# PROPERTY CYCLE COMMENTARY

## FEBRUARY 2008

## Why Property Confusion Reigns and How to Avoid it!

*By Kieran Trass*

This year we can expect further confusion over whether property values will rise or fall.

**But why more confusion?**

Well, we know that at the current point in the property cycle, just about everyone has an opinion about the merit of current property prices and whether or not they will rise or fall.

These opinions are formed by each individual's summation of evidence gathered about two major topics.

**First** is evidence about individual property values which is often based on personal knowledge or experience like this… "the house next door just sold for $50,000 less than it was worth a year ago" or indeed the exact opposite "the house next door just sold for $50,000 more than it was worth a year ago".

Of course the problem is that not everyone is looking at the exact same property sales and just because the house next door sold for more or less than it was worth a year ago does that mean the whole market has experienced the same direction in values?

Unfortunately not because every property sells for a price which is based **not only** on the overall state of the market but based also on the properties own individual merits… and those merits can easily be enhanced (i.e. by adding value in some way) or indeed those merits can easily be reduced (i.e. the property used to have a beautiful garden but now its overgrown and messy)

So the individual merits of each property combined with subjective opinions over the value of those merits can cause some confusion.

**Second** is evidence about the property market. This evidence is often based on the combination of **anecdotal evidence presented in the media**, personal knowledge, experience and/or information from acquaintances. Whilst that evidence is certainly useful to have it has little value unless it is supported with the rigorous analysis of quality data.

**The anecdotal evidence in the media in my opinion is the root cause of the most confusion.**

This is because of the poor quality price data that is often relied upon by the property industry and the media to 'gauge' the state of the property markets. The guilty party here appears to be the Median property price data which is released every month. Median price data is the most abused real estate data produced but it gets an undeserved amount of media coverage every month simply due to its immediacy (it is released a few days after each months end so its immediacy is great for the media but its usefulness as a tool to gauge the direction of property values is badly flawed.)

An interesting observation of how the industry and the media interpret the median data is this;

***When median prices rise the implication often made is that property values are rising (when in fact they may not be) but when median prices are falling the implication often made is that the figures are distorted by 'compositional error'.***

If you haven't read my article on the Median/Average House Price Myth then here is where you can find it;
http://www.hybridgroup.co.nz/content/1274/The%20Median%20or%20Average%20House%20Price%20Myth.pdf

If you are wondering why the media dont wait for the more accurate Index data then the old adage "You get what you pay for" is most appropriate here because the Median data is FREELY available to the media whilst the QV HPI and SuburbWatch Index are generally closely guarded due to ongoing research which comes at a significant price to collate and analyse. That is also why there are Intellectual Property rights protecting the QV HPI and the SuburbWatch Index.

**To avoid the confusion** which is set to reign at least in the first half of 2008 make sure you do not rely on the Median or Average house price data to gauge the direction or trends of property prices.
Much more accurate data is available from www.QV.co.nz and www.SuburbWatch.co.nz

## So Are We Still in For a Soft Landing?

We are currently in the process of collating and analyzing our latest datasets on our Key Drivers, Market Influencers and property price trends from Suburbwatch. Whilst the data is only partially analysed so far (we analyse over 1,000 new sets of data each month) we do note, with some concern, that there appears to be some concerning trends emerging combined with weak support of current property market conditions.

**We will be issuing a press release soon** to outline our 'big picture' analysis findings and will include a more in depth look at the analysis which forms our opinion in this commentary next month.

# THE NEW ZEALAND PROPERTY MARKET


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**The country's property cycle overall continues to experience the early slump phase.**

Expect continued soft market conditions in the short term with some areas starting to reveal a large oversupply of properties for sale whilst others are still experiencing a small shortage. In 2008 New Zealand's property market will generally deteriorate as the market becomes more and more of a buyers market. At this point in time indications are still that New Zealand will probably not feel the full effects of this Slump until 2009-10.

The Key Drivers indicate we are in the early Slump phase of the cycle.

It is now looking more likely that there MAY be a sudden and rapid deterioration in our economy overall. We could well be setting our property market up for a sharp correction in the 2008-09 years. It is now looking more likely that we may suffer a difficult time in the property market in 2008-09 given the current combination of factors influencing the market.
Many of the Key Drivers we monitor reached their peaks at the peak of the boom and now they are trending in the opposite direction. We closely monitor the peaks and troughs of each of the Key Drivers to determine what the 'time' is on the real estate cycle clock.

Below is a summary of many of the identified Key Drivers and Market Influencers in my book “Grow Rich with the Property Cycle” revealing the trend direction of each Key Driver/Market Influencer and whether this trend creates a positive environment for further property investment purchases or a negative one and why. I focus on the impact for further property investment rather than existing property investments. In some instances these trends can provide a 2 edged sword for investors i.e. Inflation means higher property values which decreases our returns on further property purchases but of course means we achieve more equity from any already owned property! (If you have not yet read my book then you need to be aware that the Key Drivers of the property cycle provide the gravitational pull to propel the property cycle through its phases. In contrast the Market Influencers simply have a short term influence on the market that can cloud the perception of what is happening to the property cycle).

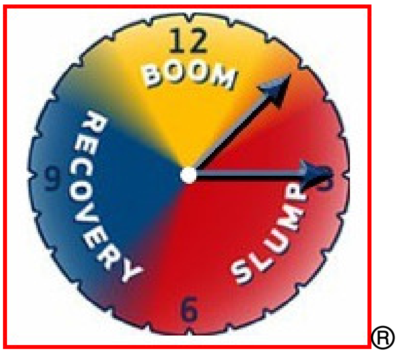
# NEW ZEALAND’S KEY DRIVER & MARKET INFLUENCER TRENDS

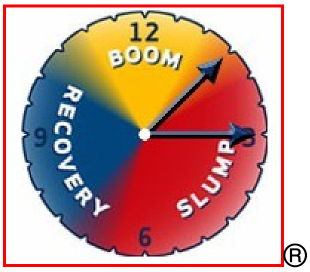
| KEY DRIVER | TREND DIRECTION | IMPACT | WHAT IMPACT? |
|---|---|---|---|
| Net Migration | ☞ | ☹ | Remains soft @ 7,000 p.a. mainly due to NZers migrating to Australia. |
| Population Growth | ☞ | 😐 | Still up but slow because of net migration. |
| Dwelling Consents | ☟ | ☺ | Softening |
| Number of People Per Household | ☝ | ☹ | Evidence of increasing people per house as rents become less affordable |
| Employment | ☞ | 😐 | Stable consumer confidence |
| Average Rents | ☝ | ☺ | Slightly higher |
| Average Hourly Wages | ☞ | 😐 | Still growing slightly but stabilising |
| Property Affordability | ☟ | ☹ | Unaffordable for 1st home buyers. Yields too low for investors |
| Gross Domestic Product | ☝ | ☺ | Stabilising economy |
| Median Days to Sell | ☝ | ☺ | More keen vendors |
| Property Sales | ☟ | ☺ | More keen vendors |

| MARKET INFLUENCER | TREND DIRECTION | IMPACT | WHAT IMPACT? |
|---|---|---|---|
| Interest Rates | ☞ | ☹ | Little chance of falls in sight |
| Confidence in Property Investment | ☟ | ☺ | Rapidly falling. Less competition when buying |
| Inflation | ☞ | 😐 | Still high but stabilising |
| Legislative Amendments | ☞ | 😐 | None of significance but could be some coming |
| Offshore Investors | ☟ | ☺ | Less purchasers |
| Investment Alternatives | ☝ | 😐 | Speculation on exchange rates, commodities etc increasing |

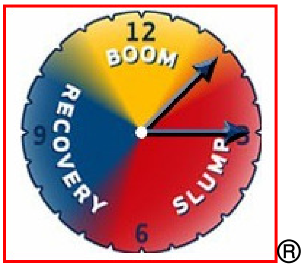
# THE AUCKLAND PROPERTY MARKET

## All of Auckland

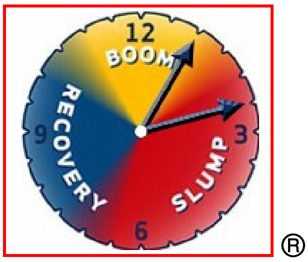


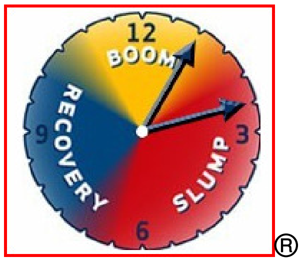

North Shore




Central Auckland




West Auckland




South/East

**Central Auckland and the North Shore have now shifted cyclically out of the Boom completely and will continue to remain soft.** South/East and West Auckland are hanging onto the boom by a thread. Sales volumes have failed to rebound from their low levels. The market is clearly showing signs of slowing further.

**Other factors in Auckland's market at present include;**

- Auction clearance rates remain light.
- House sales volumes remain soft compared to volumes of a year ago.
- New property listings are more rapidly increasing but the asking prices are generally decreasing.
- Open Homes remain like Ghost Towns as a rule…
- Days to sell are increasing in most suburbs but still remain low in a few others.
- Rents are still rising but with limited upside growth due to **rental affordability**.
- **Rental affordability** is stretched and we are now seeing the number of people per household to increase as a result, which will increase vacancy rates and soften the current upward pressure on rents.
- Employment levels remain high.
- Incomes remain under some slight upward pressure in light of the lack of a skilled workforce.
- Vacancy rates remain stalled across much of Auckland and the level of vacancy will be determined in part by **rental affordability** (see above).

**In summary** Auckland overall continues to experience the classic early slump signals of lower sales volumes and less interest in property, ironically at a time when more keen vendors are becoming apparent by the day...
There is no need to rush to buy in this market and given more time the keenest vendors will be easier still to find because they will represent a larger % of vendors in the market to sell.
A lift in sales volumes early in 2008 is no longer expected to arrive.

# THE WELLINGTON PROPERTY MARKET

## All of Wellington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**Central Wellington** **Wellington Hutts and Porirua**

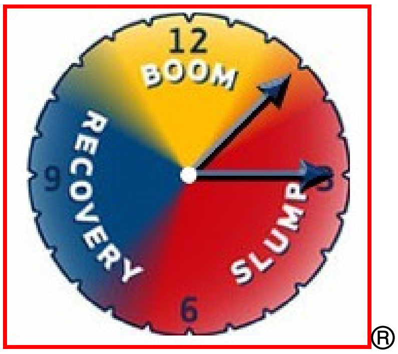
**Wellington's property market** continues to progress into the slump phase of the cycle.

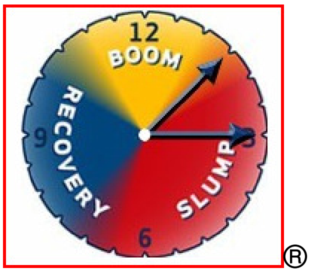
- Wellington sales volumes still remain lower than at the same time of year in 2006 and 2005 **indicating a weakening** in demand continues. Price growth rates are still rapidly diminishing in many parts of Wellington.
- The average number of days to sell is similar to the same time of year in 2006 and 2005 indicating demand has stabilised.
- House price **growth rates** are no longer rising.
- Open Homes are more like Ghost Towns as a rule…
- Yields are at lower levels and investors seem to finally be losing their appetite for investment property.
- Rents are stabilizing and are not expected to fall from their current levels.

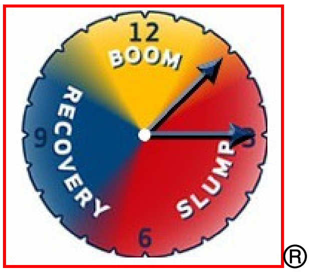
**In summary** we now expect little if any further growth in values in 2008 pretty much across the board for Wellington and we expect the property cycle will progress further into the slump in 2008. There is no need to rush to buy in this market and given more time the keenest vendors will be easier still to find because they will represent a larger % of vendors in the market to sell.
A lift in sales volumes early in 2008 is no longer expected to arrive.

# THE CHRISTCHURCH PROPERTY MARKET

## All of Christchurch




**West Christchurch** **East Christchurch**

**Christchurch has progressed further into the Slump phase of the cycle**.

The Christchurch property market continues to start to feel the slumps effects and **values remain soft in most** of Christchurch.

- Sales volumes remain soft in most parts of Christchurch. Overall sales volumes are still significantly lower than at this time of the year in the previous 3 years indicating a continued softening market.
- The number of days to sell is much higher.
- Open Homes are more like Ghost Towns as a rule…
- 2008 is now expected to deliver little, if any, growth in values pretty much across the board and property price growth rates are subsiding in most suburbs.
- Rents appear to be stabilising.

**In Summary** the Christchurch property market has turned fast with the former momentum of activity fading and that is continuing to slow house price rises and **the rate of property price growth continues to reduce from the strong rates of growth enjoyed in 2007**. There is no need to rush to buy in this market and given more time the keenest vendors will be easier still to find because they will represent a larger % of vendors in the market to sell.
A lift in sales volumes early in 2008 is no longer expected to arrive.

# SUMMARY

**The country's property cycle overall is still experiencing the early slump phase.**

**The anecdotal evidence in the media in my opinion is the root cause of the most confusion.**

This is because of the poor quality price data that is often relied upon by the property industry and the media to 'gauge' the state of the property markets. The guilty party here appears to be the Median property price data which is released every month. Median price data is the most abused real estate data produced but it gets an undeserved amount of media coverage every month simply due to its immediacy (it is released a few days after each months end so its immediacy is great for the media but its usefulness as a tool to gauge the direction of property values is badly flawed.)

An interesting observation of how the industry and the media interpret the median data is this;

***When median prices rise the implication often made is that property values are rising (when in fact they may not be) but when median prices are falling the implication often made is that the figures are distorted by 'compositional error'.***

There is no need to rush to buy in this market and given more time the keenest vendors will be easier still to find because they will represent a larger % of vendors in the market to sell.
A lift in sales volumes early in 2008 is no longer expected to arrive.

The Key Drivers indicate New Zealand overall is in the early Slump phase of the cycle with a toehold in the late boom phase.

**In summary** Auckland overall continues to experience the classic early slump signals of lower sales volumes and less interest in property, ironically at a time when more keen vendors are becoming apparent by the day...

**In summary** we now expect little if any further growth in values in 2008 pretty much across the board for Wellington and we expect the property cycle will progress further into the slump in 2008.

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***How to read the "Property Clock"***

*The "Property Clock" is designed to give an indication of where the overall Residential Property Market is in light of the traditional Property Cycle.*
*The "Property Clock"* ***is a registered trademark*** *in NZ, Australia, UK and the USA (owned by Kieran Trass)*
*The "Property Clock" differs from a normal clock in several ways:*
*1) It gives a range of time instead of an exact time.*
*2) It has no PM or AM.*
*3) Both hands are hour hands.*
*4) It has no minute hand.*
*5) Each "notch" is half an hour.*
*6) There are three distinct phases, Gold = BOOM, Red = SLUMP, Purple = RECOVERY.*