

WHO'S BEEN BUYING UP OUR SMALL TOWNS?

During the last 18 months or so, in what has been described as another property boom, the focus for many investors has been the small towns and secondary cities. This has occurred for a number of reasons.

Residential property prices have risen sharply in the main cities (although prices for many have now begun to level off). Examples are: in June 2004, Auckland North Shore had a median price of \$385,000, and increased by 13.6% for the June 2004 year. Wellington Central had a median price of \$390,000 and this increased by 37.6% for the June 2004 year.

New purchasers in the market, as well as those who already had investments, and wanted to add to their existing portfolio quickly discovered that their limited dollars no longer purchased as much as was the case 18 months previous. These price increases, coupled with the recent hikes in mortgage interest rates, have seen many investors become concerned that their existing investments, which had previously been cash positive (or cash break even) had quickly turned to being cash negative, and they have had to subsidise their investment out of other earnings. John Burley, the renowned US property investor would say one of the "cardinal sins" of property investment was now being committed. Robert Kyosaki would say this was no longer an investment, as, it now costs you cash to own it. Prospective new investors in the larger cities, who have recently appraised the situation and done their sums accurately, realize that it may be too late to purchase these expensive city properties as rental investments. With gross rental yields typically of say 6-7%, and with mortgage interest rates now exceeding these yields, (assuming they are highly mortgaged), it is patently obvious that these investments will provide negative cash returns. In addition, the recent decrease in immigration has resulted in a softer rental market, as rentals in these cities have not kept pace with property prices. If the investor can afford to subsidise these properties for an uncertain future period, their saving grace can only be the anticipated capital gain and/or sharp decreases in interest rates. Looking at the economic forecasts, neither is likely in the next 2-3 years. The Reserve Bank has just a few days ago again raised the official rate, being the fifth increase this year. This will push the floating mortgage rates up from 8.25 per cent to 8.5 per cent. The latest rise means New Zealand interest rates are the highest for any developed country and a full percentage point above Australia's. Another predicted interest rate increase in December will push floating mortgage interest rates to 9%. Existing borrowers on fixed rates will get some short or medium term respite, but will have to bite the bullet when their fixed term expires.

Many of these disillusioned investors have now changed to an alternative strategy, which is purchasing low cost residential properties in the many smaller towns or cities such as Huntly, Tokoroa, Taumaranui, Wanganui, Timaru, Oamaru, Invercargill, and so on. Most of these places offer attractive rental returns; as many of the properties can be bought for between \$40,000 and \$80,000 and can produce rentals of typically \$140 per week, which can result in a 10-18% yield. These locations have been targeted by those shifting from the larger city strategy, initially because of the desirable yields. However, mainly as a result of this shift and the demand in this market, there has been a huge capital gain in these smaller towns and cities. For many years there has been potentially a huge profit to be made from these out of the way and forgotten regions, but they have

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been largely ignored by investors because of the perception that prices were never going to move upwards and the uncertainty of rents, because of the weaker regional job opportunities. "Professional property finders" who locate properties on behalf of buyers for a fee of typically \$3-5,000 per property, have been creating demand for at least the last 2 years through their internet sites. Many of these purchases have been made by main city dwellers, often by people uneducated in property investment who have made purchases in places such as Tokoroa, or Invercargill merely from optimistic projected rentals, optimistic valuations and colour photos all provided. Armed with all this theoretical information the purchasers have often purchased 'sight unseen'. Many purchasers have not committed to any research prior to the purchase, to consider property price movements past and projected, employment and population growth prospects, demographics, whether the town is basically a one industry town, whether beneficiaries are the main source of tenants and so on. I believe that without this property education and the research, then their whole investment is such a gamble. For those who have done the research and bought well, in the best towns say 2 years ago, have often received capital gains of 50 - 100%.

Also there has been amazing numbers of properties purchased by individuals and syndicates of Australian investors. After experiencing 2-3% yields (and negative cash results) from their Australian residential property investments, they have firstly been doing their research at home, crossing the Tasman in planeloads, and heading for the outlying areas. Many of my firm's Australian clients have visited New Zealand for two weeks, toured the outlying towns and gone home having purchased typically 10 or more properties. Real Estate Agents in these areas are continuing to have boom times. They will recount stories of some syndicates buying in excess of 50 properties in one visit. Providing finance is flush, it is easy to purchase properties. However it is much harder to manage these as an absentee owner, over the long haul, with unreliable tenants, who are prone to intentionally damage their rented homes; malicious damage insurance cover is a must for these properties. Some of my Australian clients a year down the track are now reassessing their New Zealand portfolio, and shedding those particular problem properties or properties in the problem towns and replacing them with better long-term properties in other centres. A little bit of fine tuning should resolve their problems, and provide the double outcome of great cash positive yield returns, as well as great capital gains.

Is all this for good for the New Zealand resident investor ? It depends very much on which side of the fence you are on. If you already own a large portfolio in any part of the country, then you will be delighted at the capital gains you can continually measure. If you do not own many properties, or any, then you will be frustrated that this now busy small town market, has become considerably more expensive.