



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

Housing Hell Revisited

EXECUTIVE SUMMARY

The Raving “**Are we heading for housing market hell?**” lives in the Literacy Centre of our website - <http://www.sra.co.nz/literacycentre.html> - and has experienced as many hits in each of the last two months as it did when it was released in August of last year. In that Raving I observed that “to get the rental yield back to the historical average of 7.7%, the average rental income will have to increase 71% or the median house price will have to fall 42%. Or, more likely, some combination of the two will unfold.”

With the REINZ measure of the national median house price falling 3.3% between September 2007 and January 2008, maybe the August Raving is proving popular because more people are taking seriously the idea that NZ could be facing a much larger fall in house prices than experienced in recent downturns.

This latest Raving adds some analysis to the debate over whether we face imminent double digit falls in house and section prices, both for the national market and for a number of cities, districts and regions. It concludes that while landlords in many places will be looking to wind up rents now they aren't getting capital gains, rental yields are so low there is still the risk that in inflation adjusted terms the national median house price will end up falling more than 20% before the dust settles. While the likelihood of section prices falling 10% or more in many places, and significantly more in the places where investor feeding frenzies have resulted in supply increasing massively relative to end-user demand, should be taken for granted.

But in the best capitalist tradition we reserve the full analysis and predictions about the magnitude and timing of Armageddon for paying clients of our **Housing Prospects** report (a must have for anyone serious about understanding the outlook for the housing and section markets).



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Are we heading for housing market hell?

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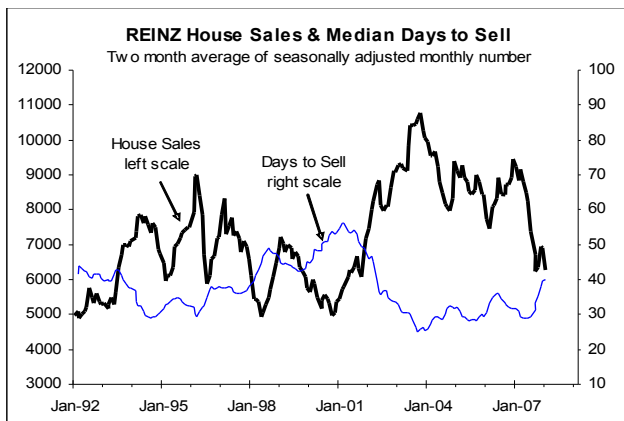
The media are hanging around the housing market like vultures after tasty morsels, and for good reason. While in Hamilton recently I was told that one real estate firm had 43 properties listed with it for mortgagee sale in the Waikato while a year ago it had only two (although another firm reported no noticeable increase in mortgagee sales, but let’s not let a proper assessment of the facts get in the way of a good story). The demise of many Auckland apartment investors is now almost ancient history. More recently investors are struggling to sell sections in some coastal and resort markets (e.g. <http://www.sra.co.nz/pdf/Kinloch.pdf>). The liquidation of around 18 Blue Chip associated companies has left hundreds and potentially thousands of investors in strife (http://www.nzherald.co.nz/section/3/story.cfm?c_id=3&objectid=10492344&pnum=0). And most recently a real estate firm has collapsed (<http://www.stuff.co.nz/4411730a13.html>).

The predicament of investors in the likes of Kinloch is just the tip of the iceberg in terms of the number who will get fingers, toes and in some cases whole limbs burnt off as the investor-frenzy turns nasty. The smell of burning flesh is an unpleasant experience at the best of times, but when it is your own it can become a rather emotive issue. And nothing sells newspapers like flared emotions.

But does NZ face the imminent risk of a large fall in prices (i.e. 20-30%)? This question is especially relevant to the coastal and resort markets where investors have indulged in feeding frenzies that have in many cases fuelled massive increases in the supply of sections. Because the coastal/resort boom is likely to be a once in a lifetime experience we have done quite a bit of in-depth research on this topic, as covered in the numerous **Property Insights** reports accessible on our website (<http://www.sra.co.nz/free.html>). And in the places where supply increases have massively outstripped growth in demand by end-users (i.e. people who actually want to own holiday homes as opposed to get-rich-quick investors) we are confident it will ultimately result in large price falls for both sections and dwellings.

Demand and supply is the best place to start in the journey for understanding

At the heart of good economic analysis is consideration of what is driving demand and supply, with the interaction between the two ultimately driving prices, albeit sometimes with quite a lag, especially in the likes of property markets where prices tend to be downward sticky (except when there are lots of mortgagee or forced sales). The chart below should be the ideal starting point for assessing the current state of the balance between demand and supply in the national market for existing dwellings. The black line shows the monthly number of existing houses or dwellings sold nationally via real estate agents, with the number of sales largely driven by the level of demand (a seasonally adjusted two month average is used to smooth the volatility in the monthly numbers). The blue line, which shows the median number of days dwellings take to sell nationally, should reflect the interaction between demand and supply. A large fall in demand, as has occurred over the last year and is reflected by a large fall in the number of house sales, should result in a large increase in the median number of days dwellings take to sell.



When the black line has fallen below the blue line, reflecting low demand relative to supply, it has resulted in a mild fall in the national median house price (e.g. 1992, the first half of 1998 and 2000-01). In these cases the national median house price fell by 3.2%, 2.4% and 4.2%, respectively, based on the REINZ measure, but these falls were as much noise in the monthly data as the real thing and happened over a couple of months in each case.



Based on the chart on the previous page, with the number of house sales still above the previous trough levels (the black line), the median number of days properties are reported to be taking to sell being below the previous peak levels (the blue line) and the black line still above the blue line, the national median dwelling price should not be falling. But it appears that the national median house or dwelling price is falling based on the REINZ data. Either prices aren't falling and the REINZ median house prices data are wonky, or there is something awry with the days to sell data. Certainly the REINZ median price data can be volatile, but my money is on the days to sell data being the most bogus of the two.

As at 24 February 2008 (10.37am to be precise) there were 54,137 ads for dwellings, excluding lifestyle properties, on the REINZ website, www.realestate.co.nz, while if we annualise the number of dwellings sold by REINZ members over the last three months it weighs in at just under 80,000 sales per annum. If every for sale ad equated to a property for sale, it means NZ currently has a stock of properties for sale equal to around eight months of sales. However, a number of the ads will be repeat ads related to multiple lists. If we assume 20% of dwellings for sale have two listings, which is a vaguely educated guess, the stock of properties advertised for sale reduces to the equivalent of 6.8 months of sales.

Of course, with such a large stock of properties advertised for sale there is no way the median number of days they are taking to sell is as low as reported by REINZ in recent months. The actual median number of days properties are taking to sell has probably been nearer 50 days or even higher for some months, and if this number is put on the chart in the previous page it would be consistent with mildly falling house prices.

So why the discrepancy between the median days to sell reported by REINZ and reality? As explained to me by a real estate agent last week, increasingly vendors are switching real estate firms before their properties sell and only the days the property is listed with the firm that actually sells it are counted. I was told that sole agency agreements generally last for three months and prior to the fall in the number of sales over the last year most properties were selling prior to the termination of the first sole agency agreement. However, with properties taking longer to sell it gives more time for would-be vendors to switch real estate firms, while there also appears to be an element of people being more inclined to make a switch after even a month. The specific example I was given was of a property that had been listed 30 days with one firm followed by 28 days with a second firm before it sold, but only the 28 days are counted in the REINZ data.

To put the NZ situation in context, in the US the stock of dwellings listed for sale with realtors has been running around 10 months of sales for the last six months, and associated with this the national median dwelling prices has fallen 12.3% since the peak in June last year, with more near-term downside likely. (Source: [http://www.realtor.org/Research.nsf/files/EHSreport.XLS/\\$FILE/EHSreport.XLS](http://www.realtor.org/Research.nsf/files/EHSreport.XLS/$FILE/EHSreport.XLS)). We may not be comparing pavlovas with apple pies, but it appears that while NZ has a large stock of dwellings in search of owners, and certainly enough to result in a moderate fall in the national median house price this year, NZ is not currently in a sufficiently oversupplied situation to justify talking of an imminent large double digit fall in the national median house price. However, the level of oversupply is not shared evenly around the country and it is quite possible, if not most likely, that some parts of the country do have a sufficiently large excess supply of properties for sale that double digit falls in house prices are underway.

When we do the same maths for the residential section market as we did for the dwelling market the outcome is staggering! On 25 February 2008 we found 13,932 ads for sections for sale on the REINZ website. This means there is probably something in the ballpark of 14,000 sections currently on the market for sale with real estate agents (i.e. the number of repeat ads or sections advertised by more than one agent is probably roughly offset by the number of ads that relate to more than one section). If we annualise the number of sections sold by real estate agents in the last three months it comes out at an annual rate of 7,670 section sales. This implies that it would take something close to two years to sell all of the sections currently on the market for sale, and yet the REINZ is reporting that the median number of days sections took to sell averaged 66 over the last three months. The actual numbers will differ significantly around the country, but in many places sections must be taking much, much more than 66 days to sell.

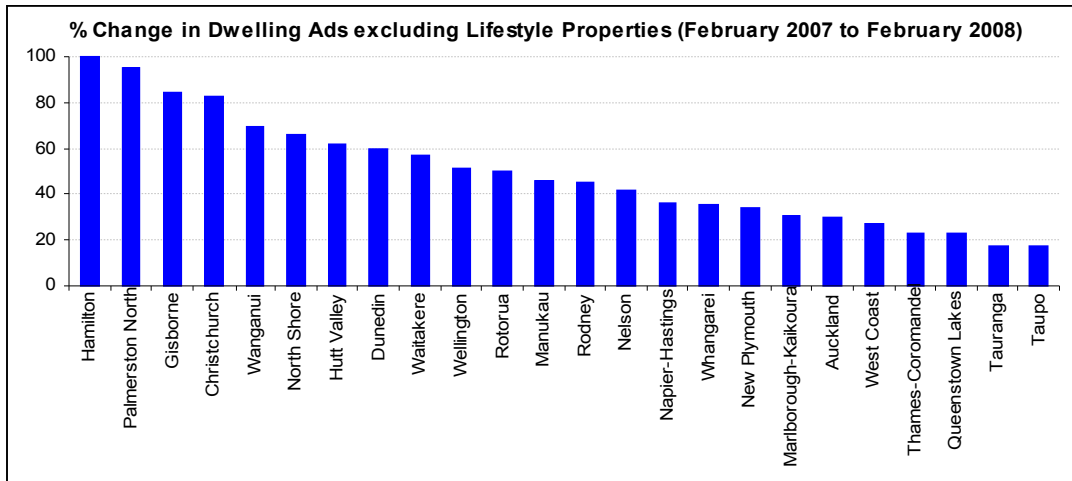
It is possible that some sections are sitting on the market and never selling so they don't impact on the REINZ days to sell numbers. While some sections will pass through the hands of several real estate firms before selling, with only the number of days they are listed with the final agent counting in the REINZ numbers. But no matter how we try and explain the discrepancy between the humungous stock of sections on the market for sale and the days to sell reported by REINZ, something doesn't add up. And we can only conclude that if any part of the property market faces the risk of imminent double digit downside in prices it is the section market. But even more so than the dwelling market, the state of demand and supply in the section market varies dramatically from place to place around the country.

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Some insights into the pockets of extreme oversupply

In terms of the dwelling market, the chart below shows the percentage increases over the last year in the number of for sale ads for the 24 cities/districts we cover in our monthly **Housing Prospects** reports. The increases in the number of for sale ads have ranged from 19% in the Taupo District (which already had a high level of listings in February 2006) to 100% in Hamilton. Interestingly, while in Hamilton on a contract research job over the last couple of weeks a couple of the property people I have meet have said that local prices for repeat sales (i.e. properties that sold around a year ago and recently resold) have already fallen 10%, although opinions on this were not unanimous. However, the increases don't tell the whole story because some of these cities/districts had low stocks a year ago and some already had huge stocks.



The table below shows the number of ads for dwellings for sale in the 24 cities/districts including and excluding lifestyle properties (first two columns). It also shows the number of ads excluding lifestyle properties expressed as months to sell based on historical average sales for the last 10 years (Average Sales), the maximum annual number of sales in the last 10 years (Maximum Sales), and the minimum annual number of sales in the last 10 years (Minimum Sales). Spot the overstocked markets!!!

REINZ Dwelling Ads Relative to Annual Dwelling Sales - February 2008

	Number of Dwelling For Sale Ads (1)		Ads expressed as months of sales (3)		
	Including Lifestyle (2)	Excluding Lifestyle	Average Sales	Maximum Sales	Minimum Sales
Whangarei District	1,210	897	8.3	5.8	12.7
Rodney District	2,001	1,342	11.3	7.3	18.8
North Shore City	2,372	2,324	5.1	3.7	7.3
Waitakere City	1,926	1,865	5.4	3.8	8.5
Auckland City	4,345	4,343	5.1	3.8	7.3
Manukau City	2,800	2,716	5.4	4.1	7.8
Hamilton City	1,740	1,582	5.9	4.4	10.0
Thames-Coromandel District	1,850	1,709	26.4	15.3	46.5
Tauranga District	2,324	2,133	8.4	5.4	13.2
Rotorua District	928	819	7.3	5.0	12.3
Taupo District	996	888	13.5	9.5	18.8
Gisborne District	490	434	7.9	5.4	11.1
Napier-Hastings District	1,908	1,622	8.0	5.9	10.5
New Plymouth District	599	521	5.3	4.3	6.9
Palmerston North City	761	703	4.9	4.0	6.2
Wanganui District	864	782	10.2	6.3	16.7
Wellington City	1,174	1,156	3.4	3.0	4.1
Hutt Valley District (4)	941	926	3.5	3.0	3.9
Nelson City	453	426	4.6	3.5	6.2
Marlborough-Kaikoura District	911	671	8.5	6.0	12.9
Christchurch City	4,257	4,205	6.1	4.9	9.0
West Coast Region	764	531	15.1	7.5	34.1
Queenstown Lakes District	1,432	1,286	13.8	9.5	26.9
Dunedin City	1,023	969	4.5	3.1	6.1

(1) Source: www.realestate.co.nz

(2) Includes houses, apartments, units, townhouses, home & income and lifestyle

(3) Ads including 50% of lifestyle relative to the historical annual average, maximum and minimum number of sales

(4) Upper & Lower Hutt

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The Thames-Coromandel District, for example, has enough properties advertised for sale to satisfy around 26 months of demand based on the historical average level of sales, but this blows out to 47 months based at trough level sales rates. At the other extreme Wellington City has only enough properties advertised for sale to met around 3.4 months of historical average demand. This assumes one add equals one property for sale, which somewhat overstates the situations because of multi listings, but this shouldn't materially affect the relative situation between the 24 cities/districts.

It is not an exact science in that the cities/districts with the highest stock of properties advertised for sale aren't necessarily those most at risk of experiencing double digit downside in median dwelling prices. Other factors, like the level of demand, investor involvement in the market and the level of mortgagee sales, are also of considerable importance. However, the table on the previous page is a good starting point for assessing the markets most at risk of experiencing large falls in median dwelling prices.

The table below repeats the exercise for sections, but at the regional level. The most useful column is the Average Sales one which shows how many months it would take to sell the number of sections currently advertised for sale with REINZ members based on the historical average number of sales over the previous ten years. Again, because we are measuring the number of ads and not the number of sections these are best viewed as estimates not facts written in concrete, but even if the numbers are discounted materially the table tells a story of massive oversupply in some regions, especially the West Coast (see our recent West Coast lifestyle report - <http://www.sra.co.nz/pdf/WestCoastlifestyle.pdf>), Thames-Coromandel, Northland, and Waikato Country (Waikato excluding Hamilton City).

This does not mean section prices in all these places are about to experience double digit falls, but the preconditions for large falls, even well in excess of 10%, exists in some places. The places most at risk will be those with both large oversupply and where the most distressed or forced vendors emerge, which puts many of the coastal and resort markets, where supply increases have been fuelled by investors much more than by end-users, most at risk (i.e. a repeat of what we have seen in the Auckland apartment market).

REINZ Section Ads Relative to Annual Section Sales - 22 February 2008

	Number of Section For Sale Ads (1)	Ads expressed as months of sales (2)		
		Average Sales	Maximum Sales	Minimum Sales
Northland	2241	43.1	22.0	103.0
Auckland	2919	19.2	14.7	25.9
Hamilton City	175	7.1	3.8	12.7
Waikato Country	599	26.8	11.4	75.7
Thames-Coromandel	848	45.0	21.4	88.5
Bay of Plenty	888	15.2	7.8	27.6
Taupo & King Country	393	17.3	9.6	28.4
Gisborne	62	21.1	9.7	106.3
Hawkes Bay	262	15.9	8.3	68.3
Taranaki	212	17.1	6.3	50.9
Manawatu-Wanganui	455	19.0	9.8	49.2
Wellington	612	10.3	7.7	14.0
Marlborough	260	14.9	7.6	31.2
Nelson-Tasman	231	7.7	3.5	14.7
Canterbury	1297	12.7	6.8	26.4
West Coast	455	68.0	26.4	455.0
Southland	219	19.8	9.4	82.1
Central Otago-Lakes	1275	27.6	13.7	147.1
Otago	289	19.3	9.8	59.8

(1) Source: www.realestate.co.nz

(2) Ads relative to historical average, maximum and minimum sales numbers from www.reinz.co.nz

The truth, the whole truth but only half the story

This Raving has added an element of analysis to the debate over whether we face imminent double digit falls in house and section prices. The last Raving on this topic identified the risk that the national median house price would have to fall around 42% to bring dwelling prices back into line with rental incomes, if everything else, and especially rents, didn't change. Obviously landlords in many places will be looking to wind up rents now they aren't getting capital gains, but rental yields are so low there is still the risk that in inflation adjusted terms the national median house price will end up falling more than 20% before the dust settles. But, in the best capitalist tradition, we will reserve the full analysis and predictions about the magnitude and timing of Armageddon for paying clients of our **Housing Prospects** report (a must have for anyone serious about understanding the outlook for the housing and section markets).

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