Tauranga City (seemingly also called Tauranga District in some definitions), which includes Mt Maunganui and Papamoa. The right map shows roughly the same area but including some names. Mt Maunganui and even more so Papamoa have been engines of population growth, and with plans for a massive extension in Papamoa East, this will again be the case in 5-10 years when the development of this area eventually proceeds. But the focus of growth has shifted to the peripheral areas of Tauranga “township”, including Bethlehem, Pyes Pa (near Greerton) and the new comer of Tauriko where the single largest subdivision is in progress.



Sources: www.snz.govt.nz and www.wises.co.nz

The left chart below shows Tauranga District population growth thrashing the national performance. Traditionally Tauranga has attracted retirees from the main urban centres like Auckland and Hamilton, as well as from smaller urban centres and from the farming community. Population growth has been greatly supplemented by working age people and associated children, as service sector jobs have been created on the back of a growing retired population. Horticultural jobs are part of the growth story, as is some industrial/semi-industrial development, although the latter has been limited, especially when compared to what is going on in Hamilton.

Tauranga deserves its title as the sunshine City/District, with one of NZ's best climates, which has been a magnet for retirees. As at the 2006 Census the Tauranga District had 23,214 usual residents aged 60 and over, representing 22.4% of the total population (versus 16.8% nationally – see the right chart below). If the Tauranga District had 16.8% of its population aged 60 and over, in line with the national norm, it would have 17,372 usual residents aged 60 and over (i.e. 5,842 less).



However, in recent years the Mt Maunganui-Papamoa area especially has become more of a hangout for working couples and business owners than retirees, although it is still popular with retiring farmers who can afford beachfront apartments. The focus for retirees has shifted to the more affordable areas.

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A malaise has beset Tauranga City, probably reflecting price and job creation

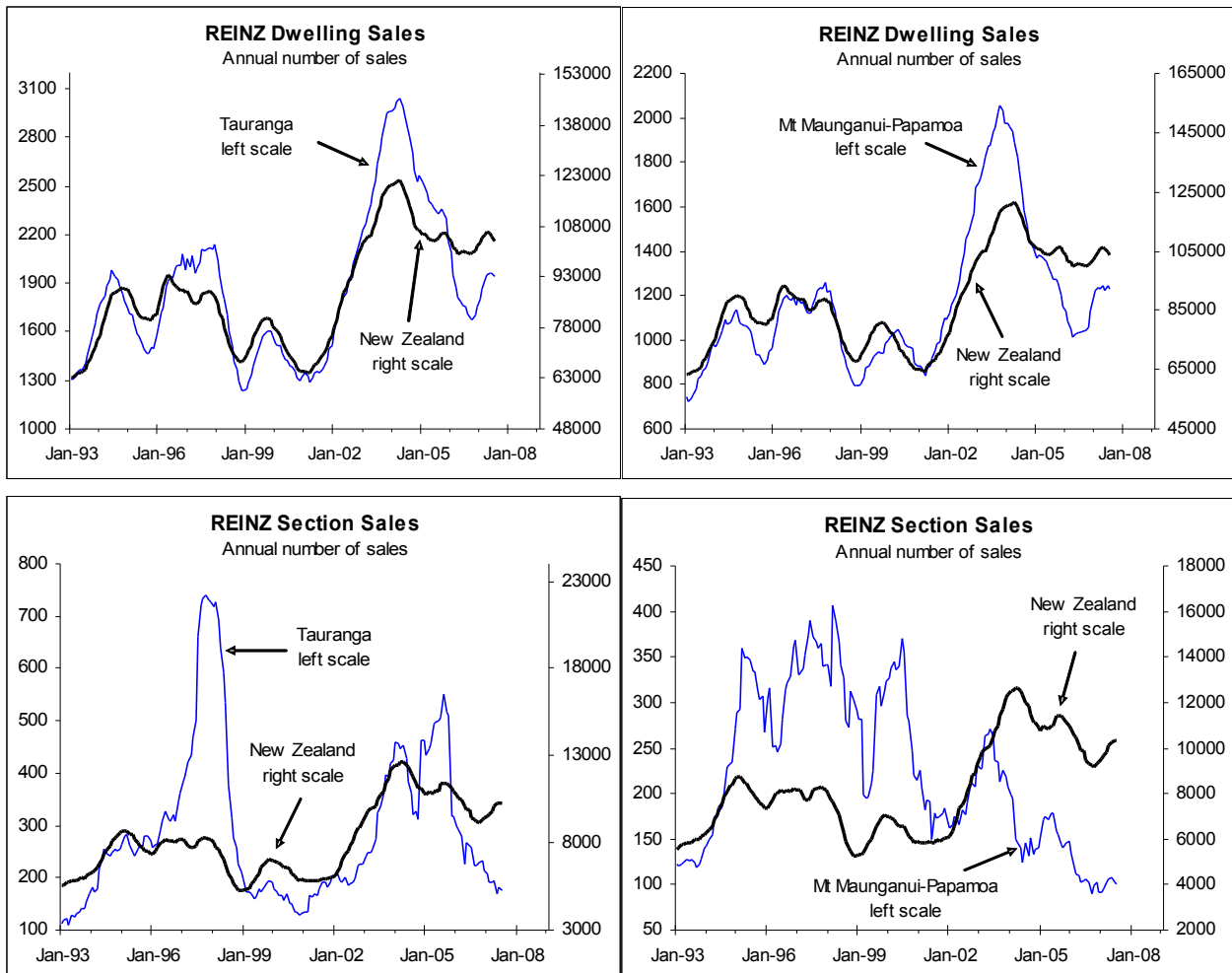
The four charts below show the performance of dwelling sales and sections sales in both Tauranga township and Mt Maunganui-Papamoa relative to nationally (see the appendix for the definitions of Tauranga township and Mt Maunganui-Papamoa used in these charts). These charts tell a story of a boom gone a touch sour. House sales in Tauranga and the Mt-Papamoa sky-rocketed in the early years of the national housing boom – 2002-2004 – but have significantly under-performed over the last two years, although the under-performance was more marked in 2006 than this year.

While the REINZ dwelling sales data picks up the vast majority of sales, the REINZ section sales data materially understate the actual number of section sales because developers often sell direct to builders and individuals and these transactions do not get picked up in the REINZ data. However, the REINZ section sales data should still give a flavour of what is happening in the section market.

While section sales in Tauranga were supercharged in 2003-05 they have fallen dramatically since. A lack of new supply has meant The Mt-Papamoa has in recent year experienced low section sales compared to the boom in sales over the 1995-2000 period, with sales now at the lowest level since the beginning of recorded time (i.e. since at least 1993). Again, the next major boom at The Mt-Papamoa will occur when the major Papamoa East development proceeds, which still seems to be several years down the track.

However, part of the story, supported by information gathered on our fact finding trip to the area, is price or affordability (i.e. by popular demand and lack of supply the Mt-Papamoa area seems to have priced itself out of the reach of a significant percentage of would-be residents). And, to a lesser extent, the same can be said about Tauranga. It is quite possible that Tauranga City/District is not currently enjoying the massive out-performance of population growth that it has enjoyed since at least 1991.

In addition, Hamilton City and the Waikato more generally seem to be winning market share from Tauranga. This seems to be based mainly on affordability, and potentially in terms of greater industrial and semi-industrial development in Hamilton (i.e. jobs). The strength of dairy farming might also come into play.



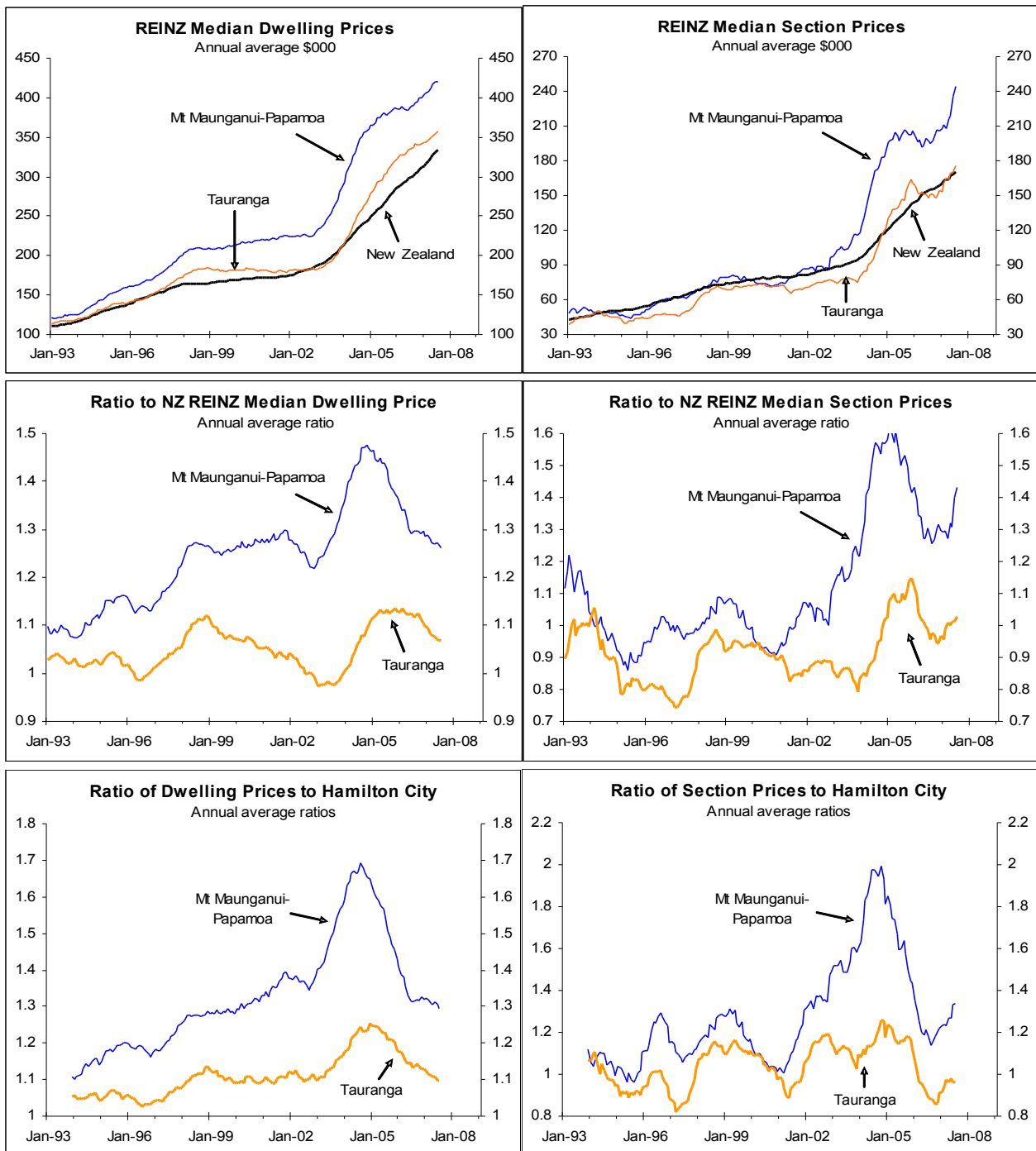
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The price even has to be right for the sunshine capital

The top two charts below show the level of median dwelling and section prices for both Tauranga and Mt Maunganui-Papamoa relative to the national average. The second two charts show the ratio of dwelling and section prices in these areas relative to the national average (a ratio or multiple of one means the prices are the same). The bottom two charts show prices in these two areas relative to Hamilton City.

Prices in Tauranga and The Mt-Papamoa performed especially strongly during the early boom years of 2003-2004, but this resulted in them becoming expensive both relative to the national market and relative to the likes of Hamilton City (e.g. the median section price in The Mt-Papamoa peaked at 2x the Hamilton City median price in 2004). The Mt-Papamoa, and to a lesser extent Tauranga, priced themselves out of the market for a growing proportion of the population and this is most likely why the number of dwelling and section sales in these areas have significantly under-performed the national and Hamilton markets over the last few years. Unaffordability on a relative basis has become less of an issue, but is still an issue.



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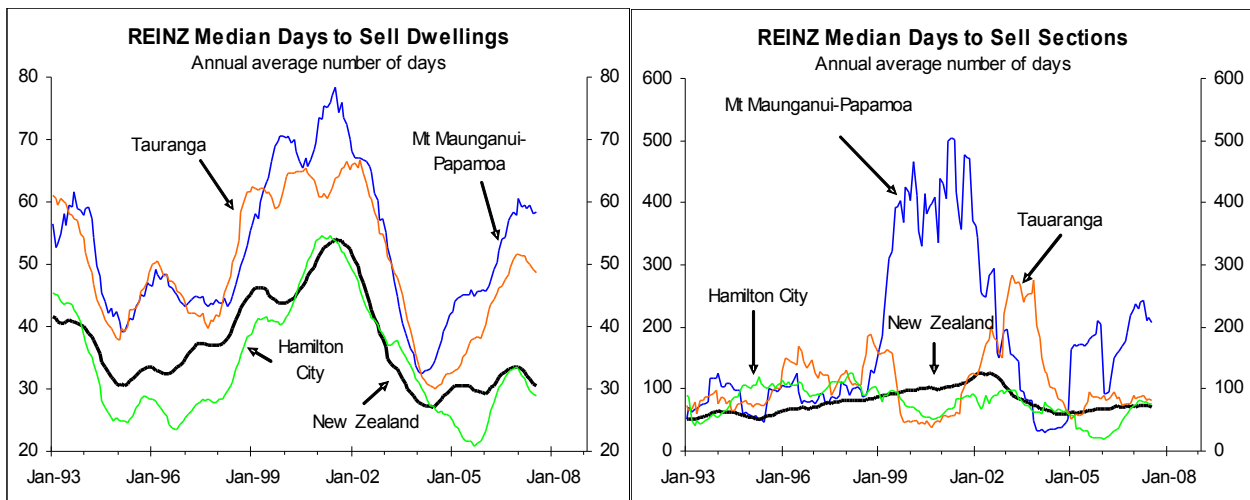


While house and section prices in The Mt-Papamoa are no longer as extreme relative to nationally and Hamilton as they were at the peak in 2004, by historical standards prices are still expensive on a relative basis. We believe this is behind the feedback we got about the sluggish market for section sales in this area during our fact finding visit. A local agent particularly involved in the section market said interest rate increases had significantly depressed sales, which is more likely to be the case in the market that is also expensive compared to competing markets. Another agent report reasonably buoyant section sales.

Limited supply of new sections is part of the story of low section sales in The Mt-Papamoa, but our fact finding discovered enough sections available to meet near-term needs, so the lack of sales will reflect the combination of expensive prices and higher interest rates as much as a lack of supply. It might also reflect a loss of consumer appetite for what this area has to offer (i.e. a response to it now being a built-up and bustling place, especially if you have to go shopping or play at the local golf courses, rather than a tranquil place on all fronts). We suspect that for all these reasons, sales levels in The Mt-Papamoa will continue to under-perform the national market, which is likely to result in prices in this area continuing to under-perform the national market.

Dwelling and section prices in Tauranga are still reasonably expensive relative to the national market, house prices are still reasonably expensive relative to Hamilton City, but section prices are now mid-range relative to Hamilton City. While the Tauranga house market will quite likely continue to under-perform the national market, the Tauranga section market might now be about to experience around national average performance, in part because it is no longer expensive relative to Hamilton City.

The median number of days properties take to sell in a market provides useful insights into the state of the market and into near-term price prospects. In that context, both the Tauranga and The Mt-Papamoa dwelling markets do not look in good shape relative to either the national or Hamilton City markets, with days to sell significantly elevated (left chart). The Tauranga section markets looks in good state relative to The Mt-Papamoa market, and relative to the national and Hamilton City markets (right chart below).



All the comments above need to be put in the context of a national housing market that is in the process of feeling the bite of rising mortgage interest rates and in which both house and section prices are extremely stretched relative to affordability. These issues are covered in depth in our **Housing Prospects** reports – the following link will take you to the relevant section in our website from where you can view a sample copy of this report <http://www.sra.co.nz/housing.html>. It is our assessment that when the next major downturn in the national market arrives, which could still be some way off, that markets that are more than normally expensive relative to the national market will be the most at risk to downside in prices.

The subdivision market

The Mt-Papamoa does not currently have large scale subdivisions underway or in the near-term pipeline (although there are major plans in the pipeline for Papamoa East, but this is still a few or several years down the track). The tail ends of a number of subdivisions are still on the primary market in Papamoa (e.g. Stage 7 of Palm Springs, Excelsa Village in Golden Sands, Tuihana, Milford by the Park, Milford by the Sea, Addison, The Glade, Ella Place). There is only a smattering of sections for sale on the secondary market (on www.realestate.co.nz there are only 11 section ads for The Mt and 63 for Papamoa). There are several small to medium sized subdivisions coming on stream or in the near-term pipeline (e.g. Sanctuary, a

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70 section gated development; Oceania, 41 sections with over half still on the market when resales are included; an extension of Excelsa Village/Golden Sands).

It seems that it is cheaper to buy an existing house than buy a section and build in The Mt-Papamoa area, with one agent giving us some details to support this. The high section prices more than the increasing building costs will be behind this. There is not a large stock of sections in The Mt-Papamoa market in search of end-users, but high prices seem to be denting demand and section sales.

In Bethlehem, at the northern end of Tauranga, we visited the St Michaels, Mayfield and Silverwood Park subdivisions, where there are only a modest number of sections still for sale on the primary market, although the majority are still to be built on in St Michaels (around 50 of 72 sections), and there are only around a dozen sections for sale on the secondary market and around 15 spec houses for sale (including show homes). The number of occupied houses for sale in the new or newish subdivisions was moderately low, reflecting a well-bedded-down supply of new houses.

Around the Pyes Pa area we visited a number of subdivisions, including some near the end of the development or sell down stage (e.g. Ve Da Glen), some with new stages recently being marketed (e.g. The Plateau, where Stage 2 still has around 20 sections for sale on the primary market when we visited and Stage 3 has a couple), and some in their early stages (e.g. Annandale Park, where the majority of the 48 sections that have been put on the market so far have been sold, including a block to a building company, although few have been built on yet; Southill Estate, Stage One of five sections with nine more proposed; and Horsley Grove, where five of the 13 sections were still for sale on the primary market, although some more were for sale as house and land packages). In total we found only 11 spec houses for sale, 25 sections advertised as house and land packages and 10 sections for sale on the secondary market. Like elsewhere, there are enough sections available to satisfy near-term demand, but not an overhang of any magnitude. There were also some sizeable retirement developments in this area (Copper Crest, 221 Villas and 56 Apartments planned; and Althorn Village, proposed Stages 4 & 5).

There is a major subdivision underway at Tauriko, being The Lakes. "Grasshopper Farms owns 254 hectares with a residential zoning. The development will yield 2,025 residential sections, 56 large sections of 3,000m² plus and two hectares of commercial / business. ... It is expected that the residential area will comprise standard residential sections, medium density sections, possibly some three-level apartments and one or more retirement villages. ... We would expect the development to house around 7,000 people." (Source: www.thelakestauranga.co.nz). This is an impressive development, with earthworks spread over what seems like a whole valley.



Source: www.thelakestauranga.co.nz

When we visited the site only one of the 140 or so sections released in Stage One was still for sale on the primary market, with seven sections under contract. However, we found 26 sections for sale on the secondary market, reflecting a moderate level of investor involvement in the subdivision, while one building company had bought 12 sections and was trying to tempt people to buy house and land packages with the offer of no progress payments, while several other sections were for sale as house and land packages, and we found three spec houses for sale. So, effectively, around 30% of the sections that have been sold on the primary market still need to find a permanent home, while our impression was that secondary market sales were slow, as was demand for the spec houses – price looked to be a factor in this.

At The Lakes a major building company has also bought a block of 104 sections and is building medium-density housing. When we visited the site around a dozen were under construction, of which a few had already been sold. There is also one retirement village of 53 units being marketed, where four units had been sold at the time of our visit. We were told that the next stage of sections in The Lakes is planned for

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release in around “spring”, but the number of sections to be released and pricing is yet to be decided or disclosed. Demand for sections was said to be mainly from locals, which will be aided by the retail and commercial developments planned for the area.

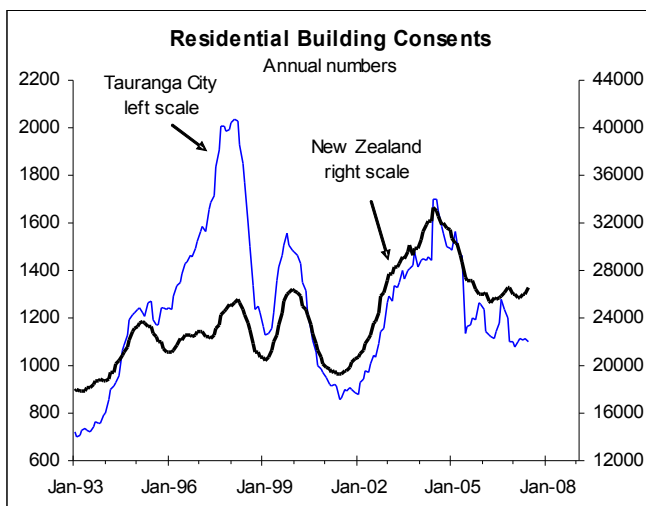
We didn't visit Welcome Bay, where there are 83 sections currently advertised for sale on www.realestate.co.nz, including a number of sections in the Ballintoy Park subdivision, as well as ads for sections in two other subdivisions.

About 15 kms north of Tauranga is Omokoroa, which is commuter belt territory and offers the Lynley Park subdivision, which we visited. There are 126 sections in what looks to be Stage One, some of which offer superb coastal views, while earthworks having been done on a similar sized area of land which we assume is Stage Two. At the time of our visit 30 sections were still for sale on the primary market, 11 sections had been built on, six houses were under construction, while there was only one section for sale on the secondary market, two sections had recently been sold as house and land packages with another two for sale, and there was no sign of spec houses for sale.

Tauranga City's malaise is reflected in the residential building numbers

The most noticeable feature of the new subdivisions in the Tauranga District when I visit a couple of years ago was the high level of new building activity and a large number of spec houses for sale, many of which were close to completion and still in search of owners. At that time the stories were about Ma and Pa spec builders, and about trades people getting into spec building more so than developers or building companies. There were also some stories of people starting to lose money on spec houses.

On our recent visit there was a noticeably smaller amount of spec building going on, no doubt reflecting lower demand for new houses. In the subdivisions we visited we found a total of 43 spec houses for sale in the Papamoa, Bethlehem, Pyes Pa and Tauriko areas - either completed or under-construction. In addition, we observed a sizeable number of sections owned by builders who are offering house and land packages. The number of occupied dwellings we found for sale in most of the new subdivisions was generally reasonably low, which is a positive sign in terms of the recently built houses being well bedded down – which is in marked contrast to the situation in the apartment market).



The Tauranga District experienced its mega-boom in house building and spec building in the 1996-98 period (blue line in the chart). This left the market oversupplied even though it continued to experience well above national average population growth. Consequently, consents collapsed back to trough levels in 2000. Having so recently learnt that spec building can be risky as well as profitable, the Tauranga District has not experienced a boom in residential building in excess of the national building boom this time around. In fact, as the chart shows, the Tauranga City/District is under-performing the national market. A feature of the subdivisions we visited was a relatively low number of sections being prepared for building. The visible malaise.

The Mt Maunganui apartment market looks to be experiencing indigestion

The stories from local real estate agents ranged from “apartments are selling well” at one extreme, which didn't seem to stack up with what looked like was going on. At the other extreme we were told a story about trades-people in one apartment under construction being offered apartments at 15% under the primary market price in lieu of payment, and not being able to resell them. Along the same lines, one contact said one developer had got friendly parties to put deposits on apartments with the enticement of buying at a 10% discount to the primary market prices, this then enabling the developer to get funding, but that title was due soon and the friendly parties had not been able to sell any of the apartments pre-title. Then there was the niche developer we meet selling up to 400 m² apartments on the beachfront for around \$2.5m to retiring farmers, who was still finding good demand.

In conclusion, there are some different stories depending on the part of the market the apartments are in, but in general we would characterise the Mt Maunganui apartment market as one where investor appetite

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had helped fuel an increase in supply significantly in excess of current or near-term end user demand. A prominent agent in the market indicated that around 80-90% of buyers of new apartments have been investors, which rings warning bells to start with. The market now seems to be struggling to absorb the increase in supply, with a moderate to material amount of additional supply in the pipeline.

Unfortunately, REINZ dwelling sales data do not include a breakdown of apartments, so we can't check actual sales levels and compare them to the stock of apartments on the market for sale. On searching www.realestate.co.nz we found 150 apartment ads for Mt Maunganui, 29 for Papamoa and 228 for the whole Tauranga City/District. It appears that there is more than ample supply, including a significant number of investors trying to exit the market, as well as a reasonable amount of supply in the primary market, while we suspect that sales levels are relatively low.

There are still apartment building under construction, including one sizeable one (around 60 apartments) and a smattering of smaller ones, as well as some major ones still being marketed (e.g. The Pacific, 70 apartments; Eleven, a smaller number of larger apartments).

On our fact finding visit we stayed in one of the established apartments in The Mt. Based on the availability of rooms when we enquired by phone, and more particularly based on the almost empty car park in the basement of the building, we assessed that the occupancy rate was particularly low even allowing for the time of year. A sample of one is pretty small, but the generally low foot traffic we noticed in the apartment precinct reinforced our suspicion that non-peak occupancy rates will be low.

We suspect that investors might struggle to get the rental incomes they hoped for. An agent suggested 6% gross yields could be achieved in managed apartments, but we took this with a grain of salt. With a majority of apartments funded by investors, The Mt is in the process of experiencing a major increase in supply of apartments for rent, mainly as holiday rentals. The increase in supply could well put downward pressure on rental yields relative to pre-sale projections, just as has started to occur in the Auckland apartment market. And not just because of the increase in supply in The Mount. On the back of the coastal property boom the supply of holiday homes has increased around much of the country's coastline. If you visit some of the bach rental websites (the one we use is www.holidayhomes.co.nz), you will most likely be pleasantly surprised at the range available at reasonable prices.

On www.trademe.co.nz we found only eight ads for apartments for rent on a weekly basis (i.e. mainly for permanent residents as opposed to holiday makers), with weekly rentals of \$300 to \$480 (\$376 average), although one of the ads covered numerous apartments in one building. Without knowing what was paid for the apartments we can only guess at the gross rental yields, but they didn't look to be high.

Appendix – REINZ Definitions

Tauranga:

Aongatete, Avenues, Bellevue, Bethlehem, Brookfield, Cambridge Heights, Gate Pa, Greerton, Hairini, Judea, Kaimai, Matakana Island, Matapihi, Matua, Maungatapu, Merivale - Tauranga District, Ngapeke, Otumoetai, Poike, Tauranga Central, Tauriko, Welcome Bay.

Mt Maunganui/Papamoa:

Arataki, Kairua, Mt Maunganui, Omanu, Papamoa.