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PROPERTY INSIGHTS

Whangamata, Waihi Beach & Whiritoa

EXECUTIVE SUMMARY

Our fact finding trip to Whangamata and Waihi Beach, which included visits to Whiritoa and Athenree, revealed a market waiting for something eventful to happen, especially in the section market which was our primary focus. The event in waiting is gravity doing its job on prices in an oversupplied market. Observing such an event is like watching paint dry but takes much, much longer to unfold.

New subdivision activity and the subdividing of existing sections have added lots of new stock to the market. A moderate number of investors are trying to sell sections, competing with developers for what looks to have become a trickle of buyers. The oversupply of sections will, in time, also weight on existing dwelling prices. However, for the moment section prices are defying gravity in the Whangamata-Waihi Beach area. But gravity will eventually come to bear for three big-picture reasons.

First, affordability has become a critical issue, with sky-rocketing property prices and higher interest rates meaning far fewer people will be able to afford holiday homes and sections for many years to come. This implies that the excess supply will sit on the market for long enough that gravity will gradually wear prices down. Secondly, without guaranteed capital gains, demand from investors will dry up and may have already done so. Thirdly, a major economic slowdown or downturn seems inevitable, schedule for some time in the next five years if the Reserve Bank takes the battle against domestic inflation seriously after next year's election. The combination of a major affordability hurdle, little interest by investors and a weak economy will prove disastrous for property markets that still have plenty of supply looking for a home.



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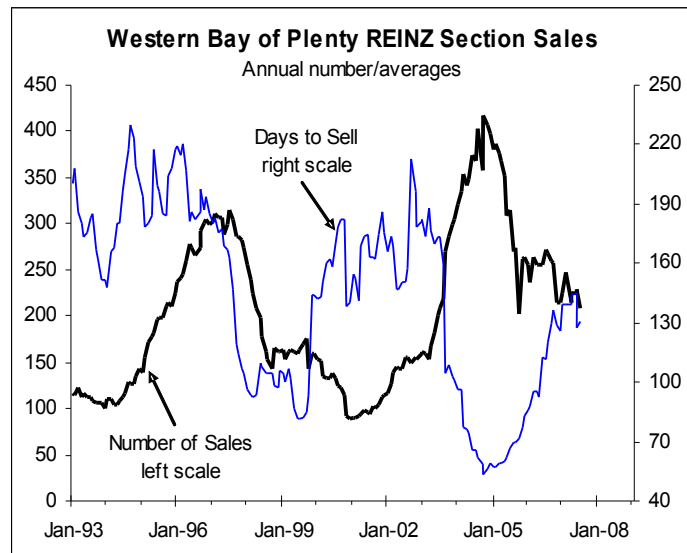
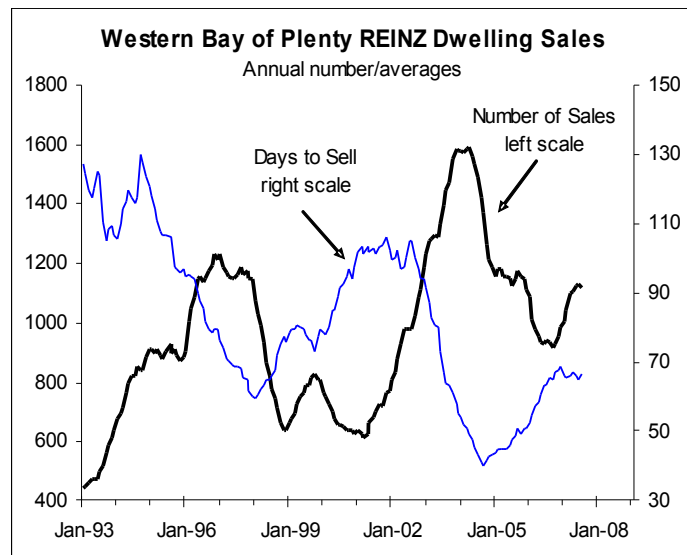


The Whangamata and Waihi Beach Areas

The primary focus of our visit was on Whangamata, Waihi Beach (including Island View and Athenree) and Whiritoa (see the maps below), with peripheral interest in Onemana and Opoutere (i.e. while in Whangamata we looked at the for sale ads for these two places in the real estate agents' literature). There has been a material increase in section supply in recent years (see pages 6-8), in part on the back of new subdivisions but also, especially in the case of Whangamata, the subdividing of existing sections. Consequently, the main focus of our visit was on the section market. However, the oversupply of sections we discovered has implications for existing house price prospects as well as for section price prospects.

We can't get data on dwelling and section sales specifically for the places we are most interested in, but the REINZ's Western Bay of Plenty (WBOP) data, as reported in the two charts below, will be broadly indicative of historical developments in our focus markets. The REINZ's definition of WBOP includes: Athenree, Katikati, Kauri Point, Maketu, Ohauiti, Omokoroa, Onemana, Paengaroa, Pongakawa, Pukehina, Pyes Pa, Te Puke, Te Puna, Waihi, Waihi Beach, Waikino, Waimata, Whangamata and Whiritoa.

Dwelling sales in WBOP have had something of a second wind over the last year and remain above average (black line in the top chart). The average number of days dwellings are taking to sell is well above recent lows, but is still below average by local historical standards (blue line, top chart). Unlike house sales, section sales have not rebounded in the last year (black line, bottom chart), which is in line with the feedback we had from agents in the local market. With sections already taking around 130 days on average to sell (blue line, bottom chart), would-be vendors, of whom the table on the next page shows there are plenty, will need to be patient or, if they want quick sales, will need to sharpen the asking price.



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As at 2 September we found 292 ads for sections for sale in the areas of interest on REINZ's website - www.realestate.co.nz – with the largest number being in Waihi Beach (126) and Whangamata (99). However, on the basis of the number of ads relative to the size of the existing urban area, the 55 ads for sections in Whiritoa probably put it in first spot in the oversupply stakes. With 200 sections sold via real estate agents in the whole WBOP in the last year, having 292 ads for sections in our focus areas equates to enough supply for the whole WBOP for around 18 months without the other places in WBOP chipping in any supply. The feedback we had from the local market plus the large stock of sections advertised for sale, suggests days to sell in the focus markets will be more than the 130 day average for WBOP.

There is also no shortage of existing houses advertised for sale, with a total of 465 ads in the areas of interest. This equates to around five months of supply relative to the 1,120 dwellings that sold in the whole WBOP in the last year. The dwelling supply in the focus markets is clearly much more in line with demand than is section supply, but there is more than enough to satisfy buyer demand.

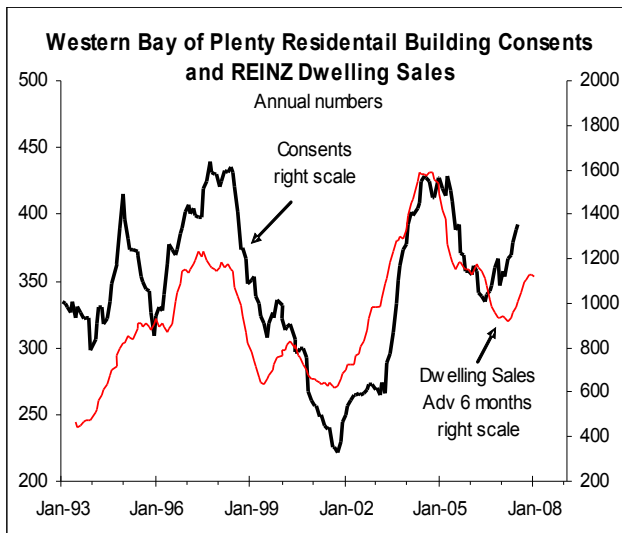
Number of Property For Sale Adverts - 2 September 2007

Source www.realestate.co.nz

	Houses *	Sections	Apartments	Lifestyle
Opoutere	1	1	0	2
Onemana	11	4	0	0
Whangamata	250	99	12	14
Whiritoa	33	55	0	0
Waihi Beach	162	126	1	8
Athenree	8	7	0	1
Total	465	292	13	25

* Houses, townhouses, units and home & income

With input from some agents we assessed that buying an existing property was probably a more economic option than buying a section and building. This will partly explain the relative under-performance of section sales relative to house sales shown in the charts on the previous page, it also means that would-be vendors of sections face another obstacle.



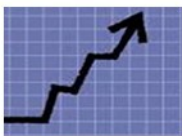
The boom in WBOP has extended to residential building consents (the black line in the chart). With plenty of recently sold sections still to build on, and builders probably still struggling to keep up with demand, consent numbers could remain high for a while yet, although we didn't notice a great deal of building activity in the places we visited.

Section sales in the last year are back down to around an average level in the WBOP and there are indications that buying existing dwellings has become more attractive than buying a section and building. Then, as covered in our **Building Barometer** reports, the rise in mortgage interest rates seen since March this year is yet to hit the residential building market. So there could be a significant fall in WBOP residential building consents over the next year.

The near-term outlook for dwelling and section prices in WBOP

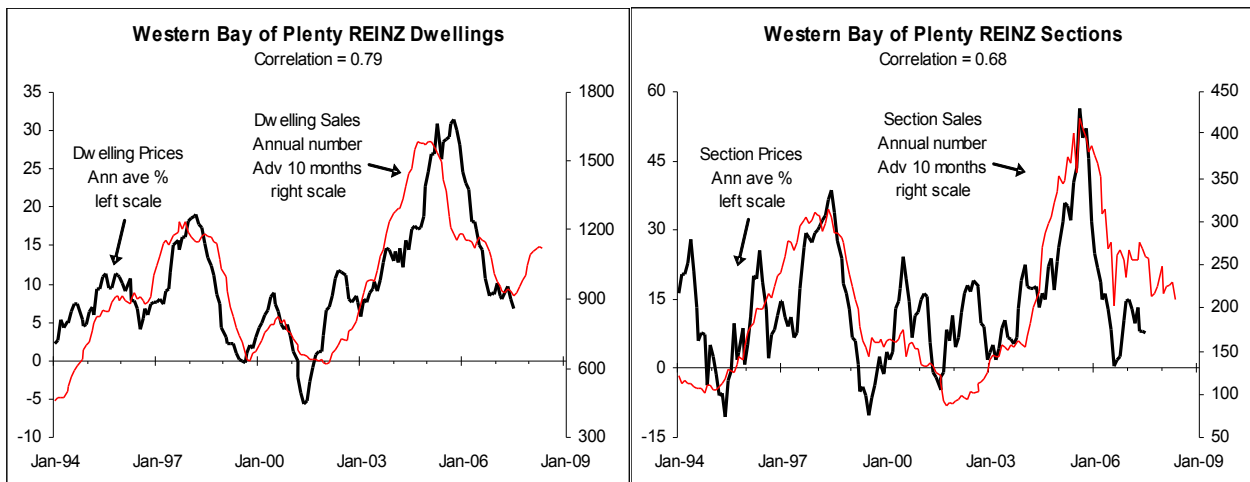
The left chart on the next page shows that the level of dwelling sales in WBOP is the key driver of dwelling price inflation. The best fit is with the red sales line, which measures the annual average number of dwellings sold, advanced or shifted to the right by 10 months. The black line measures the annual average % change in the median dwelling price. On the basis of the moderate rebound in the number of dwelling sales over the last 10 months, we could see somewhat stronger annual average house price inflation from now until around mid next year. However, what drives dwelling sales and where are they heading?

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The right chart below shows the annual number of section sales in WBOP as a moderately useful leading indicator of annual average section price inflation in WBOP. Again, the red sales line has been advanced or shifted to the right by 10 months. The recent level of section sales, which has been around the historical average level, suggests that section price inflation will remain somewhere around the recent level over the next 10 months or so. The fit in the right chart is not close enough to be particularly dogmatic about near-term section price inflation, but we shouldn't be about to see either a boom in prices or a sharp fall.

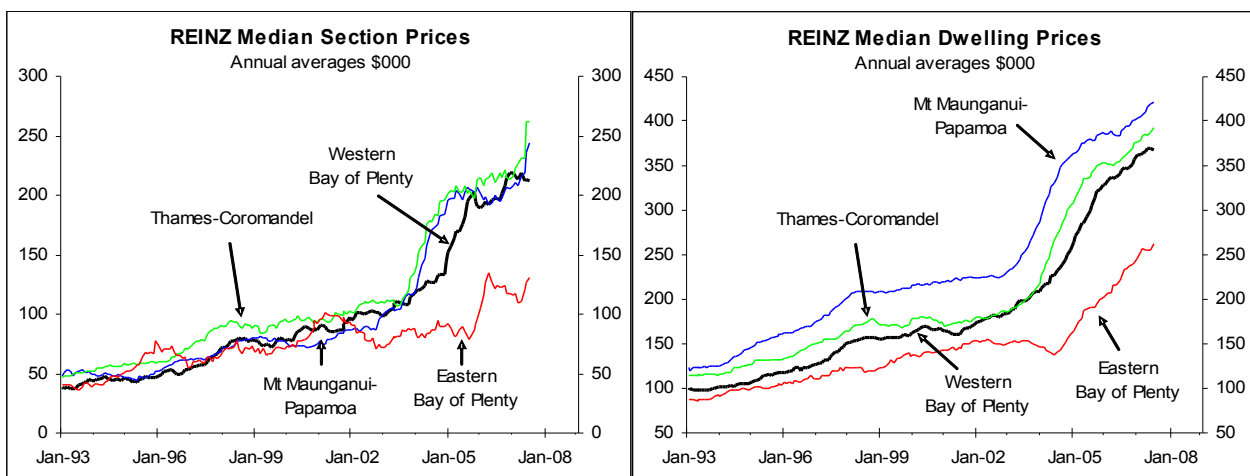
The feedback we had from the local market, as well as the high number of sections advertised for sale in the places of interest, suggest that section price inflation prospects are probably less favourable in the areas of interest than in the WBOP in general.



The link between demand, interest rates, the job market, affordability and prices

Our fact finding and research has revealed at least a near-term oversupply of especially sections in Whangamata, Waihi Beach and Whiritoa, but property markets have downwardly sticky prices (i.e. prices don't fall quickly even when supply materially exceeds demand unless there are a sizeable number of forced sales). However, in oversupplied markets prices can be ground down over a number of years if demand does not rebound and soak up the over supply.

Consistent with the oversupply identified in the WBOP section market, the left chart below shows that section prices in WBOP have in recent months under-performed section prices in competing areas like Thames-Coromandel, Mt Maunganui-Papamoa and Eastern Bay of Plenty (EBOP). There is a hint that dwelling prices in WBOP may also be starting to under-perform (the right chart below).



To get a handle on the big picture (i.e. the medium-term outlook for dwellings and especially section prices) it is useful to go back to first principals and review the numerous factors that drive demand for dwellings and sections in the likes of Whangamata and Waihi Beach. Is demand for sections going to rebound, are we heading for a long period of watching prices grind lower, or could a short-sharp correction be looming?



Who buys dwellings and sections in Whangamata and Waihi Beach?

There are Intending holiday home buyers, retirees, permanent residents and investors.

Why do people buy in Whangamata and Waihi Beach?

For the climate, the beaches, fishing and diving options, facilities/services, travel time from major urban centres and prices relative to other places.

What factors can impact on the number of buyers?

Interest rates, income levels of holiday home buyers (i.e. wages/salaries, bonuses and profit levels in owner-operated businesses), job security for holiday home buyers, job availability for permanent residents, perceived investment returns for investors, affordability for holiday home buyers and investors, growth in housing and other wealth for holiday home buyers, and the relative price to other competing areas.

What is the state or outlook for these key drivers?

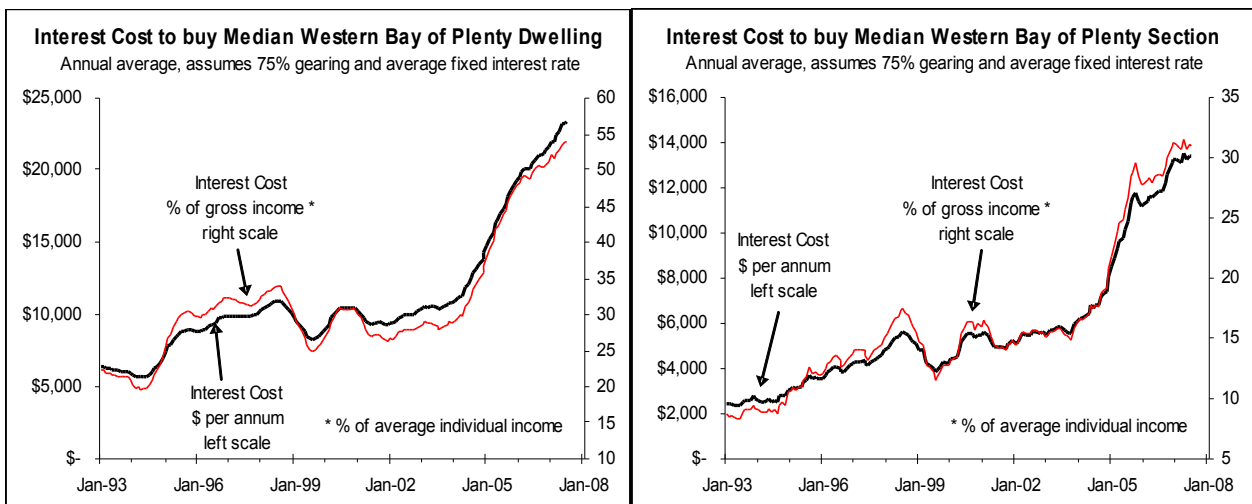
The recent rise in interest rates has not yet had its full negative impact on housing demand, as covered in our **Housing Prospects** and **Building Barometer** reports. But it seems that interest rates are on hold at around the current level for the time being. However, contrary to popular convention, interest rates are not likely to fall materially and rescue the coastal property market any time soon. The analysis in our **Interesting Times** and **Monetary Policy Briefing** reports show that, provided “nuclear bombs” don’t start falling from the sky, the Reserve Bank still has plenty to do before it will defeat domestic inflation, especially with a major fiscal stimulus still in the pipeline.

The worrying thing for the property market in general, and for the coastal market in particular, is that the Reserve Bank’s job will not be done until it has whacked the economy around the ears pretty aggressively (i.e. until the unemployment rate is materially higher and numerous businesses are no longer making good profits). So at some stage down the track two of the most important pillars of demand for holiday homes will turn unfavourable, but we will reserve the detailed insights into when that is likely to be for the subscribers of our reports. However, for the moment income growth remains robust for the majority of people, which is helping sustained demand for dwellings and sections in Whangamata and Waihi Beach.

We have little idea about the state of job availability for permanent residents in the focus area, although we suspect the housing and subdivision booms created quiet a few jobs (e.g. builder and other trade jobs, real estate jobs), and as the boom fades demand for such services will fall.

Expectations of high investment returns will be fading but some Johnny-came-last investors will still be looking for “cheap” investments. Investors are clearly no longer playing a key part in the local section market and we can’t see any reason why they will return in droves any time soon.

Affordability has become a major hurdle to future demand. The left chart below shows the annual interest costs for new buyers of the median dwelling in WBOP (the black line, assuming the property is bought with 75% debt), and the annual interest cost as a % of the average individual gross income. The right chart shows the same things for new buyers of the median section in WBOP. The massive surge in interest costs to buy dwellings and sections has put them out of reach for a large proportion of would-be holiday home owners and investors. For this reason alone future demand will be much weaker than past demand.



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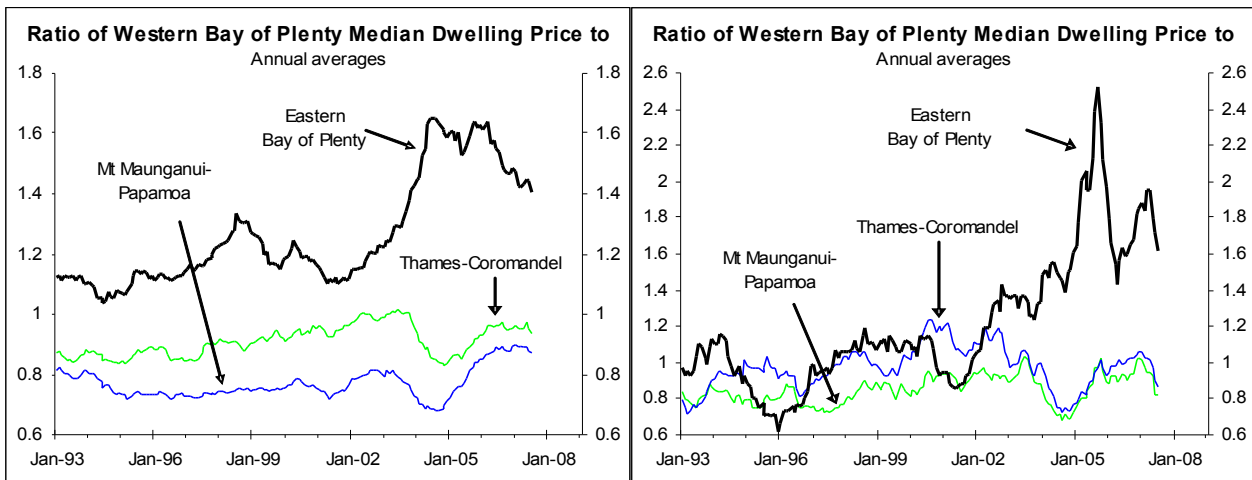


Surging property prices and the rise in interest rates since 2003 have put holiday homes and sections outside the affordability of a large proportion of would-be holiday home owners even allowing for the stronger growth in incomes in recent years. Especially when we take into account that would-be holiday home owners first need to fund their primary home before they can gear up to buy the holiday home. The affordability issue must mean that demand for holiday homes over the next decade or more will be much weaker than over the last decade and massively weaker than during the recent boom.

However, some new holiday home buyers will spring up, so how does the WBOP stack up on a relative price basis? The WBOP has roughly maintained its relativity to most competing areas, like Thames-Coromandel and Mt Maunganui-Papamoa, but has become expensive relative to the also-ran EBOP. The left chart below shows annual average median dwelling prices in EBOP, Mt Maunganui-Papamoa and Thames-Coromandel as a ratio to WBOP prices – a ratio of one means the prices are the same. The right chart below shows the same thing for section prices.

Our experience is that relative prices can have a significant impact on housing demand. WBOP dwelling and section prices have roughly maintained the historical relatively with Mt Maunganui-Papamoa and Thames-Coromandel, so we shouldn't see major price-driven swings in demand between these areas. However, with the median dwelling price in WBOP currently around 40% above the median in EBOP compared to an historical average premium of 16% prior to the boom, and the median section price in WBOP currently 62% above the EBOP median compared to a pre-boom historical average premium of zero, the WBOP may lose some market share to the EBOP. In fact, the last time we were in Whakatane we were told stories by locals that they were gaining market share from the likes of Mt Maunganui-Tauranga, driven by both cheaper prices and a quieter environment.

Eastern Bay of Plenty includes: Coastlands, Edgecumbe, Kawerau, Kutarere, Manawahe, Matahina, Matata, Murupara, Ohope, Omaio, Omarumutu, Omataroa, Opotiki, Paroa - Whakatane, Poroporo, Taneatua, Te Kaha, Te Teko, Te Whaiti, Thornton, Torere, Waihou Bay, Waimana, Waingarara, Wairata and Whakatane



After assessing all the major factors we see as relevant to medium-term demand for property in the likes of Whangamata and Waihi Beach (but also in the coastal market more generally), especially by would-be holiday home owners and investors, we conclude that it is much more likely that the current overhang of demand will result in prices drifting lower than there being a rebound in demand that soaks up the oversupply. With a major fiscal stimulus to come next year, it is unlikely we are heading for a disaster scenario any time soon, but the preconditions for a disaster exist if the Reserve Bank finally decides to get aggressive in its battle against domestic inflation after the election. However, even without higher interest rates, demand for coastal property will struggle for a long time because of the massive affordability hurdle (i.e. take a long hard look at the charts on the bottom of page five and weep if you are currently trying to sell lots of coastal dwellings and sections to would-be holiday makers and investors).

The Whangamata Area Market

Our fact finding visit to the area focused on the new subdivision market, because we believe this is of major importance to the future prices of not only sections but also of existing dwellings. We believe it will be some years before we see the full implications of the elevated level of new subdivision activity not only in the Whangamata-Waihi Beach areas but more generally around much of the coastal and resort market.

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We found the Whangamata market to be pretty quiet, with some agents saying there were some motivated vendors of sections. Whangamata has only three significant new subdivisions: Seabreeze, Waihi-Whangamata Road (name of road not of the subdivision, which is on a hillside on the road heading south), and Te Pamahue Drive-Elsinore Close (street names, at the top of the hill on the left side when heading north out of town), and a couple of small subdivisions. However, subdividing existing sections in half has been popular and there is a wide selection of these available.

Based just on the three main subdivisions, there appeared to be around 50 sections still available on the primary market, while some of the sections sold in these subdivisions are now back for sale on the secondary market reflecting a reasonably significant investor involvement in the market (which is a black mark on our report card). All of the sections in the third listed subdivision appeared to have been sold on the primary market, but it had 14 sections advertised for sale on the secondary market, which was a reasonably large number given the size of the subdivision. We heard stories of some investors struggling to sell sections in the second of the two larger new subdivisions.

As the table on page 3 shows, there are 99 ads for sections for sale in Whangamata, which will include some primary market offerings from the new subdivisions and some from one-off subdivided sections, plus secondary market offerings. So there is no shortage of supply. With 250 ads for houses for sale in Whangamata, there are plenty of options for would-be buyers in addition to the sections.

Whitiora, not far south of Whangamata, has two new subdivisions, Whiritoa Beach Estate and Tidal Beach, adding 66 sections to the market (although 12 may not be on the market yet). This is a large increase in supply relative to the size of Whiritoa. Only 10 of these sections appeared to have been sold at the time of our visit, with sales appearing to have largely dried up. The table on page 3 shows 55 ads for sections for sale in Whiritoa, much more than the 33 ads for houses for sale. This looks to be a market where current supply is particularly high relative to current and likely near-term demand, which rings warning bells.

The Waihi Beach-Athenree Market

On our fact finding to Waihi Beach the impression we gained was that the section market was particularly quiet, possibly even near dead. One of the most noticeable features was the lack of progress on section sales in the new subdivisions. Primary market sales appeared to be lower in Waihi Beach than pretty much anywhere else we visited on our Bay of Plenty-Coromandel trip (although we didn't visit the EBOP coastal market, where sales might be even quieter).

The subdivisions we visited in the area including Athendale, Athenree Heights/Pacific Vista, Mountain View, Pohutukawa Sands, Citrus Drive (street name not subdivision name), Reo Crescent-Longboard (ditto), Quayside Estate, Ocean Breeze, Maranui Estate and Mayor View Terrace (ditto).

In the subdivisions we visited we counted 55 sections advertised for sale on the secondary market, 108 for sale on the primary market, 138 sections that have been sold but were not built on yet, four spec houses for sale and five sections advertised by builders as house and land packages. This means that there are around 306 sections yet to be built on, excluding the moderate number of one-off sections advertised for sale, which is plenty to be going on with for some years to come.

In one subdivision Stage One of 30 sections was completed, but it looked like Stages Two and Three, involving a total of 62 sections, had stalled and were not being marketed (we have not counted these 62 sections in the number of sections for sale on the primary market). Another subdivision, involving 44 sections, 10 of which appear to have been sold, looks like it might not get off the ground, based on the lack of earthworks or any sign of development, but the numbers for this are included above because it still appears to be on the market.

This market looks to be awash with section supply, with developers now competing with investors for what looks to be only a trickle of buyers. This puts Waihi Beach reasonably high up our list of at risk markets. In addition to lots of sections advertised for sale, Waihi Beach has ample existing houses advertised for sale (around 170 based on the table on page 3, where Athenree should be considered part of Waihi Beach).

Another challenge faced by would-be vendors in Whangamata & Waihi Beach

The subdivision boom and house building boom has materially increased the total number of beach houses in the area, which has also happened in many other parts of the national coastline. With some of the owners of the new beach houses, in addition to some of the large number of new owners of existing houses in these areas, likely to be reasonably heavily geared, there will be a growing number of people under pressure to extract some cashflow from their coastal properties. The recent rise in mortgage interest rates

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will have increased the number of people in this category, while when the next major economic downturn arrives the number of people in this camp will escalate materially.

However, as more holiday home owners put their properties up for rent the option of renting a holiday home should become a more attractive option than buying. The rent rather than buy option is massively swayed in favour of renting because, as the charts at the bottom of page 5 show, buying has become exorbitantly expensive over the last two years. This will play a part in denting demand to buy holiday homes.

On visiting our favourite holiday home website, www.holidayhomes.co.nz, we found 22 holiday homes advertised in Wiahi Beach-Athenree, 27 in Whangamata and 12 in Whiritoa. This is not an avalanche of supply by any means, but this was from just one of the number of such websites and, most importantly, the real stress on holiday home owners will not arrive until the next major economic downturn or recession hits the national economy. That is when we expect to see a major increase in holiday homes advertised for rent, as well as when we expect the real shakeout in the coastal property market to arrive.