RESIDENTIAL PROPERTY INVESTMENT SURVEY

OCTOBER 2016 KEY FINDINGS

1. Residential property investors remain confident with the majority expecting rises in property values and rental income in the coming 12 months. 84% of investors expect values to rise by 2.5% or more in the coming year, while 53% expect rental income to rise by the same amount.
2. Two thirds of all investors plan to buy again at some point, continuing a five year trend. Aucklanders are the most likely to buy again soon with 57% planning to purchase in the next two years.
3. The tighter Loan-to-Value Ratios (LVR) restrictions have been felt by an increasing number of investors. 31% said the limits had significantly impacted their strategy, up from 16% in the previous year. Nearly half of these investors (14%) said they had not bought a property they might otherwise have purchased.
4. LVRs have decreased significantly, mostly as a result of rising house prices and lower interest rates. Only 18% of property investors have an LVR over 75%, compared with 27% in 2015.
5. The single biggest concern for investors is meth contamination, with 38% of investors viewing this as a risk. Damage to property, government regulations and tenants defaulting on payments are the three main broad areas of concern for investors.

ANZ

RESIDENTIAL PROPERTY INVESTMENT SURVEY

RESULTS, COMMENTARY AND ANALYSIS

OCTOBER 2016

The 2016 ANZ Residential Property Survey results show the impact of the LVR restrictions on investors' ability to purchase more property or change their investment strategies. Nearly a third of investors (31%) across the country said that the high LVR restrictions have significantly impacted their strategy over the past year. That's quite a step up from the previous survey when just 16% reported an impact on their strategy. Furthermore, nearly half of those investors (14%) said they hadn't bought a property that they otherwise would have bought if the restrictions weren't in place.

In the past LVR restrictions were strongly Auckland-centric. However, the move to 60% LVR right across the country was a wake-up call for investors outside of Auckland, and also for Aucklanders who have been investing in nearby regions such as Waikato and the Bay of Plenty to avoid the restrictions.

That said, it's also important to note investors' appetite to purchase further property in the future. The survey showed that about two-thirds (69%) of all investors are planning to buy again, higher than the previous year and continuing an upward trend which started in 2011. On the face of it this isn't surprising. Interest rates are very low in New Zealand and likely to remain low for some time. Investors believe money will work harder in property than it will in the bank. This upward trend may be around for a little longer yet.

So, on the one hand there is a higher proportion of investors saying LVR restrictions had prevented them from purchasing a property, while on the other hand there is an increased proportion planning to buy further property in the future. While these statements may seem to run counter to each other, one reflects a moment in time, while the other is a reflection of long term strategy. Investors are saying that while the LVR restrictions may have restricted property purchases in the short term, strategically they still believe property represents an excellent investment opportunity.

There's a perception that property investors are highly leveraged. However, the survey results suggest this isn't the case. The survey shows that just 18% of investors have an LVR over 75%. This is healthy from a risk perspective for both investors and banks. Investors have more headroom should there be a correction in house prices. Of those who have had their investments for a number of years, many have reduced their debt levels and improved their position. Over the last couple of years, however, the LVR restrictions along with a strong increase in asset prices are the largest factors that have contributed to a lowering of the LVRs.

Meanwhile drug contamination has become an increasing concern for investors, with 38% citing meth contamination as a risk. In the Waikato that figure rose to a staggering 63%. Anecdotal evidence suggests this may be because the general understanding of meth contamination by landlords is very much in its infancy in New Zealand. Currently there seems little variance in the way in which different levels of contamination are dealt with. Property investors are looking for better direction on what the different levels of contamination actually mean, particularly for their tenants.

The high proportion (89%) of investors planning to keep their property long term represents the fact property is considered a good investment and is therefore useful in wider investment portfolios over the longer term. However, it may also be a reflection that, in some instances, investors know they could be buying at the top of the cycle or paying a little bit over the odds, so their planned strategy is to hold on to the property for the medium to long term to withstand any price corrections.

While investors need to take stock of their current position and ensure they are making careful decisions, it's not surprising they are still bullish about continued house price increases and further investment. New Zealanders are wedded to property and they've had quite a number of years of receiving good returns from it.

Thanks to NZPIF Executive Officer Andrew King and to ANZ Senior Economist Sharon Zollner for their contributions to the analysis of this year's survey.

Further information on the survey will be included in the November edition of the New Zealand Property Investor magazine.

Glenn Stevenson Head of Mortgages, ANZ

THE INVESTOR'S PERSPECTIVE

Each year the New Zealand Residential Property Investment Survey provides useful insights into how investors are seeing the sector and the effect market and regulatory changes are having on their investment outlook.

This year's survey shows that residential property investment continues to have strong appeal, sustained by investor expectations of increases in rental and property values over the next five years.

The continued interest in investment in residential property is good news for the one in three New Zealanders who look to the rental market to meet their housing needs.

Increasing property values have seen the percentage of respondents who report an LVR of over 75% fall from 27% in 2015 to 18% this year. Given the year on year increases in value many investors have experienced in recent years, and ongoing positive expectations, it is unsurprising that the percentage of investors planning to purchase another rental property has been increasing since 2011. This year, just over two thirds of investors responded that they plan to buy more properties. It was good to see that younger investors, in particular, are interested in continuing to build their portfolios.

It was unsurprising to see damage to property and the negative impacts of government regulations emerge as the two main areas of risk identified by investors.

Concern about the risk of damage to property has grown sharply since last year, from 27% to 54%. Concern about methamphetamine contamination is clearly a major driver of this, as is concern about the impacts of the Appeal Court ruling on tenant liability for property damage.

Investors who have been unlucky enough to experience methamphetamine contamination of a property know the expense associated with remediation. This takes needed rental properties off the market for some time and contributes to costs that need to be covered by rents. New Zealand's guidelines for exposure are extremely conservative, with the science suggesting that there should be no health impacts from traces of methamphetamine in a home. A review by the Ministry of Health will hopefully improve the situation, as will a New Zealand standard on methamphetamine contamination remediation.

The Appeal Court ruling on the Osaki case has also affected investor perceptions of the risk of damage to property. When tenants cannot be pursued for insured damage to a landlord's house, there is little incentive for them to exercise care in their use of the property. The removal from tenants of any responsibility for property damage is a fundamental change in the nature of relationship between the owner of a rental property, and a tenant.

Engagement by the Federation with Government around the appropriate standard for addressing methamphetamine contamination and residential investment property insurance issues continues.

LVR restrictions have increased their impact from 16% of respondents last year to 31% this year. Many investors view these as initiatives driven by the political risks associated with first home buyers feeling shut out of the market. Investors are an easy scapegoat, seen as able to outbid first home buyers, and, erroneously, as able to enjoy tax advantages from their investments.

In this climate, it is not surprising that national advocacy and media profiling of property investment issues are seen by Association members as being the top priorities for the Association. Investors play a major role in the housing market, and communicating the benefits of the sector's contribution remains an important focus for us.

A high percentage of respondents this year (59%, up from 45% in 2015) were Property Investors' Association members. These respondents provided useful insights into the benefits of membership. The formal and informal exchange of information is valued by members, as is the role of the Association in lobbying on behalf of the sector. The survey identifies a challenge to better communicate the benefits of membership to younger investors.

On behalf of the Federation and Property Investors' Association members, I would like to thank ANZ for its continuing support of the rental property industry.

Andrew King Executive Officer, New Zealand Property Investors' Federation

NEW ZEALAND PROPERTY INVESTORS FEDERATION

THE ECONOMIST'S PERSPECTIVE

Property investors remain gung-ho about the direction of their property value over both the short and medium term. In 2016 there are significantly more investors expecting large returns over the short term than in 2015. This reflects the fact that the housing boom has spread out of Auckland, across the whole country.

In response, the RBNZ has tightened LVR restrictions nationwide. Although property investors say LVR restrictions and possible loan-to-income ratio limits are weighing on their minds, that hasn't translated into more modest expectations of house price inflation. Their concern is obviously that restrictions might stop them jumping on the bandwagon, but there's little concern that the bandwagon might be slowing down or heading for a cliff as a result of those measures.

This isn't surprising. Previous rounds of LVR restrictions had only a short-term impact on activity and prices. Housing has been resilient. Even in the recession following the Global Financial Crisis, property prices in Auckland fell only marginally before recovering the following year and then continuing their upward climb. Other regions took longer to recover but are now booming.

Investors also expect increases in rental income, particularly in Auckland where there is a genuine housing shortage as a result of exceptionally strong net migration. Other regions haven't experienced the same level of population growth, but with a strong economy and labour market, landlords appear confident they can charge more and still find a tenant. The only region bucking this trend is Canterbury, where investors have more modest expectations as regards rental growth as the earthquake rebuild effort starts to slow.

Hardly surprising, then, that two thirds of all investors plan to buy again at some point. In Auckland 57% of investors plan to buy again in the next two years – the highest of all the regions. Property investment has been an extremely successful strategy, so investors are understandably keen to keep backing the same horse.

But of course the higher prices go, the harder it is for them to keep going up. Given that Auckland has one of the most stretched affordability ratios in the world, any further house price increases from here would seem pretty vulnerable to being undone in real terms. This could occur either rapidly through price falls or more slowly through the stagnation of house prices while wages catch up. The latter would obviously be a more preferable adjustment path and that is the path New Zealand has followed before. But with low inflation worldwide it's difficult to envisage inflation and wages doing the work at the moment. Were we to see a deep recession, the widespread belief that New Zealand (or at least Auckland) house prices never fall could be sorely tested.

That said, debt ratios across investors at least are reasonably modest, as capital gains have diluted LVRs. Recent first home buyers are more exposed. However, partly as a result of the Reserve Bank's restrictions the ability of home buyers to leverage themselves to the hilt is now limited. Although this is understandably frustrating at the individual level, should the cycle turn aggressively some would-be buyers may end up concluding it was just as well. And in aggregate it should mean house prices do not rise as much as they otherwise would.

Turnover rates are now starting to cool as the Reserve Bank restrictions start to bite and listings run short. Anecdotal evidence suggests there's a gap opening up between vendor expectations, which continue to rise, and the prices that people are willing to pay, which have flattened out. Typically, prices follow turnover with a three to six month lag. Given the strength of the economy we are not forecasting a downward correction in house prices, but the rate of growth does look set to drop – quite possibly below the rates that the typical property investor expects, given 58% of investors expect value gains of at least 6% over the next 12 months.

If the economy were to be side-swiped by a global shock, the question is how vulnerable house prices could be to a fall. For investors it is therefore important to be able to sit tight and ride out any potential storm. Property does go through cycles and we've had a very, very big up cycle, particularly in Auckland. All else equal, there's a risk the next down cycle could therefore be exaggerated when compared with history. The rubber band is very stretched.

Sharon Zollner Senior Economist, ANZ

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