

# PMI residential property overview



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New Zealand

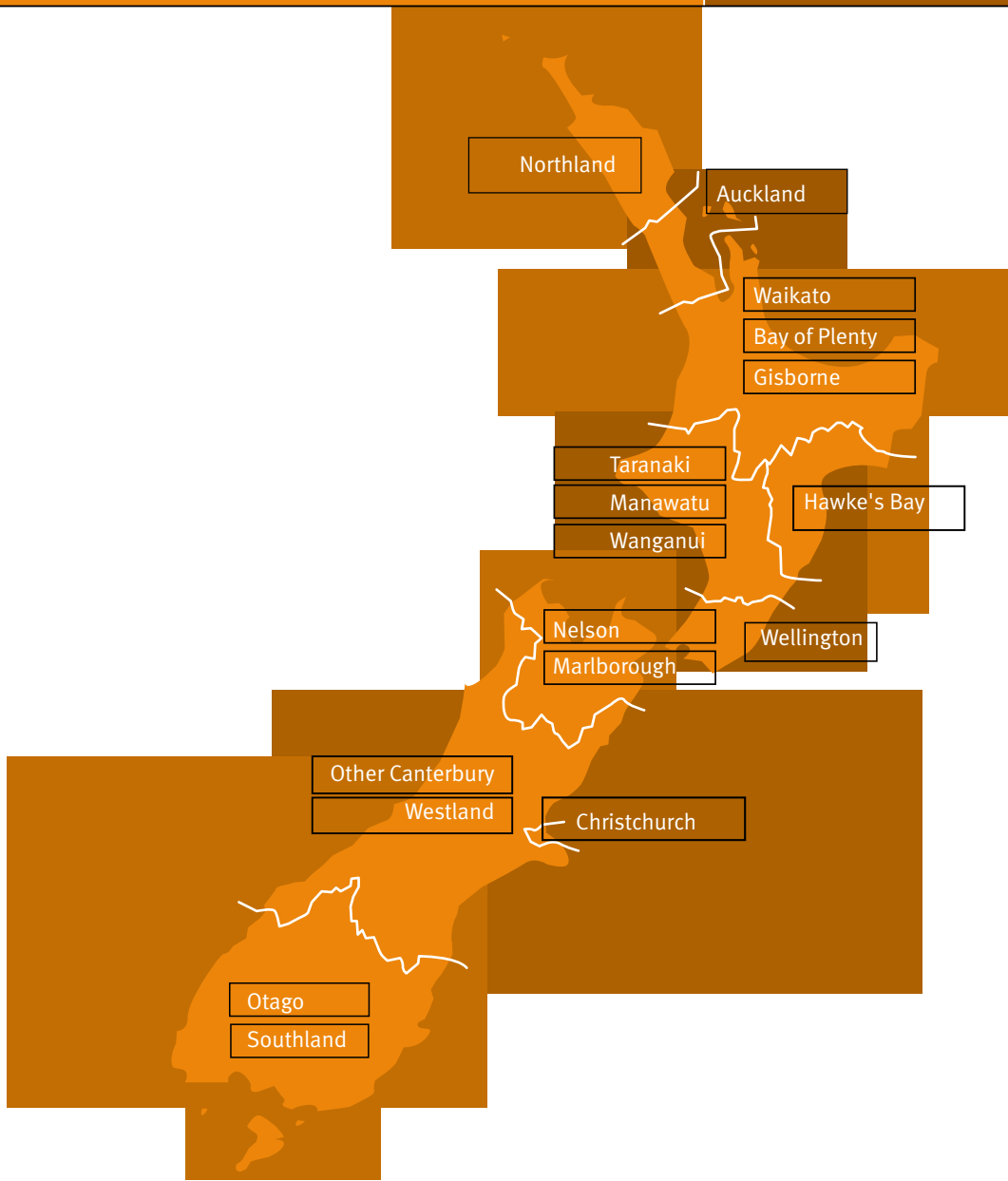
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# Contents



<b>Introduction</b>	2
<b>Executive Summary</b>	4
<b>Economic Outlook</b>	6
Inflationary outlook	7
Sustained economic growth	7
Labour market pressures	8
Export market	8
<b>Residential Demand</b>	10
State of play	10
Interest rates	11
Migration trends	11
Forecast: a return towards normal	12
Rental Performance	13
Reduced building activity	14
<b>Northland</b>	
State of play and Forecast	16
<b>Auckland</b>	
State of play and Forecast	18
<b>Waikato/Bay of Plenty/ Gisborne</b>	
State of play and Forecast	20
<b>Hawke's Bay</b>	
State of play and Forecast	22
<b>Taranaki/Manawatu/Wanganui</b>	
State of play and Forecast	24
<b>Wellington</b>	
State of play and Forecast	26
<b>Nelson/Marlborough</b>	
State of play and Forecast	28
<b>Christchurch</b>	
State of play and Forecast	30
<b>Other Canterbury/Westland</b>	
State of play and Forecast	32
<b>Otago/Southland</b>	
State of play and Forecast	34

<b>Tables</b>	
1.1: Median house prices by region	5
2.1: Economic indicators	7
3.1: Population growth by region	11
3.2: House sales by region	12
3.3: Rental growth by region	13
3.4: New dwelling consents by region	14

<b>Charts</b>	
4.1: Northland Median house prices	17
4.2: Northland Annual house sales total	17
5.1: Auckland Median house prices	19
5.2: Auckland Annual house sales total	19
6.1: Waikato/Bay of Plenty/Gisborne Median house prices	21
6.2: Waikato/Bay of Plenty/Gisborne Annual house sales total	21
7.1: Hawke's Bay Median house prices	23
7.2: Hawke's Bay Annual house sales total	23
8.1: Taranaki/Manawatu/Wanganui Median house prices	25
8.2: Taranaki/Manawatu/Wanganui Annual house sales total	25
9.1: Wellington Median house prices	27
9.2: Wellington Annual house sales total	27
10.1: Nelson/Marlborough Median house prices	29
10.2: Nelson/Marlborough Annual house sales total	29
11.1: Christchurch Median house prices	31
11.2: Christchurch Annual house sales total	31
12.1: Other Canterbury/Westland Median house prices	33
12.2: Other Canterbury/Westland Annual house sales total	33
13.1: Otago/Southland Median house prices	35
13.2: Otago/Southland Annual house sales total	35



# Introduction

Welcome to the latest edition of the PMI Residential Property Overview for New Zealand. This publication is issued twice a year and has been designed to provide you with an overview of current New Zealand property market trends.

The PMI Residential Property Overview has been produced by PMI Mortgage Insurance Ltd (PMI) in conjunction with Infometrics.

## PMI Mortgage Insurance Ltd

PMI is the largest mortgage insurer in New Zealand with over 15 years in the New Zealand market and 39 years experience in the Australian market. PMI is a leading mortgage insurer, credit enhancer and New Zealand residential property market specialist.

Our global parent, The PMI Group, Inc., is headquartered in Walnut Creek, California and through its subsidiaries is one of the largest private mortgage insurers in the United States, Australia, New Zealand and the European Union as well as the largest mortgage guaranty reinsurer in Hong Kong.

PMI have facilitated home ownership for more than 860,000 families in New Zealand and Australia.

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# Executive Summary

Monthly house sales volumes have been dropping for over a year now, but the slowdown in activity has yet to have any discernible impact on prices nationally. Floating mortgage rates have risen from 7.1% to 8.5% over the last year, their highest level since 2000. Slowing growth in residential rents points to an oversupply of housing, and combined with higher borrowing costs, this will undermine house prices next year.

It is estimated that, on average, real house prices are currently 25% above their long-term trend. However, for New Zealand as a whole, we are only forecasting a drop of 4% in average prices (or 6% in real terms) by mid-2005. This is because property owners will tend to put off selling for a lower price for as long as possible. There are historical precedents for prices to remain above (or below) their long-term real trend for a sustained period of time.

Apartments and lower-priced property is likely to fare worse than average. Apartment prices will come under downward pressure as a large number of projects are completed and supply increases (particularly in Auckland). Demand for lower-priced property will be limited by low affordability (due to higher interest rates) for first-home buyers, as well as reduced investor demand for rental properties, with rental yields having fallen to low levels.

- Population growth is easing in Auckland, reducing demand for housing. The slowdown in activity is likely to continue until

the second half of 2005, when more stable population growth and falling interest rates are likely to lead to an improvement in prices. Over the three years to June 2007, we predict a 13% rise in house prices (or a 5% rise in real terms).

- Property sales volumes in Wellington are falling at their fastest rate in more than a decade. The real estate market in the region has generally avoided large fluctuations in activity over recent years, and we do not expect the current decline in turnover to persist. A growing public sector will ensure continued demand for property and house price growth will take a breather after its good run over the last eight years. It is estimated that prices will rise 8% over the three years to June 2007 (prices will remain unchanged in real terms).
- The Waikato/Bay of Plenty/Gisborne region has benefited from a buoyant export sector, but price growth has not been as strong as in other regions around New Zealand. This suggests that housing in this region is not as overvalued as in other parts of the country, and implies a positive outlook for property prices over the medium term. A 13% rise in house prices through until June 2007 is forecasted for this region (or 5% in real terms).
- The Christchurch property market has outperformed expectations over the last six months and continues to benefit from an increased number of New Zealanders returning from overseas. This trend will decline over the forecast period and population growth in the region is likely to slow resulting in an outcome of less buoyant property prices. It is predicted that house prices will be just 4% higher by June 2007 (a 3% fall in real terms).

- Property in parts of Otago/Southland is among the most overvalued in the country. High prices are putting a dampener on sales activity, and flagging population growth will undermine turnover across much of the region. The resort areas of Queenstown and parts of Central Otago will fare the best over the next three years, but on average we forecast that house prices will be 5% lower by June 2007 (or 12% in real terms).
- Taranaki/Manawatu/Wanganui has enjoyed a late increase in property values this year, despite rising interest rates, and population growth turning negative. Palmerston North and parts of Taranaki are unlikely to encounter further population decline over the next 2-3 years, but other parts of the region such as Wanganui will not be as fortunate. The region's mixed prospects are reflected in the outlook for house prices and it is estimated that there will be a 3% rise in prices by June 2007 (or a 4% fall in real terms).
- The Nelson/Marlborough property market is leading the housing downturn, with the very strong house price growth over the last two years reducing affordability and pricing many buyers out of the market. We expect some price falls over the next 9-12 months, but most vendors will avoid selling unless

they have no choice. By June 2007, we predict average house prices will have fallen 3% (or 10% in real terms).

- Hawke's Bay property values have risen strongly on the back of demand for coastal land, but the interest in the region's property market has not translated into faster population growth. This leads to a question of sustainability of house price rises in the region. A 2% drop in house prices over the three years to June 2007 is forecasted (or 9% in real terms).
- In the Canterbury/Westland region (excluding Christchurch), activity has been very strong and there has been an improvement in population growth that we expect to be partially sustained. Property prices have been rising strongly across the region, and are probably most overvalued in the areas furthest from Christchurch. Over the three years to June 2007 we expect house prices to rise 4% (or fall 4% in real terms).
- The property market in Northland has recently shown signs of cooling with an increase in the average length of time on the market. The medium-term outlook for property differs across the region, with solid employment prospects, coastal areas and housing in towns are likely to be the best performing. On average, we expect house prices to climb 13% over the three years to June 2007 (or 5% in real terms).

**Table 1.1: Median house prices by region**

June Quarter <sup>(1)</sup>	Northland		Auckland		Waikato/Bay of Plenty/Gisborne		Hawke's Bay		Taranaki/Manawatu/Wanganui	
	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>
1998	142.8	6.6%	232.3	-0.9%	149.8	3.2%	117.9	-6.2%	97.8	-1.6%
1999	150.4	5.3%	235.0	1.1%	154.8	3.3%	128.7	9.1%	98.8	1.1%
2000	148.3	-1.4%	238.2	1.3%	158.0	2.0%	120.7	-6.2%	103.1	4.4%
2001	153.5	3.5%	245.5	3.1%	159.2	0.7%	125.8	4.3%	102.1	-1.0%
2002	159.7	4.0%	264.3	7.6%	166.2	4.4%	132.0	4.9%	108.0	5.7%
2003	161.7	1.3%	289.3	9.5%	178.0	7.1%	156.5	18.5%	113.8	5.4%
2004	190.1	17.6%	330.9	14.4%	194.8	9.4%	208.0	32.9%	133.2	17.1%
Forecasts										
2005*	196.3	3.3%	338.3	2.2%	202.1	3.8%	194.3	-6.6%	131.6	-1.2%
2006*	210.7	7.3%	360.7	6.6%	216.1	6.9%	198.6	2.2%	135.7	3.1%
2007*	215.6	2.3%	374.4	3.8%	219.7	1.7%	204.8	3.1%	137.4	1.2%
June Quarter <sup>(1)</sup>	Wellington		Nelson/Marlborough		Christchurch		Other Canterbury/Westland		Otago/Southland	
	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>	\$'000	APC <sup>(2)</sup>
1998	161.6	7.3%	145.2	7.1%	150.7	2.7%	104.0	-7.0%	84.6	-10.0%
1999	174.0	7.7%	141.0	-2.9%	153.3	1.8%	117.5	13.0%	89.4	5.7%
2000	188.0	8.0%	143.6	1.8%	156.8	2.2%	113.2	-3.7%	92.4	3.4%
2001	196.0	4.3%	151.4	5.5%	152.3	-2.8%	109.4	-3.4%	90.2	-2.4%
2002	204.7	4.4%	159.8	5.5%	154.5	1.4%	109.2	-0.2%	95.2	5.6%
2003	226.8	10.8%	211.3	32.3%	174.8	13.1%	122.0	11.8%	113.6	19.3%
2004	266.0	17.3%	264.3	25.1%	229.0	31.0%	162.1	32.9%	162.6	43.2%
Forecasts										
2005*	264.7	-0.5%	244.6	-7.5%	219.1	-4.3%	154.2	-4.9%	148.1	-8.9%
2006*	277.0	4.6%	245.3	0.3%	230.1	5.0%	162.9	5.6%	148.3	0.1%
2007*	286.9	3.6%	255.8	4.3%	239.3	4.0%	168.0	3.1%	154.2	3.9%

Source: Real Estate Institute of New Zealand; \* Infometrics forecasts <sup>(1)</sup> Average median price over three months to June; <sup>(2)</sup> Annual percentage change Composite regions are weighted average of each region's median prices.





## Economic Outlook

*A period of softer economic growth is likely to encourage the Reserve Bank to return the official cash rate towards neutral over the second half of 2005.*

The New Zealand economy is operating at full capacity. Four consecutive years of strong growth have produced inflationary pressure across the country. If economic growth is to be sustained over the medium term, this pressure will need to be relieved. This year the Reserve Bank has increased interest rates significantly, hoping to bring about a slowdown to free up capacity.

At this stage, a slight weakening in economic growth (from the current rate of 4.5% pa) is inevitable. There are already clear signs that higher interest rates and slower population growth are resulting in weaker activity in the housing market after strong growth over 2002 and 2003. With floating mortgage rates over 8.5%, it is forecasted that house prices will fall 6% in real terms by mid-2005 taking some of the vitality out of household spending. Combined with the reduction in building activity, and economic growth over the year to December 2005 is expected to proceed at the milder rate of 2.6% pa, before recovering to more than 3% pa by mid-2006.

**Table 2.1: Economic indicators**

Annual average percentage changes June years	1995-2004 Average	2002/03	2003/04	2004/05 Forecast	2005/06 Forecast	2006/07 Forecast
<b>Real expenditures</b>						
Private consumption	3.8%	4.8%	5.7%	4.4%	2.7%	3.3%
Government consumption	2.9%	1.4%	4.4%	5.3%	6.2%	3.6%
Residential investment	5.0%	24.9%	13.0%	-9.3%	-11.4%	-6.6%
Non-residential investment	5.0%	-0.3%	6.1%	9.3%	5.1%	-0.5%
Total private investment	6.5%	14.6%	15.5%	5.0%	1.7%	2.6%
Total government investment	6.5%	-4.8%	1.4%	1.2%	5.4%	2.8%
<b>Gross national expenditure</b>	<b>4.1%</b>	<b>5.4%</b>	<b>7.3%</b>	<b>4.5%</b>	<b>3.1%</b>	<b>3.2%</b>
Exports of goods and services	4.5%	5.6%	3.5%	4.2%	5.0%	5.7%
Imports of goods and services	6.5%	9.6%	12.3%	8.6%	4.7%	5.2%
<b>Gross domestic product</b>	<b>3.4%</b>	<b>3.9%</b>	<b>4.3%</b>	<b>3.5%</b>	<b>3.1%</b>	<b>3.3%</b>
<b>Households</b>						
HLFS employment	2.2%	2.1%	3.0%	2.3%	1.6%	2.1%
HLFS unemployment rate <sup>(1)</sup>	6.0%	5.0%	4.3%	4.0%	4.3%	3.8%
Hourly wage	2.9%	3.2%	3.5%	4.6%	3.7%	3.6%
CPI <sup>(2)</sup>	2.1%	1.5%	2.4%	3.0%	1.5%	3.1%
<b>NZ interest rates<sup>(3)</sup></b>						
10-year government bonds	6.8%	6.1%	6.0%	6.3%	6.5%	6.0%
90-day bills	6.8%	5.8%	5.4%	6.6%	5.9%	6.0%
Floating mortgage rates	8.7%	7.8%	7.4%	8.4%	7.8%	7.8%

*The labour market is in a position of unusual strength.*

Source: Statistics New Zealand, Reserve Bank of New Zealand, Infometrics forecasts  
 (1) Annual average for year ended (2) June on June, CPI ex credit prior to June 99 (3) Annual average rates

## Inflationary outlook

Inflation is set to briefly move out of the Reserve Bank's 1-3% target band over the next couple of quarters, providing ample justification for the tightening in monetary policy throughout 2004. But the price surge looks likely to be short-lived.

A cooling housing market will eliminate construction cost inflation and help to slow consumption growth. Capacity pressures for domestic firms will ease, implying a peak in unit labour cost growth, and importers will be forced to pass on more of the effects of the strong currency to try and maintain market share.

This period of softer economic growth is likely to encourage the Reserve Bank to return the official cash rate towards neutral over the second half of 2005, in a continuation of the "one year up, one year down" nature of New Zealand's monetary policy. Nevertheless, our forecast dip in economic growth barely goes below the Bank's estimate of New Zealand's sustainable growth rate. We're looking for productivity benefits as a result of the high levels of investment spending over the last couple of years, supporting sustainable higher potential growth and 90-day bill rates around 6% over the medium term.

## Sustained economic growth

It is anticipated that the economy will again strengthen post-2005, with growth returning to above 3% pa by mid-2006. We are not dismissing the severity of the shock a housing downturn can have on the economy, but in this instance there are compelling reasons to believe that the economy can withstand this downturn:

- The labour market is in a position of unusual strength. Rapid employment growth, coupled with solid wage increases, means that households' incomes are reasonably secure. Although employment growth is likely to halve from its current rate of 3% pa by 2006, job security for workers will remain strong.
- The cash injection provided by the Working for Families package will provide some extra spending power for households over the next three years.
- The government is also well-positioned fiscally to release more money to voters prior to next year's election.
- High commodity prices are providing an effective offset to the impact of the higher currency, and the global economy is still growing strongly. The rural sector is likely to provide another leg of support to domestic demand.
- Non-residential construction has significantly increased, and will help to offset the effects of the slowdown in residential building on overall construction activity.





## Labour market pressures

For some time now, increasing employee numbers has been the easy solution for New Zealand businesses trying to satisfy growing demand. This, we suspect will not be the case for much longer. With almost all measures of labour market tightness at record levels, wage growth is set to accelerate over the next year.

We expect annual average wage inflation to reach 4.6% pa by June 2005, putting immense pressure on unit labour costs for businesses. Rapid wage growth coupled with the extreme difficulty of finding suitable employees may provoke employers into changing their business practices. The focus will be on obtaining productivity gains, rather than simply expanding the workforce. Government policy that confers more bargaining power on workers and costs on employers will emphasise the need for focusing on productivity.

As domestic demand softens in response to weaker house prices, employment growth will slow, and unemployment will climb slightly to 4.5%. However, buoyant real wage growth and an unemployment rate that is low by historical standards are clear signs that the household sector is fundamentally in good health. Fiscal support from the government will ensure that consumption growth softens at a steady pace.

## The export market

Exporters are expanding their sales despite the high New Zealand dollar. Export volumes in the June quarter were 11% ahead of the same period a year earlier, with food and beverage exports leading the way (up 17%). The rebound in export volumes has been relatively widespread, with both manufactured and primary goods making significant contributions to growth.

Commodity prices have been setting long-term highs, and we expect them to hold up over the forecast period, consistent with solid world growth of around 3% pa over the next three years.

*Exporters are expanding their sales despite the high New Zealand dollar.*

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- **Online Product Guide** – designed to answer common underwriting questions.
- **PMI Property Overviews (archived editions)** – provide an overview of New Zealand and Australian and property market trends.



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## Residential demand

*Current sales volumes remain relatively buoyant when compared with the long-term average of the last ten years.*

### State of Play

The level of property sales activity has continued to reduce in the residential property market and although the decline has been relatively consistent, it has not been that dramatic given the peak in sales volumes. Sales over the September quarter were down 23% on a year ago (compared to a 32% pa fall recorded in 1997/98).

To put the current level of activity into perspective, the monthly sales total between July and September averaged 8,273 (seasonally adjusted), only 7% below the 1996 peak in turnover. Therefore, current sales volumes remain relatively buoyant when compared with the long-term average of the last ten years.

The Nelson/Marlborough property market is the most advanced in terms of the current downturn, and provides an example of what may happen in other regions around New Zealand. In Nelson/Marlborough, the number of sales is down 30% on the same time two years ago (compared to a 4.5% rise for all New Zealand). After reaching a peak of \$286,000 in December 2003, this year the median house price has fluctuated between \$248,500 and \$275,000. Furthermore, the average length of time a property is on the market has more than doubled, from 20 days in August 2003 to 52 days by September this year.

## Interest rates

The steady rise in interest rates is cooling activity in the property market. The Reserve Bank's focus over the last few months has switched from containing the housing market to more widespread domestic inflationary pressures.

We predict that floating mortgage rates will begin to ease over 2005 as inflation begins to slow and the probability of rate cuts by the Reserve Bank increases. Fixed mortgage rates will also come under some downward pressure. However, we do not anticipate that borrowing costs will fall as low as in 1999 or 2001/02.

The official cash rate is currently at 6.5%. We expect that, by the end of 2005, monetary policy action by the Reserve Bank will have returned interest rates to neutral levels (i.e. an official cash rate of 5.75%). That implies floating mortgage rates of around 7.5-7.75%. More substantial monetary stimulus, through further interest rate cuts, will not be necessary given the ongoing good performance of the New Zealand economy and the fiscal stimulus being provided by current levels of government spending.

## Migration trends

Over the last six months, the monthly net migration balance has stabilised at a level consistent with our net migration forecast of 13,600 for the year to March 2005. Although still positive, net migration is making a reduced contribution to population growth, which will slow from 1.8% pa in mid-2003 to 1.1% by early next year.

We expect net migration to remain steady over the next three years in the 13,000-17,000 pa range as labour market conditions remain attractive and the government seems determined to push up the rate of residency approvals to address the shortage of labour domestically.

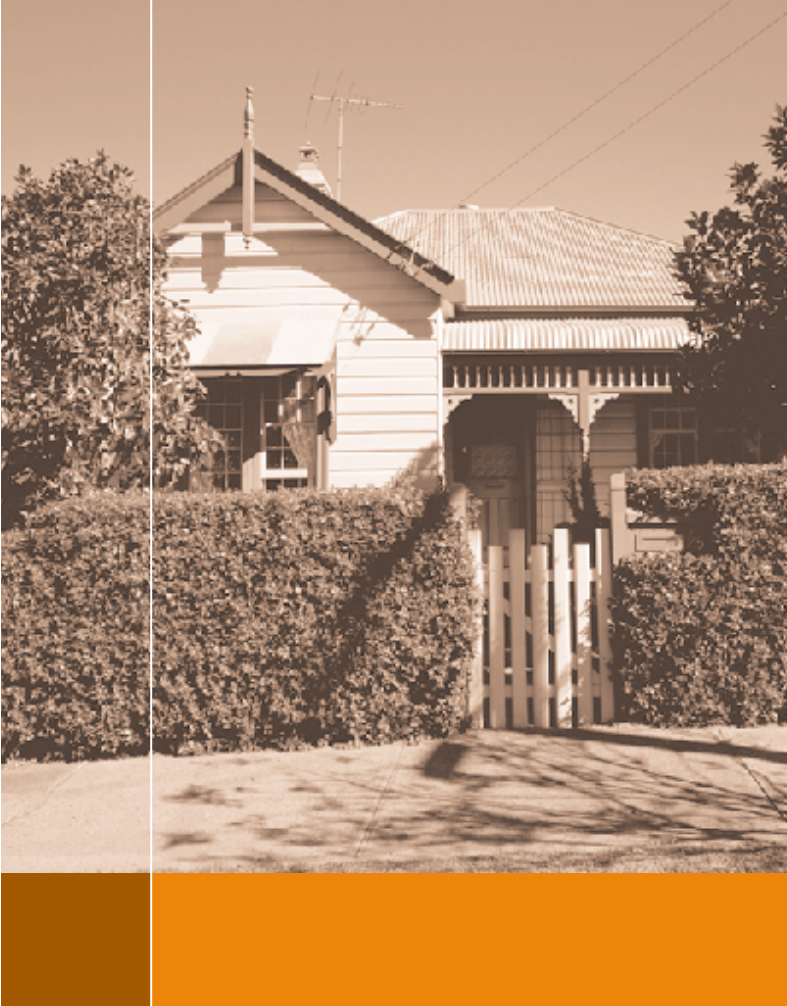
*Over the last six months, the monthly net migration balance has stabilised.*

**Table 3.1:** Population growth by region

Year ended June	Northland	Auckland	Waikato/Bay of Plenty/Gisborne	Hawke's Bay	Taranaki/Manawatu /Wanganui
1998	0.8%	1.9%	1.1%	0.1%	-0.5%
1999	0.4%	1.3%	0.6%	-0.2%	-0.6%
2000	0.3%	1.4%	0.5%	0.0%	-0.6%
2001	0.0%	1.4%	0.2%	0.0%	-1.0%
2002	0.7%	2.9%	1.0%	0.5%	-0.2%
2003	0.8%	3.1%	1.3%	0.3%	0.1%
Forecasts					
2004*	0.5%	2.0%	0.9%	0.3%	-0.4%
2005*	0.2%	2.1%	0.9%	0.2%	-0.2%
2006*	0.3%	2.2%	0.9%	0.3%	-0.1%
2007*	0.5%	1.8%	1.0%	0.5%	0.1%
Year ended June	Wellington	Nelson/Marlborough	Christchurch	Other Canterbury/Westland	Otago/Southland
1998	0.6%	1.2%	0.6%	0.5%	-0.8%
1999	0.4%	1.0%	0.4%	0.2%	-0.9%
2000	0.4%	1.1%	0.3%	0.4%	-0.4%
2001	0.6%	1.0%	0.4%	0.7%	0.2%
2002	1.2%	1.7%	1.5%	0.8%	0.9%
2003	1.4%	2.2%	2.0%	1.1%	0.9%
Forecasts					
2004*	1.1%	1.7%	1.4%	0.9%	0.4%
2005*	0.6%	1.2%	0.7%	0.6%	0.3%
2006*	0.7%	1.2%	0.8%	0.7%	0.3%
2007*	0.7%	0.9%	0.8%	0.7%	0.3%

Source: Statistics New Zealand, \* Infometrics forecasts





## Forecast: a return towards normal

We expect the current decrease in property sales to continue until the second half of 2005. If this were to occur there would probably be a fall in mortgage rates leading to a levelling off in sales volumes at around 90,000-95,000 sales per annum. Turnover in the property market will still be above the average of the last decade (87,400).

By June 2005, we forecast that average house prices will be 0.9% lower than a year earlier. We have incorporated three quarters of falling house prices in our forecasts, between December 2004 and June 2005 – a total decline of 4.3%. Taking consumer price inflation into account implies a 6.5% drop in real property values.

Forecasts of a 5% decline in house prices over the next year are now commonplace. Given that we estimate property throughout New Zealand is now overvalued by around 25% on average, a larger fall in house prices would seem likely. However, we believe the adjustment mechanism will come through a small fall in nominal prices in the short term,

Table 3.2: House sales by region

Year ended June	Northland		Auckland		Waikato/Bay of Plenty/Gisborne		Hawke's Bay		Taranaki/Manawatu /Wanganui	
	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>
1998	2,213	-21%	23,438	-20%	12,306	-14%	2,571	-4%	5,299	-5%
1999	2,135	-4%	26,262	12%	11,770	-4%	2,752	7%	6,000	13%
2000	1,883	-12%	23,137	-12%	10,409	-12%	2,767	1%	5,492	-8%
2001	1,764	-6%	22,032	-5%	9,557	-8%	2,436	-12%	5,080	-8%
2002	2,225	26%	31,594	43%	12,684	33%	3,168	30%	6,519	28%
2003	2,757	24%	38,144	21%	16,693	32%	3,880	22%	7,613	17%
2004	3,846	39%	40,361	6%	20,307	22%	4,136	7%	8,962	18%
Forecasts										
2005*	2,615	-32%	33,621	-17%	14,371	-29%	3,352	-19%	7,047	-21%
2006*	2,562	-2%	33,077	-2%	13,933	-3%	3,312	-1%	6,996	-1%
2007*	2,454	-4%	30,606	-7%	13,059	-6%	3,043	-8%	6,449	-8%
Year ended June	Wellington		Nelson/Marlborough		Christchurch		Other Canterbury/Westland		Otago/Southland	
	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>
1998	10,564	0%	2,404	-12%	7,593	-20%	2,833	-16%	4,670	-17%
1999	11,394	8%	2,724	13%	7,298	-4%	2,938	4%	5,398	16%
2000	10,656	-6%	2,581	-5%	6,417	-12%	2,771	-6%	5,032	-7%
2001	9,921	-7%	2,622	2%	5,927	-8%	2,570	-7%	5,793	15%
2002	11,355	14%	3,809	45%	7,740	31%	3,498	36%	7,807	35%
2003	12,224	8%	4,155	9%	9,373	21%	4,921	41%	9,585	23%
2004	12,210	0%	3,392	-18%	10,341	10%	5,396	10%	9,507	-1%
Forecasts										
2005*	11,195	-8%	3,330	-2%	8,077	-22%	3,926	-27%	7,994	-16%
2006*	11,916	6%	3,322	0%	7,928	-2%	3,771	-4%	7,578	-5%
2007*	10,927	-8%	2,982	-10%	7,126	-10%	3,545	-6%	6,922	-9%

Source: Real Estate Institute of New Zealand; \* Infometrics forecasts (1) Annual percentage change

**Table 3.3: Rental growth by region**

June quarter, annual % changes	Northland	Auckland	Waikato/Bay of Plenty/Gisborne	Hawke's Bay	Taranaki/Manawatu/Wanganui
1999	-0.8%	-3.4%	-1.5%	0.7%	0.5%
2000	-4.0%	1.4%	-0.9%	0.6%	-0.6%
2001	2.2%	2.4%	0.3%	0.3%	1.4%
2002	3.7%	7.6%	3.9%	3.1%	4.3%
2003	3.1%	10.2%	6.8%	5.3%	6.0%
2004	11.2%	1.9%	9.2%	8.6%	3.3%
June quarter, annual % changes	Wellington	Nelson/Marlborough	Christchurch	Other Canterbury/Westland	Otago/Southland
1999	0.9%	-1.0%	-1.9%	-0.1%	4.2%
2000	1.1%	1.6%	-0.2%	0.3%	1.0%
2001	3.7%	2.1%	2.5%	-1.1%	4.3%
2002	2.3%	5.6%	6.9%	6.4%	12.7%
2003	2.9%	12.3%	10.2%	7.7%	11.1%
2004	3.0%	8.4%	9.0%	9.8%	7.2%

Source: Infometrics calculations from Tenancy Services Bond Centre/Real Estate Institute of New Zealand data.

followed by a prolonged period of below-average house price growth. Vendors will simply refuse to sell property for prices below their expectations unless they are dictated to by their personal, employment, or financial situations.

### Rental performance

Rental growth has slowed over the last few months, dipping from a peak of 12% pa in February to 8% by September this year. The slowdown is reflected in most areas around the country, but is most pronounced in Auckland and Southland, where rents are now rising by less than 1.5% pa.

Residential rents have failed to rise as quickly as house prices over the last five quarters, resulting in a drop in gross rental yields from 5.8% to 5.3%. At the same time, the benchmark ten-year government bond rate has climbed from 5.2% to 6.2%. The relative return on rental property is much less attractive than in mid-2003 given that further significant capital gains are unlikely for the next 2-3 years.

*Vendors will simply refuse to sell property for prices below their expectations.*

With the stock of accommodation increasing as new housing from the higher level of building activity over 2003/04 becomes available, there is likely to be an excess supply of rental property. This oversupply will result in pressure to either reduce residential rents or increase the number of rental properties up for sale as landlords struggle to attract tenants. We expect rental inflation to be flat or slightly negative over the next year. Rental yields are likely to deteriorate further from their current levels, and will only improve as the excess supply of housing is absorbed through population growth.



## Reduced building activity

It is anticipated that the annual building consent total will fall to below 24,000 by the end of 2005, to around 22,300 by the end of the following year. These forecasts, combined with our estimate of underlying demand, suggest that the total number of building consents granted over the three years to March 2006 will be about 8,300 higher than underlying demand would justify. Slightly more than half of these new dwellings will remedy the shortage of housing that developed during 2002 and 2003 (which contributed to rapid house price growth). The remainder will end up as an oversupply that will need to be absorbed as additional households are formed over subsequent years.

The annual total of building consents peaked at 32,851 for the year to June 2004, and has reduced over the last few months. The fall in the annual total has been driven by a decline in non-apartment consents (down 1,000) however, the number of apartment consents in the September quarter was also the lowest in 1.5 years. This suggests that the construction downturn will be felt right throughout the residential property sector.

Although rising interest rates during 2004 have been seen as the main factor behind the property market downturn, we believe they have acted as more of a catalyst than as a fundamental driver of demand. The groundwork for the slowdown was set when the net migration inflow peaked and population growth began to slow in mid-2003.

**Table 3.4:** New dwelling consents by region

Year ended June	Northland		Auckland		Waikato/Bay of Plenty/Gisborne		Hawke's Bay		Taranaki/Manawatu /Wanganui	
	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>
1998	1,212	15%	9,259	10%	5,544	5%	386	-18%	605	-6%
1999	1,095	-10%	9,209	-1%	4,705	-15%	382	-1%	649	7%
2000	1,100	0%	9,965	8%	4,638	-1%	457	20%	875	35%
2001	936	-15%	7,407	-26%	3,489	-25%	432	-5%	732	-16%
2002	882	-6%	9,374	27%	3,939	13%	494	14%	840	15%
2003	1,082	23%	12,277	31%	4,828	23%	611	24%	947	13%
2004	1,408	30%	12,537	2%	6,293	30%	734	20%	1,301	37%
Forecasts										
2005*	1,095	-22%	11,063	-12%	4,895	-22%	565	-23%	970	-25%
2006*	979	-11%	9,750	-12%	4,312	-12%	430	-24%	724	-25%
2007*	971	-1%	9,731	0%	4,289	-1%	404	-6%	687	-5%
Year ended June	Wellington		Nelson/Marlborough		Christchurch		Other Canterbury/Westland		Otago/Southland	
	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>	Number	APC <sup>(1)</sup>
1998	2,323	51%	914	5%	2,117	4%	1,325	0%	553	-43%
1999	2,104	-9%	745	-18%	1,906	-10%	1,282	-3%	529	-4%
2000	2,451	16%	801	8%	1,744	-8%	1,370	7%	842	59%
2001	2,157	-12%	775	-3%	1,342	-23%	1,132	-17%	941	12%
2002	1,934	-10%	954	23%	1,530	14%	1,270	12%	1,315	40%
2003	2,574	33%	1,298	36%	2,338	53%	1,556	23%	1,562	19%
2004	2,592	1%	1,318	2%	2,539	9%	2,111	36%	2,015	29%
Forecasts										
2005*	2,293	-12%	1,052	-20%	1,794	-29%	1,576	-25%	1,640	-19%
2006*	2,100	-8%	814	-23%	1,510	-16%	1,312	-17%	1,072	-35%
2007*	2,113	1%	765	-6%	1,447	-4%	1,289	-2%	1,077	0%

Source: Statistics New Zealand; \* Infometrics forecasts (1) Annual percentage change

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## State of play

The annual total of new building consents in Northland has continued to rise this year, and has reached 1,422 for the 12 months to September 2004. Growth in residential building activity has been stronger and more sustained than we previously expected, with the annual total peaking 12% above the preceding high recorded in 1998.

Northland's net overseas migration moved into negative territory over the year to June 2004, as the nationwide net inflow fell back from the high levels of the previous year. Increased departure numbers from Northland have been responsible for approximately two-thirds of the drop in net migration, in line with an improving world economy.

## Forecast

Population growth in Northland appears to be easing, although not as rapidly as previously anticipated. However, the return to a net migration outflow may also be matched over the next couple of years by the loss of people to other regions within New Zealand. Northland's unemployment rate is among the highest in the country (at an average of 6.1% over the year to June 2004), and recent employment growth has been much slower than in neighbouring Auckland.

Although property sales activity in the region has been slow to turn, we predict that turnover will decline quickly in 2005, with a 32% drop in sales over the 12 months to June 2005. Such a decline reflects the height of the peak in property sales volumes reached this year and would still leave sales about 8% above the average of the last decade.

# Northland



Annual property sales rose to a peak of 3,846 in June 2004, before easing 4.2% over the September quarter. Similar to its trend on the way up, the property market in Northland is still lagging behind the national market as activity slows.

The median house price in Northland peaked at \$205,000 in March 2004. Annual price growth has quickly slowed since then, from 22% to 9.4% pa, with higher interest rates negatively impacting on affordability and buyer demand.

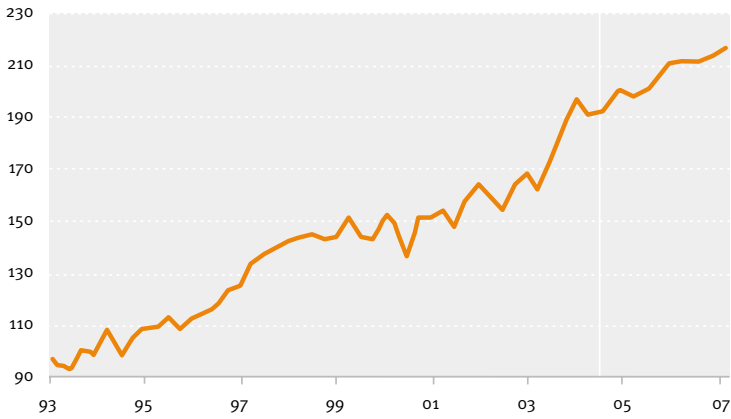
Rental growth has held up throughout 2004 and reached 7% pa in September this year. Gross rental yields dipped to a new low of 4.6% in April but have since recovered to over 5%, a trend that has not been repeated nationally. This suggests that, unlike much of the rest of the country, there is not a significant oversupply of rental property in Northland.

Despite the projected decline in property sales activity, it is not anticipated that there will be any significant drop in property values in Northland. Price growth will slow to around 3% pa by the first half of 2005, with some acceleration occurring during 2006 as mortgage rates become more favourable and buyers look to purchase property in attractive coastal locations in the region. It is likely that, during the strong lift in sales activity between 2001 and 2004, coastal property in Northland has not received as much attention as many other areas around New Zealand, and this will underpin further increases in house prices in the region.

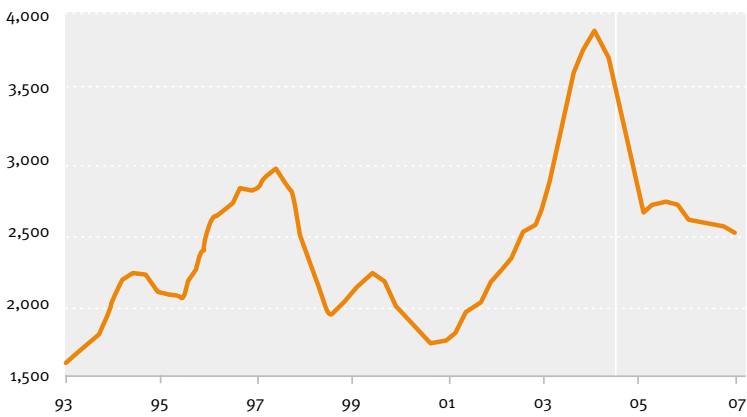
Both building activity (which is anticipated to ease over the next two years) and house price growth are likely to be unevenly spread throughout the region. The best-performing parts of Northland's residential property market are likely to be concentrated in coastal locations and towns with solid employment growth.

*Annual property sales rose to a peak of 3,846 in June 2004.*

**Chart 4.1:** Northland Median house prices (\$'000)



**Chart 4.2:** Northland Annual house sales total



*The best-performing parts of Northland’s residential property market are likely to be concentrated in coastal locations.*



## State of play

Residential building activity in Auckland significantly increased over the first half of this year, with the annual building consent total climbing 12% between December 2003 and June 2004. The increase was due to a revival in the number of building consents for apartments, which lifted from 3,064 over the 2003 calendar year to 4,382 during the 12 months to June 2004. The high number of building consents for apartments suggests that a significant oversupply will develop in this section of the property market as buildings are completed and become available for occupation.

Auckland's population growth has eased in line with the reduction in migrant arrivals from overseas. Auckland traditionally attracts a high proportion of new immigrants to New Zealand (around 45-50%), and so the slower population

## Forecast

The nationwide net migration inflow continues to subside, but we remain confident that it will level off between 13,000 and 17,000 arrivals per annum. This is likely to translate into population growth in Auckland stabilising at around 2% pa similar to the estimated growth over the year to June 2004. Property sales activity is likely to drop over the next nine months, before levelling off in the second half of 2005 as interest rates begin to decline. By early 2006, the number of sales will still be 12% higher than the average of the last decade, but sales activity will record another small fall over the 2006/07 year as population growth eases.

The outlook for house prices in Auckland is not as optimistic as it was six months ago. However, house price growth is still expected to remain positive over the forecast period, reaching

# Auckland



growth recorded over the last 12 months is unsurprising. It is possible that the slowdown in population growth due to overseas migration trends has been partially offset by an improvement in interprovincial population flows.

House sales activity in Auckland has moved in line with the nationwide trend this year. The annual sales total fell 9.6% between April and September 2004 as higher interest rates and weaker population growth reduced turnover in the property market.

Property prices in Auckland are still rising more slowly than the national average, a situation that has been the case since mid-2002. Over the year to September, average prices in Auckland were up 8.7%, compared to a 16% rise for all of New Zealand. However, median prices in Auckland over the last few months may have been pulled down by a reduction in the number of high-value properties being sold. If this is the case, actual price growth in Auckland may not be as low as the figures suggest.

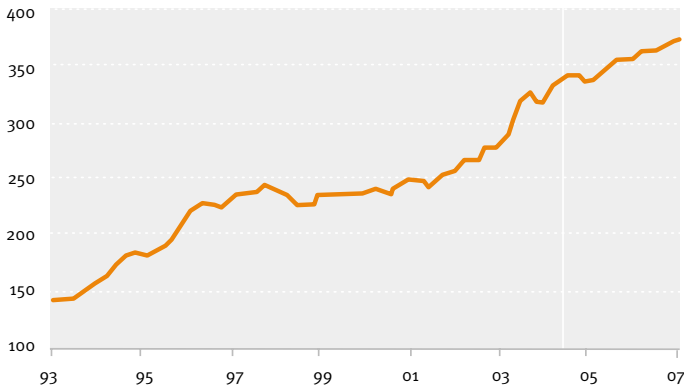
Rental growth in Auckland is among the slowest in the country, having fallen to a three-year low of 1.4%pa in September 2004. With fewer migrants arriving, new demand for rental accommodation has slowed. Average rents in Auckland City fell during the middle of this year, for the first time since 1999. Rental growth outside the main urban areas (i.e. in Rodney and Franklin) is more positive but is also slowing.

a low of 2.2% pa over the year to June 2005. This will be followed by a bounce in prices over 2005/06 as mortgage rates retreat from their peak levels and there is a moderate lift in buyer demand. Above-average population growth in Auckland means that property values in the region will rise faster than the national average.

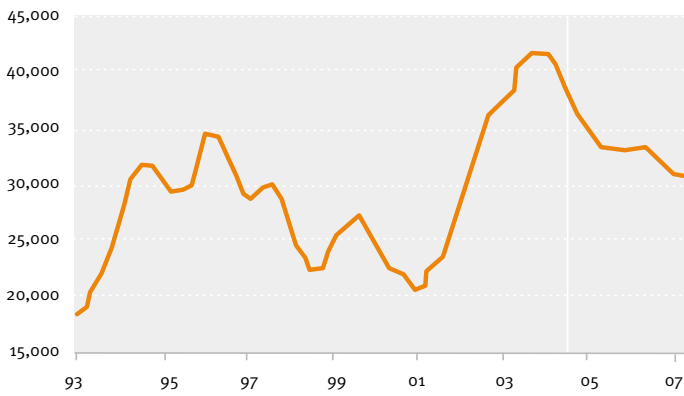
The rate of construction activity is likely to fall into a trough in late 2006, but given Auckland's higher rate of population growth, the drop in building will not be as sharp as nationwide. The apartment market in particular appears to have become oversupplied, and this section of the market is where the largest slowdown in activity will take place.

*Auckland traditionally attracts a high proportion of new immigrants to New Zealand.*

**Chart 5.1:** Auckland Median house prices (\$'000)



**Chart 5.2:** Auckland Annual house sales total



*House sales activity in Auckland has moved in line with the nationwide trend this year.*



## State of play

Growth in building activity in Waikato/Bay of Plenty/Gisborne (WBG) has been stronger than the national average over the last year. Activity peaked in June this year, surpassing the previous peak in 1997/98 by 6.4%. Building activity in the Waikato area has only just started to slow.

An increased number of departures by New Zealander's heading overseas has negatively impacted on population growth in WBG. However, we estimate that the region's population is still expanding at a faster rate than it did between 1999 and 2002.

The annual total of house sales is now starting to decline. However, it is still higher than it was a year ago. The sharpest slowdown has taken place in the Bay of Plenty, where sales

## Forecast

Slowing population growth across the region is beginning to impact on demand for property in WBG. Furthermore, building activity over recent months has been significantly stronger than we expected, generating an oversupply of housing in the region.

One positive factor for WBG's property market has been the resilience of export incomes in the face of the strong New Zealand dollar. This has helped economic growth in the region, which is currently ahead of the national average. It also means the region is well positioned for continued population growth of around 1% pa.

Sales volumes peaked this year at 34% above the previous high reached in 1997. We anticipate a sizeable correction in

# Waikato/Bay of Plenty/Gisborne

volumes have declined by 11% over the last six months. This is a reflection of the very strong price growth that has taken place in Tauranga, meaning that some buyers are starting to be priced out of the market.

Over the entire WBG region, average house prices lifted 16% over the year to September 2004. Price growth in Tauranga has started to slow after peaking at 37% pa earlier this year. Prices in Hamilton have risen 23% over the last year as urban property values continue to rise faster than those in rural areas.

Rental growth in WBG had kept pace with rising prices until recently. House price growth has accelerated and rental growth has slowed to 7.9% pa. Consequently, average gross yields have fallen to a new low of 5.4% after holding steady between 5.5% and 5.7% over the last four years.

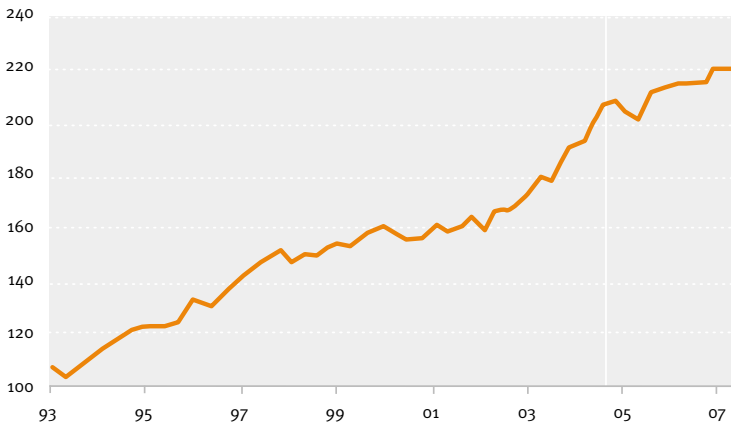
sales activity through until the middle of 2005, with the largest drop in volumes likely to occur in the Bay of Plenty area. Nevertheless, the annual sales total will still be above the average of the last ten years over the entire forecast period.

House price growth in the region has been slower than the nationwide trend. Despite the fall in sales activity, declining prices are not expected in WBG. Property in Waikato, in particular, does not appear to be especially overvalued. Falling interest rates over the second half of 2005 could contribute to another lift in house prices in Waikato over 2005/06. However, recent strong price rises in the Bay of Plenty will see prices there come under some downward pressure over the next year, with buyer interest spreading outside the main centres to smaller outlying towns such as Te Puke and Katikati instead.

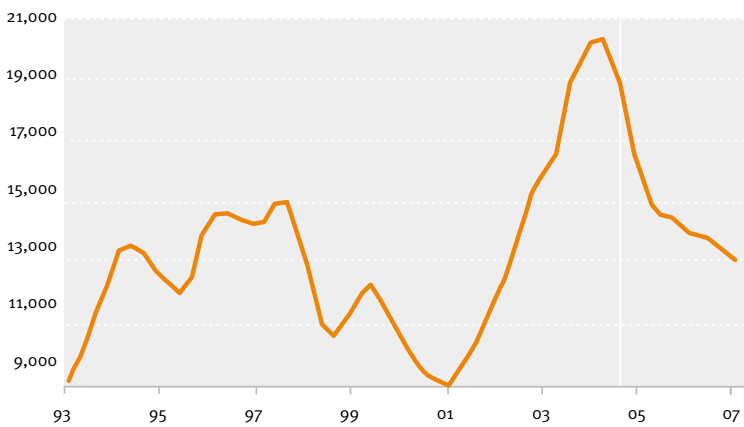
Building activity in the region will retreat in line with the national trend with the expected consequence being a fall of 33% from its peak by the end of 2006.

*Growth in building activity has been stronger than the national average over the last year.*

**Chart 6.1:** Waikato/Bay of Plenty/Gisborne Median house prices (\$'000)



**Chart 6.2:** Waikato/Bay of Plenty/Gisborne house sales total



*A positive factor for WBG's property market has been the resilience of export incomes in the face of the strong New Zealand dollar.*



## State of play

Building activity peaked in Hawke's Bay earlier this year, with 747 dwelling consents issued over the 12 months to April 2004, surpassing the high recorded in 1994. However, the downward trend in building consents has yet to gather momentum, as a large increase in house prices over the last two years has underpinned a sustained lift in building activity.

Population growth in the region remains sluggish at around 0.3% pa. As noted earlier this year, the surge in the Hawke's Bay property market has not been driven by an influx of people to the area. A re-valuation of coastal property appears to have driven up prices, and it is uncertain whether this price shift will be maintained given low population growth.

## Forecast

We expect that Hawke's Bay's population growth will remain relatively static over the forecast period, as the region continues to lose people both overseas and to other regions within New Zealand.

Strong price growth and high interest rates have reduced housing affordability in Hawke's Bay to its lowest since 1996 and this is likely to undermine sales activity over the next year. But falling interest rates over the second half of 2005 will prevent sales volumes from declining indefinitely.

The median house price in Hawke's Bay fell over the September 2004 quarter, and it is anticipated that this is the beginning of a period of decreasing prices over the year to June 2005. A 6.6% price fall has been incorporated into the

# Hawke's Bay



The annual total of house sales has been drifting downwards since the end of 2003, and by September was 8.9% below its high point. The fall has not been as swift as that which has occurred nationwide.

House price growth climbed to 33% pa by June this year, with the median house price fluctuating between \$190,000 and \$220,000 for most of 2004. Price growth is now beginning to slow as the surge in coastal property values ends and some buyers begin to question the sustainability of such high property values.

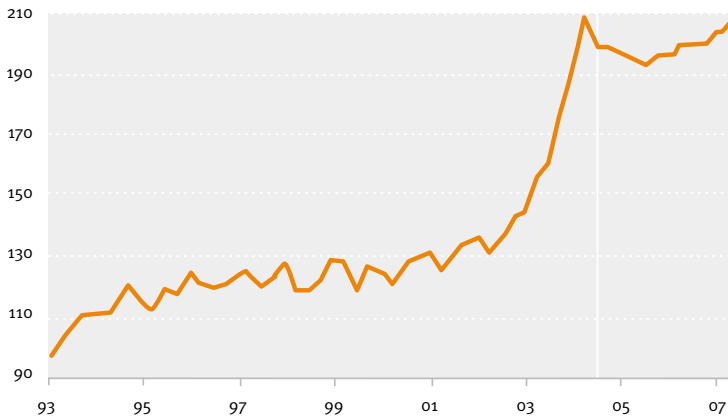
Rental growth has ranged between 8% and 12% pa throughout 2004, which has not been sufficient to prevent a further drop in rental yields. The gross return on rental property in Hawke's Bay has dropped from 5.5% to 5.2% this year, and is considerably lower than the 6.9% average return in mid-2002.

forecasts, which is slightly larger than previous price falls of 6.2% recorded in both 1998 and 2000. Over the following two years (to June 2007), a modest upward trend in property values will develop. However, by the end of the forecast period prices are still expected to be 1-2% below the peak reached in June this year.

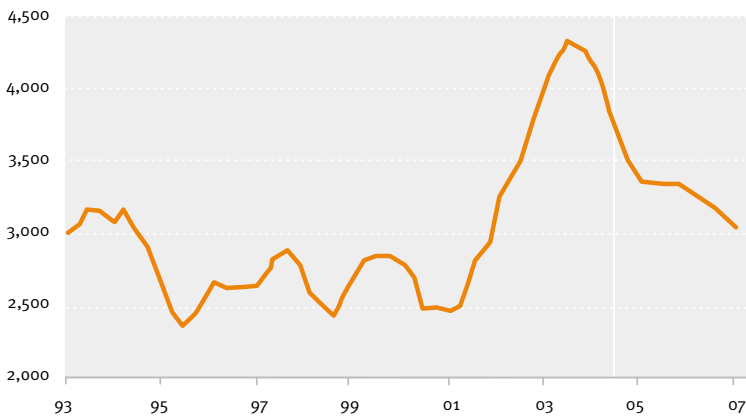
Falling prices for existing property will stunt building activity in the region. Consent numbers are set to decline throughout the forecast period, dropping 45% over the three years to June 2007. This is significantly larger than the nationwide average fall of 31%, and highlights the importance of population growth as a driver of demand for property over the medium term.

*House price growth climbed to 33% pa by June this year.*

**Chart 7.1:** Hawke's Bay Median house prices (\$'000)



**Chart 7.2:** Hawke's Bay Annual house sales total



*Strong price growth and high interest rates have reduced housing affordability.*



## State of play

Building activity has started to ease in Manawatu and Wanganui and is close to peaking in Taranaki. Annual growth in consent numbers is the strongest in the country at 30%, reflecting the relatively late acceleration in house price growth compared to the rest of New Zealand. Nevertheless, the lift in construction has not been enough to surpass consent numbers recorded in 1993.

We estimate population growth in the Taranaki/Manawatu/Wanganui (TMW) region turned negative again over the year to June 2004, with the population shrinking by around 0.4%. The region had previously benefited from New Zealand's strong net migration inflow, but that effect has waned, and TMW continues to lose residents to other areas of the country.

## Forecast

We expect that the population in TMW will continue to decline slowly over the forecast period. Income growth for exporters will help prevent the population from contracting as rapidly as it did between 1998 and 2000, when repeated droughts and reduced global demand for New Zealand's exports hurt the profitability of the farming sector. Investment in the gas fields in Taranaki (Kupe and Pohokura) also suggests improved population and employment growth in this part of the region.

Sales activity is declining in TMW and will mirror the nationwide trend over the next two years. As with most other regions, we expect housing turnover in the region over the forecast period to hold above the average of the last decade.

# Taranaki/Manawatu/Wanganui

The number of house sales has peaked and is now falling right across the region, with activity in Wanganui being the last area within the region to start easing. The annual sales total in Wanganui rose almost 150% from its low point in 2001, in contrast to Manawatu, where turnover increased by just 66%.

House prices have been rising rapidly across the region, and by September this year were up 30% compared to a year ago. After previously failing to see any significant price gains, house price growth in Wanganui climbed to 37% pa in September 2004.

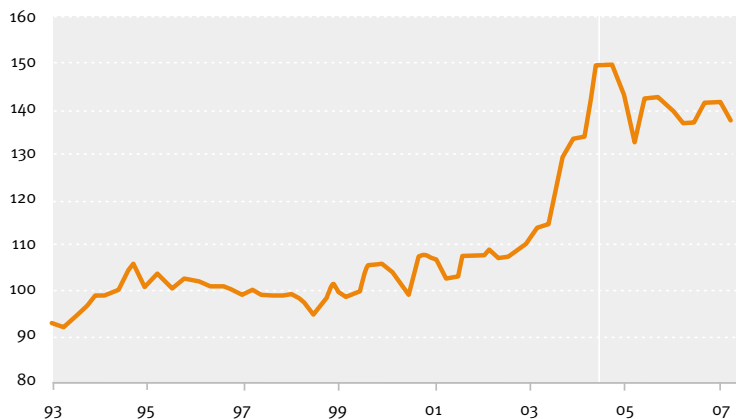
The increase in house prices has helped boost rental growth, which accelerated to 7.3% pa in September 2004. But this rise has not been sufficient to maintain rental yields in TMW – they fell from 8.3% at the start of 2003 to 6.3% by September 2004. Earlier this year, we noted that rental growth in Wanganui had managed to keep pace with house prices, but this is no longer the case.

House prices in TMW are likely to hold on to some, but not all, of the gains made over the last 1-2 years. The affordability of housing in Manawatu and Wanganui has been sharply reduced by the recent lift in prices. The median price is now around \$150,000 (up from \$115,000 a year ago). We expect the region's median price over the forecast period to hold between \$130,000 and \$150,000, well up on the \$90,000-110,000 range maintained between 1993 and 2002.

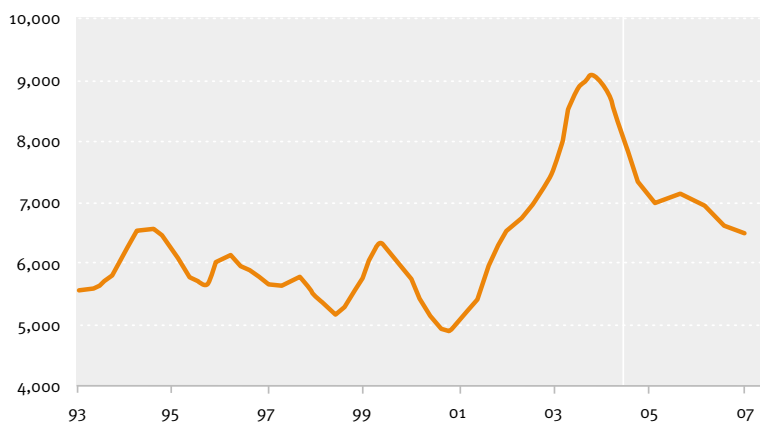
Building activity will decline as the population begins to shrink again. The largest falls are expected to occur in Wanganui, where consent numbers will halve between June 2004 and June 2006. Manawatu's population growth is likely to remain positive, implying a slightly more upbeat outlook for this part of the region.

*House prices have been rising rapidly across the region, and by September this year were up 30% compared to a year ago.*

**Chart 8.1:** Taranaki/Manawatu/Wanganui Median house prices (\$'000)



**Chart 8.2:** Taranaki/Manawatu/Wanganui Annual house sales total



*We expect the region's median price over the forecast period to hold between \$130,000 and \$150,000.*



## State of play

Building activity in Wellington has shown patches of strength this year, with the annual consent total holding above 2,400. Some recovery in building consent numbers, particularly in apartment construction, has prevented annual growth in new dwellings becoming more negative than the -6.7% reached in August 2004.

It is estimated that population growth in Wellington over the year to June 2004 was the weakest in three years at 1.1%, as the nationwide influx of migrants began to slow. The region's employment growth over the last year has also been sluggish (1% pa compared to 3% for all of New Zealand), despite strong growth being recorded in public sector employment.

## Forecast

The slowdown in population growth in Wellington has been less marked than we predicted six months ago. We have previously highlighted the Wellington region's reliance on the public sector and continued growth in the size of government. The need to implement policy changes such as the Working for Families package is expected to ensure further growth in demand for workers over the next three years.

Consequently, we predict that property sales volumes will hold up well over the next two years, recording a relatively small drop of 11% over the three years to June 2007. This compares favourably with our forecast of a 26% fall in nationwide property turnover.

# Wellington



Property sales in Wellington over the September 2004 quarter were down 28% compared with a year ago, the largest annual fall in more than a decade. Downturns in property market activity in the region have not been as pronounced as those in the rest of the country over the last ten years. Wellington's property market is among the least likely to move in line with national trends.

House price growth has held between 14% and 19% pa over the last year, despite the drop-off in turnover. The upward pressure on prices now appears to be dissipating, particularly in the areas closest to the city centre.

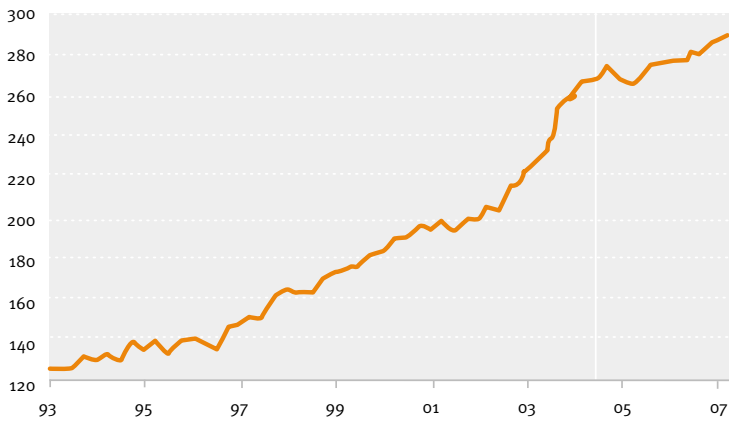
Rental growth in the region remained stubbornly low at 4.9% over the year to September 2004. We noted a significant deterioration in rental yields earlier this year, but yields have stabilised over the last few months at around 5.1%. This suggests that the willingness of rental property investors to rely on capital gains has been eroded in the face of the slowing property market.

However, the region will not be immune from price falls. We anticipate that prices will drift down by around 3% over the first half of 2005 to be marginally lower than a year earlier (down 0.5%). From mid-2005 through to 2007, property prices will follow a similar trend to the rest of the country rising by around 4% pa on average. Prices are likely to be most buoyant in areas closest to Wellington City, with property further from the central city (e.g. in Porirua or Upper Hutt) failing to rise in value as quickly.

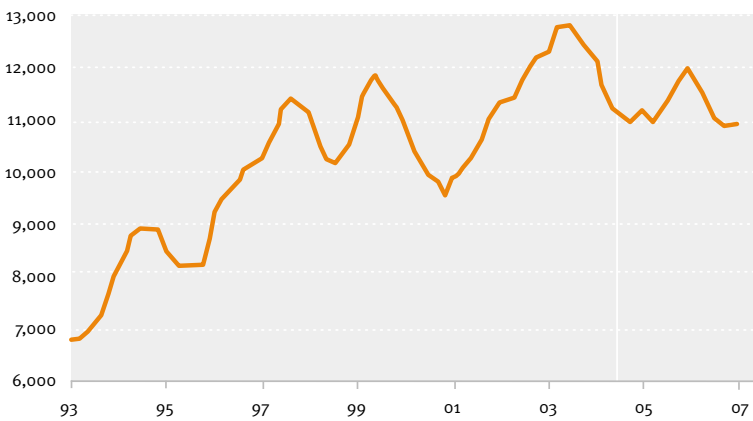
The rate of new dwelling construction will pull back from early next year, dropping 17% over the course of the 2005 calendar year. As with sales activity, the decline is less marked than the national average, reflecting positive medium-term prospects for housing demand in the Wellington region. Construction of apartments looks set to be a major feature of building activity in Wellington over the next 2-3 years.

*House price growth has held between 14% and 19% pa over the last year.*

**Chart 9.1:** Wellington Median house prices (\$'000)



**Chart 9.2:** Wellington Annual house sales total



*We predict that property sales volumes will hold up well over the next two years.*



## State of play

The annual total of new building consents in Nelson/Marlborough (NM) has fallen 9% over the last six months. The drop has been concentrated entirely in the Nelson area, where the number of building consents has been falling since the start of the year. In contrast, the rate of building activity in Marlborough has yet to decline significantly.

Sharply higher house prices in NM over the last year have begun to undermine population growth in the region. NM has traditionally been seen as a good place to live with relatively cheap property given the attractive location. However, housing in the region is now among the least affordable in the country when compared with average incomes (second only to Auckland). We estimate that population growth over the year

## Forecast

Even with high property prices, the NM region will remain one of the most attractive areas to live in New Zealand. Although population growth has slowed and will continue to do so over the next year, it is expected to stabilise at around the national average of 1.1% pa over the forecast period. This population growth is faster than in all other regions except Auckland.

The rate of turnover in the NM property market has already declined considerably from its peak, and is unlikely to fall much further. The average number of property sales per year over the last decade has been about 3,000, and we expect activity levels to hold up above this level for most of the forecast period.

# Nelson/Marlborough



to June 2004 was about 1.7%, slower than the 2.2% recorded over the preceding 12 months.

The volume of property sales has dropped 25% in the NM region over the last year, compared to a 4.5% fall nationwide. The slump has been largest in Nelson, where sales are down 19%. The excessive price rises in the region have clearly squeezed prospective buyers out of the market.

House price growth slowed from a peak rate of 53% pa in December 2003 to just 14% by September 2004. Since peaking at the end of last year, median prices in the region have been volatile on a month-to-month basis, fluctuating between \$248,000 and \$275,000.

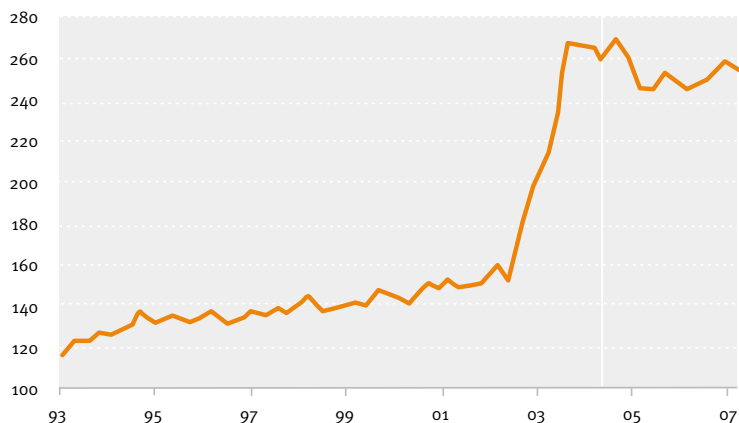
Rental growth has eased over the same period. By September 2004, average rents were up 7.8% on a year ago. Slowing house price inflation has meant that gross rental yields have stabilised at around 4.5%. However, at that level, yields are still among the lowest in the country.

Although house price growth has cooled as anticipated, prices have yet to register any significant falls. The large drop in property sales volumes suggests that vendors are avoiding selling for "unsatisfactory" prices. However, for those sellers who need to move, the higher interest rates currently on offer will constrain the ability of buyers to pay top dollar. We continue to expect an 8% decline in prices over the year to June 2005. Price growth over 2006 and 2007 is anticipated to be disappointing as property in the region remains overvalued compared to its long-term trend.

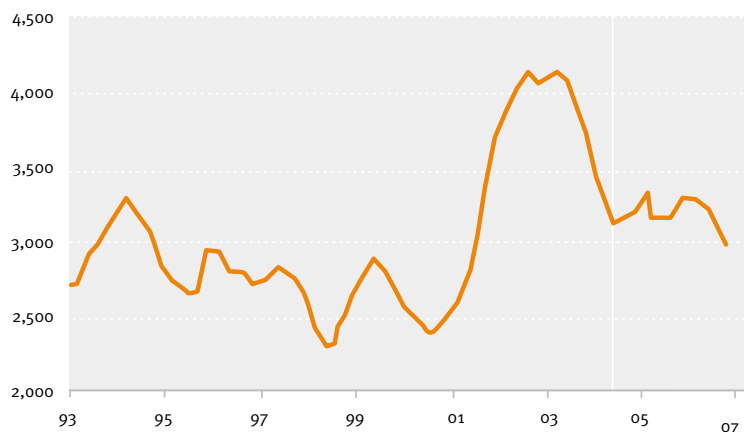
The combination of slower population growth and a weaker property market will constrain building activity in NM over the medium term. A sharp drop in building consent numbers over the next year is likely to occur in Marlborough which, unlike Nelson, has yet to experience any significant slowdown in building activity. The rate of construction could return to levels similar to those recorded between 1999 and 2001.

*This has traditionally been seen as a good place to live with relatively cheap property given the attractive location.*

**Chart 10.1:** Nelson/Marlborough Median house prices (\$'000)



**Chart 10.2:** Nelson/Marlborough Annual house sales total



*Price rises in the region have clearly squeezed prospective buyers out of the market.*



## State of play

Building activity in Christchurch has maintained momentum this year at an annual build rate of 2,500-2,600 new dwellings. Part of the buoyancy in activity has been due to a relatively high number of apartment consents – there were 247 apartments consented during the first nine months of 2004, compared to 113 for all of last year.

Christchurch's population growth has eased, but like other South Island regions, the cooling appears to have been less dramatic than we expected. Although the overseas net migration flow is now less positive than it was a year ago, Christchurch continues to attract an increasing proportion of new arrivals to New Zealand. This matches up with increasing numbers of returning New Zealanders, who now make up 31% of all long-term arrivals (up from 27% two years ago).

## Forecast

It is expected that Christchurch's population growth will ease further over the coming 12 months, as the net flow of New Zealanders out of the country increases. A moderate softening in New Zealand's economic growth and small rise in the unemployment rate will help to encourage more people to travel overseas for work or on OEs.

Property sales activity will decline further and is expected to stabilise between mid-2005 and mid-2006 as anticipated lower interest rates prevent any further softening in buyer demand. With population growth dropping by almost two-thirds between 2003 and 2005, turnover in the Christchurch property market will generally be less buoyant than the national average.

# Christchurch



Annual property sales have fallen 6.8% over the last five months. Turnover in Christchurch's property market continues to follow a similar trend to that of the country as a whole, and has come under downward pressure as rising interest rates and higher house prices have made housing less affordable.

House prices have performed strongly over the last 12-18 months, with house price growth hitting a peak of 31% pa earlier this year. The rise in Christchurch property values has been faster than the nationwide average over the last 18 months.

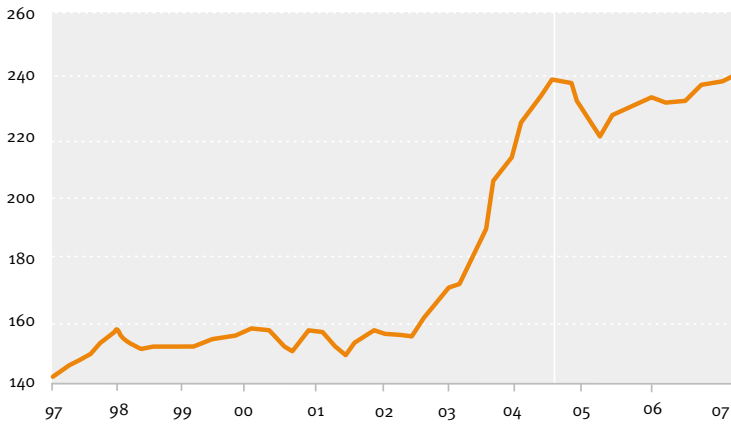
Rental growth has slowed from 13% pa in early 2004 to 9-10% in recent months. The slower increase in residential rents has coincided with accelerating house prices, pushing average yields down more than half a percentage point this year.

Some of the most recent increase in house prices over the last few months will be reversed by the middle of next year as property sales volumes drop. After a 4% correction in prices by mid-2005, we expect house prices in Christchurch to exhibit a similar trend as the rest of the country, rising 9% over the following two years to June 2007.

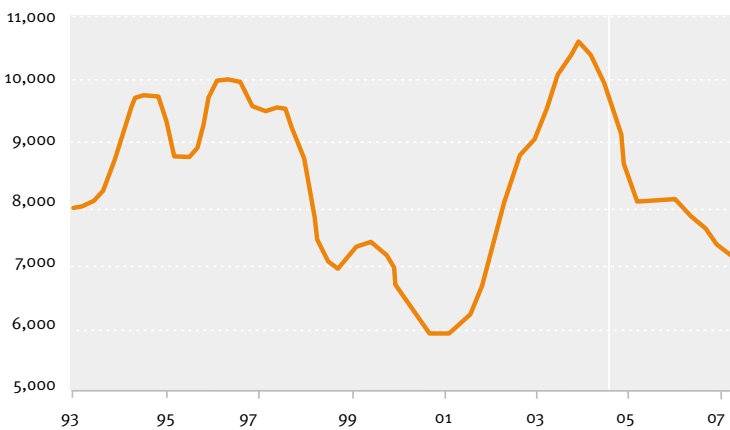
It is anticipated that new building activity throughout much of the forecast period will be undermined by weaker population growth and, over the next 6-9 months, falling house prices. By mid-2006, it is predicted that the annual consent total will have dropped to around 1,500, well below the average of 2,014 over the last decade.

*Building activity in Christchurch has maintained momentum this year.*

**Chart 11.1:** Christchurch Median house prices (\$000)



**Chart 11.2:** Christchurch Annual house sales total



*House prices have performed strongly over the last 12-18 months, with house price growth hitting a peak of 31% pa earlier this year.*



## State of play

Building activity in Canterbury/Westland (CW) is now at a peak. Over the year to September, there were 2,151 new building consents issued, up 28% on the previous 12 months. In contrast, nationwide growth in consent numbers had declined to 4% pa. The region has been enjoying the effects of stronger than normal population growth and healthy export incomes.

It is estimated that population growth over the year to June 2004 will be maintained at close to 1%. An important factor behind the continued increase in CW's population has been its ability to continue attracting arrivals from overseas. This lift is supplementing the population spillover that the region already enjoys from Christchurch.

## Forecast

At this stage, it is unclear whether CW can maintain some of the improvement in population growth that has occurred over the last three years. Our forecasts see population growth slipping to an average of 0.7% pa over the next three years, slightly higher than the 0.4% pa average between 1997 and 2000.

Property sales activity is cooling rapidly, a trend that is expected to continue until the second half of next year. By mid-2005, it is forecast that sales volumes will be down 27% compared with a year earlier, with further small declines over the subsequent two years. By the end of the forecast period, it is predicted that property turnover will still be 14% above the 1993-2002 average, reflecting some improvement in population growth for the region.

# Other Canterbury/Westland



Property market activity in CW has declined more sharply than in the rest of New Zealand, with sales volumes dropping 12% over the last six months (compared to 8% for the country as a whole). Rapidly rising prices appear to have squeezed some buyers out of the market, particularly in areas such as North and South Canterbury and the West Coast.

Despite the cooling in sales activity, house prices continued to rise strongly over the year to September 2004, with the average price in CW rising by 44%. Property in Ashburton and Timaru now looks to be among the most overvalued in the country.

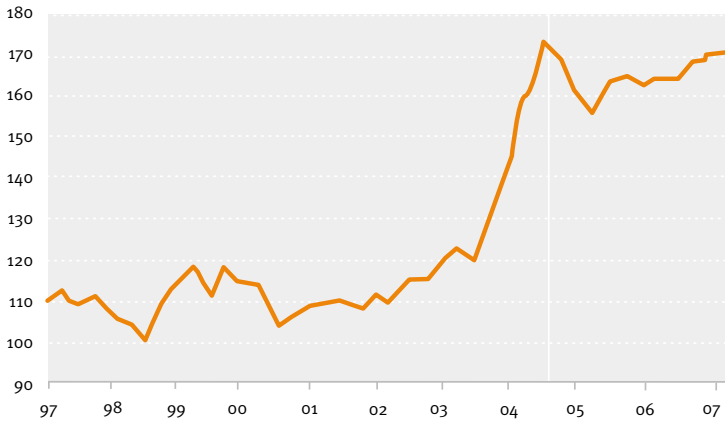
The likelihood that property in the region has become significantly overvalued is confirmed by rental yields. Although rental growth has been strong at over 10% pa for much of 2004, gross yields have plunged from 6.5% to 5.2% since the start of this year. On average over the last seven years, yields in CW have generally been about 0.3 percentage points higher than in neighbouring Christchurch, but yields in the two regions are now almost identical.

It seems unlikely that house prices in CW will maintain all the gains made over the last 1-2 years. A 5-6% drop in prices over the next year is anticipated as higher interest rates force buyers to re-evaluate how much they are willing to pay for properties. Areas further away from Christchurch look to be the most susceptible to a period of falling prices. Prices will move in line with national trends from 2006 onwards, but will still be lower than current levels by June 2007.

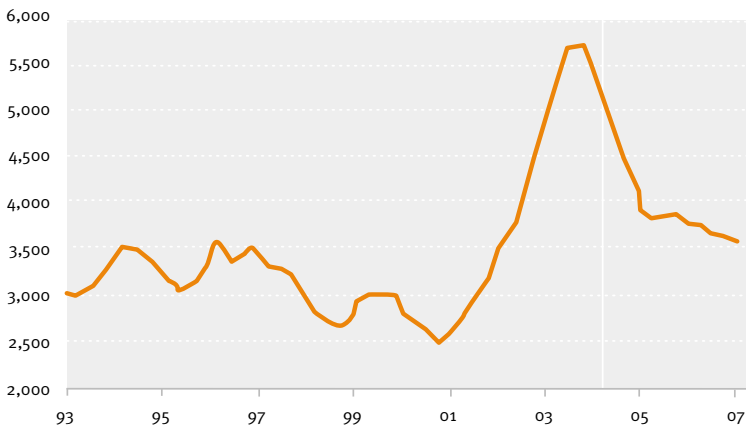
The unprecedented rise in building activity since late 2002 is expected to reverse out over the next two years, with the annual consent total falling 40% by the second half of 2006 (compared to a 31% drop nationwide). We predict the medium-term build rate in CW will be close to the 1993-2002 average of 1,300 new houses per annum.

*An important factor behind the continued increase in CW's population has been the ability to continue attracting arrivals from overseas.*

**Chart 12.1:** Other Canterbury/Westland Median house prices (\$'000)



**Chart 12.2:** Other Canterbury/Westland Annual house sales total



*House prices continued to rise strongly over the year to September 2004, with the average price in CW rising by 44%.*



## State of play

Building activity has now peaked in Otago/Southland (OS), with the annual building consent total reaching 2,015 in June this year. The high point was a phenomenal 268% above the trough in 1998. The strongest growth has come in the Queenstown-Lakes and Central Otago areas, due to their growing international reputation as holiday and luxury resort areas.

Population growth in the OS region has eased back as we expected, and over the year to June 2004, we estimate it turned negative in the Southland area for the first time since 1999/2000. A shrinking population will take the pressure off the housing stock in many areas of the region, and could result in an increased number of vacant dwellings.

## Forecast

It is anticipated that there will be no further significant deterioration in population growth in OS over the forecast period. The increases in population that do occur will be unevenly distributed across the region, and concentrated primarily in inland Otago and, to a lesser extent, Dunedin. Coastal Otago is likely to have flat population growth, while we expect Southland to continue losing people to other regions around New Zealand.

We predict that house sales volumes in OS will decline in line with the nationwide trend over the next year it is anticipated that the resilience of the Queenstown market will prevent a sharper fall in activity. Although parts of the New Zealand property market will enjoy a levelling off in sales during

# Otago/Southland



Property sales activity has slowed across much of the region this year, with the annual sales total dropping 12% since the start of 2004. The trend has been most pronounced in Otago, and it is estimated that property in the Waitaki area is the most overvalued in New Zealand, with prices having risen as much as 63% over the last year. Queenstown, however, has been immune to the downturn in sales volumes so far despite Inland Revenue's investigations into potential tax bills owing on capital gains made on property in the area.

House price growth in OS peaked at 46% pa earlier this year, and had cooled to 31% pa by September 2004. The diminishing price growth is spread right across the region, although property values in Invercargill remain buoyant, a surprising factor given the lack of population growth in Southland.

Average rents in OS have risen 9.5% over the last 12 months, but there has been a divergence in trends across the region. In Dunedin, rents are still rising at between 10% and 23% pa (with significant variation between suburbs), but rental growth in Invercargill is just above zero. The inability of landlords to put up rents in Invercargill suggests that there is an oversupply of rental accommodation in the city.

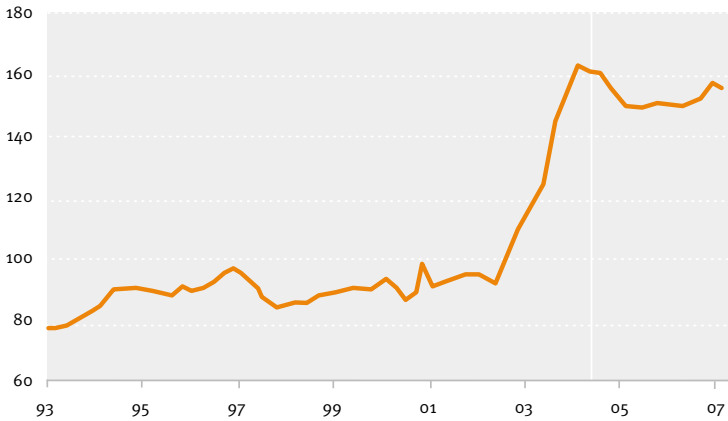
2005/06, it is forecast that activity will continue to decline in OS as population growth across much of the region remains lacklustre.

A downward correction in prices over the next year is anticipated, with prices dropping by as much as 9% by mid-2005. Over the following two years, price growth in OS will struggle to keep up with the national average, and we predict average prices will be 5% lower in June 2007 than three years earlier.

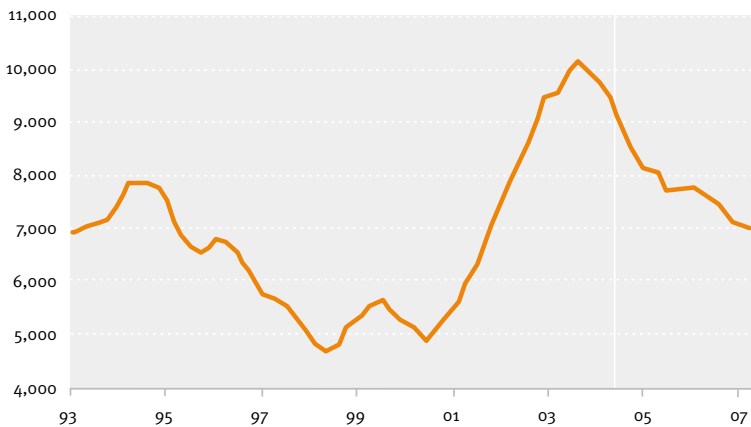
Building activity is also set to weaken over the next two years, dropping almost 50% by mid-2006, compared to a 30% fall for all New Zealand. It is expected that Southland will record the largest fall in consent numbers (down 57%), but activity levels in Otago won't fall as far due to continued construction work in Queenstown.

*Queenstown has been immune to the downturn in sales volumes.*

**Chart 13.1:** Otago/Southland Median house prices (\$'000)



**Chart 13.2:** Otago/Southland Annual house sales total



*The diminishing price growth is spread right across the region, although property values in Invercargill remain buoyant.*



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