NZINVEST
secure your future

investigate

INVESTMENT NEWSLETTER | Issue 10.1

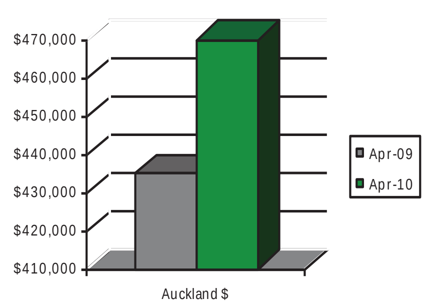
Market Watch

REINZ figures for 2010 thus far have demonstrated *growth* and *stability* in the property market nationwide, particularly in Auckland which experienced growth of 8% on the prior year during April.

This backs up the Reserve Bank of New Zealand's (RBNZ) Financial Stability report in November last year which suggested that the New Zealand property market had reached a turning point.

Property Sales
While the April national median residential house price is slightly down on the March figure, it remains up (almost 5%) on the median price for April 2009.

After rising in March both the total sales and the Auckland median house price fell back slightly in April. Regardless, at $470,000 it still demonstrates solid growth from the April 2009 median house price of $435,000.



Auckland Median House Price Growth
Taking a longer term view, the below chart shows the median house price during the month of April, over the past decade - showing positive steady increases year on year. The Auckland market remains consistently ahead of the national average house price.
Since January this year the median house price in Auckland has risen from $450,500 to $470,000 - an increase of almost $4000 per month or $130 per day.

"There are may positive signs that the property market is recovering and that ***we're poised for further growth in property prices,*** *however the market is still currently in favour of buyers.*

While the national median for days to sell increased slightly in April to 40 from just 35 in March, this is still an improvement on the figure of 42 days for the same period last year. The fastest sales times in April were achieved in Auckland at 35 median days and Canterbury/Westland at 36 days.

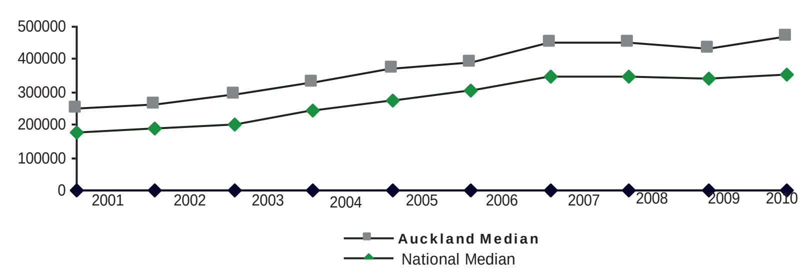
Interest Rates
The Official Cash Rate (which most strongly impacts on the floating interest rate) has recently been increased from 2.5% to 2.75% based on confidence from RBNZ that some of the monetary policy stimulus that is currently in place can be removed in light of a "steady but unspectacular" economic recovery over the next 18 months.

The further removal of stimulus will be reviewed in light of economic and financial market developments, taking into account how the economy reacts. Currently businesses are aggressively paying down debt while households are barely growing their debt levels at all.

According to Dr Bollard, the Reserve Bank is not likely to raise the OCR as high as it was during the last property boom – it peaked at 8.25% – because bank funding costs are higher, long-term interest rates are higher than short-term interest rates, and a greater proportion of borrowers use floating rate mortgages.

BNZ economist, Tony Alexander believes that most borrowers will remain well-served by floating the bulk of their debt and budgeting for that floating rate cost to rise 3% between now and the end of 2011.

Consumer Confidence
Consumer confidence is measured by consumer activity related to spending and saving. Recent reports show that while caution remains, despite the improved outlook, New Zealanders are gradually becoming more optimistic, in particular amongst higher income earners.



Auckland & National House Price Growth – April 2001 – April 2010

Market Watch *cont*

Continued
The Westpac-McDermott Miller Consumer Confidence Index in March 2010 showed more optimists (40%) than pessimists (30%) regarding whether there will be good economic times in the year ahead.

This is a huge improvement from March 2009 when 67% of consumers believed New Zealand was in for bad economic times over the year ahead.

Confidence is significantly higher amongst higher income earners (more than $70,000) and the Westpac-McDermott Miller report showed that only non-working and lower income consumers groups are now outright pessimistic.

The April/May figures were not available at the time of publication of this newsletter.

Employment
Confidence is expected to further increase as economic growth strengthens, also increased by wages and employment growth. ASB Bank economist, Chris Tennent-Brown, expects the unemployment rate to stay at or above 7% of the workforce until mid next year.

High unemployment also keeps the Reserve Bank of New Zealand (RBNZ) in check and prevents interest rates from rising significantly.

Conclusion
There are many positive signs that the property market is recovering and that we're poised for further growth in property prices, however the market is still currently positioned in favour of buyers.

Unemployment levels together with cautious consumer behaviour should keep interest rates manageable till at least mid 2011.

Forecasts suggest that property values may increase 8.5% in 2010 (RBNZ), 4-5% in 2011 and six to seven% in 2012.

While any time is a good time to invest in property, getting in before significant growth takes place allows you the fastest increase in equity.

Contributing to your community

Property investors make a significant contribution to the community. In Winter 2007 we ran the below article. In the wake of the recent changes for property investors we thought it was worth repeating.

NZINVEST clients know that a key benefit of investing in property is financial independence. But have you considered the other ways in which your purchase contributes to the community?

Here are some of the ways a property investor contributes:

- Homes for those people who can not afford to, or do not wish to purchase their own homes. This in turn eases the pressure on government housing and directly helps to address the waiting list

- Work for many professions including lawyers, real estate agents, accountants, valuers, mortgage brokers, newspapers/ advertising channels, insurance brokers, plumbers/ painters/electricians and their respective suppliers, handymen, cleaners, property managers, landscapers, curtain suppliers, appliance and furniture suppliers and many more
- In turn these people and businesses pay GST and employ others; who in turn pay PAYE, business taxes, and spend in the community
- Funding of city services through rates payments
- Contributions to central government services through PAYE, unrecoverable GST, tariffs and levies
- Security for their own retirement - by taking control of your retirement you are helping to ease the financial burden on future generations of New Zealanders.

The fact that you will most likely not rely on government hand-outs to fund your golden years means that there is more money in the budget for economic development in other areas.

WINTER PROPERTY MAINTENANCE

As we enter into Winter it's a good time to ensure your gutters have been cleared of Autumn leaves and debris. A build up in your guttering may cause water to flow back into internal walls and will attract nest building wasps and bees.

NZINVEST's Maintenance Services team can help prepare your property for Mother Nature's Winter onslaught. As well as cleaning, maintenance and protection of gutters and downpipes, our experienced team can also provide the following services for your home or investment property:

- Exterior cleaning
- Water blasting of slippery driveways, pathways and decks
- Garden maintenance, lawn mowing, hedge trimming and landscaping
- Internal and external painting
- Home handyman chores such as repairs to fencing or gates, cleaning of waste disposal units and installation of security bolts.

Our team are reliable, professional, friendly and offer quality workmanship and great rates. Give Debbie, Murray or Rob a call today on 09 966 5560 or email debbiem@nzinvest.co.nz for a no obligation consultation and quote.

Proposed changes to tax treatment

In the 20 May budget a number of changes were announced, many of these impact upon property investors. These changes will not have come as a surprise to most property investors as the concept has been on the table in various forms for at least five years.

The good news is that Capital Gain Tax, Land Tax, ring fencing of tax losses and a deemed rate of return tax have all been disregarded at this stage. So, let's look at the key changes of relevance to property investors:

- Personal tax rates will change from 1 October 2010
- Company tax rates will be reduced to 28% from 1 April 2011
- GST will rise from 12.5% to 15% from 1 October 2010
- For residential or commercial buildings with a useful life of over 50 years, depreciation will be set at zero from 1 April 2011. Depreciation of residential chattels is unchanged.
- Legislation will be introduced requiring Loss Attributing Qualifying Companies (LAQCs) to be treated as flow through entities for both profits and losses from 1 April 2011, therefore taxing both profits and losses at the shareholders personal tax rate
- Working for Families eligibility criteria tightened to prevent rental and investment losses being offset against taxable income when determining benefit eligibility

So what is the likely impact of these changes for property investors? Tax cuts are relatively straight forward so for the purpose of this publication we will look at the impact of the changes regarding depreciation and ownership structures. While each case will differ, requiring each to be reviewed on a case-by-case basis, some general implications follow.

Depreciation
From 1 April 2011 depreciation for residential or commercial buildings with a useful life of over 50 years will be set at zero.

The depreciation changes have been made on the premise that on average, New Zealand buildings do not drop in value over time. The new rules aim to better reflect how buildings actually change in value and make the tax treatment of property fairer compared to other forms of investments.

Currently property investors claim depreciation allowances however, if at time of sale it is found that the building has appreciated in value, i.e. it sells for an amount in excess of the original cost price, then the investor is required to repay the depreciation that has been claimed over the years of ownership. Therefore it is important to recognise that deprecation allowances were only ever a timing/cash flow advantage.

While there is undoubtedly an impact upon cash flow for property investors, we believe this is very manageable in the vast majority of cases. Most property investors will fall into the highest tax bracket of $70,000 per annum or more. These clients will benefit from a reduction of 5% in their personal tax rate – from 38% to 33%. Our calculations show that in many cases the reduction in income tax payable will more than compensate for the additional tax payable as the result of removal of the building depreciation allowance.

For example, the impact of loss of building depreciation for someone on a marginal tax rate of 33% equates to a loss of approximately $54.96 per week or $2858 per annum. The tax cut for an individual on $80,000 equates to a gain of approximately $50.57 per week or $2,630 per annum.

Depreciation of chattels will still be available to all chattels that the IRD does not class as part of the building. Carpets, blinds, light fittings, heaters, hot water cylinders, waste disposal units, motorised garage doors, smoke alarms, stoves and dishwashers will still be depreciable property. Partitions, telecommunications caballing, handrails, tiles, linoleum, fitted furniture, doors, garage doors and ducted fans will be classified as part of the building and no longer depreciable from 1 April 2011.

"While there is undoubtedly an impact upon cash flow** for property investors, we believe this is very* ***manageable in the vast majority of cases."

Ownership Structure
The ownership structure of your investment property has always been an important consideration. An LAQC has generally been a favoured structure for property investors looking to offset their losses, due to the ability to deduct losses at the shareholders' marginal tax rates while taxing the profits at the lower company tax rate. Between 2003 and 2007 - during the housing boom - the number of active LAQCs doubled and the average tax loss claimed by investors increased by almost 50%.

From 1 April 2011 LAQCs and QCs will be treated as flow-through entities for tax purposes, similar to limited partnerships. While shareholders will still be able to offset losses against their personal income, profits will also be taxed at their personal rates. Further proposals have been made to limit the amount of losses that can flow back to shareholders to the amount of capital invested. Consultation is currently underway regarding this.

Over the past few weeks we have received a number of enquiries from LAQC owners asking whether they can now change their ownership structure. One of the advantages of an LAQC has been its flexibility to alter your ownership. Going forward however, changing the ownership structure will be treated as the sale/disposal of your shares and will trigger the tax consequences associated with disposing of your shares, such as depreciation recovery if your property has increased in value.

If your investment property is owned by a company you'll benefit from reduced company tax rates, providing you reinvest profits into the company rather than distributing them as dividends. While the trust tax rate has not been reduced, a trust is generally set up with the primary intention of protecting the asset. This protection remains unchanged.

The proposed changes to the ownership structures may mean that, for future investment properties, it is preferable to own a property in your own name(s), using a "tenants in common" structure for simplicity of ownership. Each situation is unique so NZINVEST is committed to working closely with all our new and existing clients to determine the most effective ownership structures for each individual set of circumstances.

The Impact of Tax changes on the Property Market

There has been much speculation about what impact these changes are likely to have on the property market. While the changes may put some conservative investors off in the short term, the current housing shortage should mostly negate any resulting softening of property values due to continued pressure on supply. Early indications show no sharp or immediate reaction to these changes in the Auckland housing market so far. For those looking to purchase their first investment property, or extend their portfolios, any softening in property values can be used to their advantage.

The most likely result is upward pressure on rental prices i.e. landlords will increase their rents to off-set any impact upon cash flow. A recent survey conducted for the New Zealand Business Council for Sustainable Development showed that when asked if denying depreciation would cause landlords to put up rents, 65% of New Zealanders and 69% of landlords said yes. Only 17% of landlords said no and 14% didn't know.

An article in the New Zealand Herald in February this year outlined the impact of a similar change in Ireland. As a result of the changes rents climbed from an average of 21% below the mortgage costs on a similar property to 27% above the average monthly mortgage costs within six months of the changes in policy. Some more cautious investors delayed investing until rents increased sufficiently to cover any shortfall, when they did return to the market rents continued to increase further.

Regardless, it is important to remember that you only realise the value of your property when you sell it and given that the majority of our clients are invested for long term gain any impact on property values is unlikely to have a significant impact for them.

It is also worth noting that New Zealand has been and continues to be undoubtedly one of the most investor friendly nations in the world. Australia has Capital Gains tax, stamp duties and depreciation that is half of what is available in New Zealand, yet property prices in Australia continue to escalate and investors continue to generate solid returns.
The NZINVEST team will continue to monitor the impact of these changes and will work with clients to provide advice on a case-by-case basis. If you have any questions or concerns please do not hesitate to contact us by emailing Kim Yeoh at kyeoh@nzinvest.co.nz) or phoning him on (09) 966 5572. "Early indications show no sharp or immediate reaction to these changes in the Auckland housing market so far".

"Early indications show no sharp or immediate reaction to these changes in the Auckland housing market so far"

Protecting Your Investment

Risk management is an important part of any investment strategy. At NZINVEST we strongly recommend having a landlords' protection (LLP) insurance policy in place. LLP is a valuable backstop offering financial protection against the wrongful actions of tenants.

Most standard insurance policies do not cover the risks often associated with rental properties, such as malicious damage or theft by tenants and their guests. Even though the Residential Tenancies Act allows for a four week bond collection, landlords can easily find themselves out of pocket if they aren't adequately insured (see examples). Are you sufficiently protected should the unthinkable happen?

NZINVEST has recently carried out a review of the various landlords' insurance policies available to our clients and as a result we have established a preferred supplier relationship with REAL Landlord Insurance NZ Ltd (RLINZ).

Unlike other LLP providers who offer a suite of insurance products, RLINZ focus 100% of their time on providing cover, assistance and advice in relation to rental property insurance, resulting in a comprehensive insurance policy specifically tailored to meet the needs of New Zealand property investors, together with dedicated service by people who understand property investment. RLINZ has a solid reputation and has been a preferred supplier for REINZ members for the past five years.
Some of the key benefits of this policy include:

- Competitive pricing (equivalent to one week's rent plus GST per annum), paid in monthly premiums
- Fast, efficient processing of claims
- Comprehensive cover for loss of rent, malicious damage, contents, liability and theft
- Bond is not used to offset the cost of loss of rent claims One excess per claim when discovered at the same time (rather than charging multiple excess charges as is the case with some other policies)
- Limited cover is available even if current tenants have experienced rent arrears.

The policy is only available to property management practitioners selected and approved by RLINZ. NZINVEST is pleased to offer this product to our property management clients. For more information about LLP or our property management services please call 09 966 5560 or email Debbie McKinnie on debbiem@nzinvest.co.nz.
The example to the right demonstrates the value of LLP.

Example One: Jill and John Brown discovered that their tenant had abandoned the property, stealing the curtains and damaging the property. Their annual premium was $375. Loss of rent was calculated to absconded date plus 3 weeks vacancy as this was a periodic tenancy. As per the policy conditions as this was one event - only one excess applied to the entire claim.

Loss of rent (41 days)	$2108.22
Less rent in credit	- $35.00
Repair door, hole in wall, various other	$ 939.98
Replace stolen curtains and install	$ 902.13
Total Claimed	$3915.33
Less excess	-$500.00
Claim amount payable	$3415.33

Example Two: Peter and Mary Halloran evicted their tenant after discovering malicious damage to the premises. Their annual premium was $570.

Loss of rent (48 days)	$3908.64
Less rent on hand	$ -350.00
Less excess (one week)	$ -570.00
Replace carpet in bedroom	$ 849.84
Repair and paint walls	$ 630.00
Cleaning of walls and ceilings (smoke damage)	$ 202.50
Less balance of Bond once expenses deducted	$-479.40
Claim amount payable	$4191.58

Example Three: Kerry and Brent Walters' investment property suffered water damage to the bedroom as the result of a burst hot water cylinder. Their annual premium was $425.

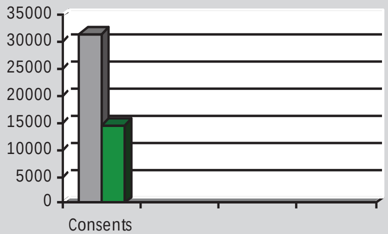
Carpet Cleaning - extract water and dry carpet	$125.00
Carpet Court - replace carpet stained with water	$1225.00
Less excess	$150.00
Claim amount payable	$1200.00

RENTAL MARKET SHORTAGE

Many factors contribute to the sustainability of the rental property market, including, but not limited to developer funding and consents; migration; population demographics and growth; affordability and investor confidence.

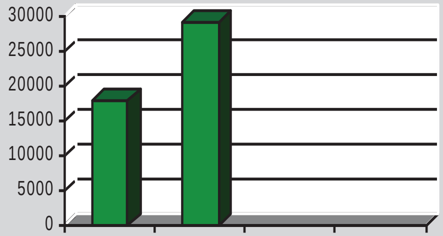
Construction
Construction by developers has been crippled over the past few years as a result of more expensive international borrowing and tight access to developer funding following the finance company market collapse. Annual consent numbers have now fallen by 23%. In the year to December 2009 14,425 housing consents were issued versus 31,423 at the peak in 2004. An expected 17,300 to 18,600 houses will be completed annually in 2010 and 2011, versus an expected demand of 29,000 units per year.

2004 vs. 2009 Building Consents Issued



Migration
New Zealand has been ranked as the 5th most desirable country in the world to live in and Auckland was recently ranked 4th equal in the Mercer 2010 Quality of Living Survey. The appeal of New Zealand, and Auckland in particular, leads to increased migration. On top of already high domestic demand, a record net migration of 26,000 is expected next year. Over the next three years a further 45,000 immigrants are expected to move to New Zealand.

2010 – 2011 Expected Supply versus Expected Demand



Adding an already undersupplied rental market, there are also suggestions that ex-pats are returning home from overseas and pulling their properties out of the rental pool, to live in.

Demographics
New Zealand demographics are changing. In Invest-igate in 2006 we discussed New Zealand's changing demographics, highlighting steady population growth, particularly in the Auckland region. We also outlined a trend towards smaller households, as a result of couples having children later in life and having less children, combined with an increasing population of singles and one-parent families. More people and smaller households translate to increased demand for housing.

Home Ownership
Home ownership is declining in New Zealand. Property continues to become less affordable over time in relation to average incomes and New Zealand has typically rated poorly compared to other countries. The 6th Annual Demographia International Housing Affordability Survey, for 2010, showed a sharp escalation in the gap between income and house prices in New Zealand.

On a scale where a rating of over 5.0 (times the median household income) was considered severely unaffordable, Auckland rated 6.7. Of the countries surveyed only Australia fared worse than New Zealand, at 6.8 times the median household income. The more unaffordable property is for average income earners the more demand we can expect for rental properties.

Land Shortage
A shortage of land means that cities are pushing out further and further. With a lack of effective and efficient public transport in some cities and a high level of traffic congestion, many workers want to stay close to business centres. Therefore renting is becoming a lifestyle choice for those who can't afford to buy in the suburb of their choice.

Impact on Rents
Basic economics tells us that when demand exceeds supply prices will rise. BIS Shrapnel's analysis forecasts rents in New Zealand will mirror the rise of nearly 6% predicted for Australia over the next three years.

Barfoot & Thompson figures suggest rents are steadily increasing. The average weekly rent in May was $398 per week versus $390 in February and $380 in February 2009.

Property investors are critical to New Zealand's rental pool (see 'Contributing to Your Community' article in this edition of Invest-igate) so if new taxes deter investors from entering the market at sufficient levels, the existing shortage will become more severe, pushing rents up even higher.

In a recent NZ Business Council for Sustainable Development survey, when asked if denying depreciation would cause landlords to put up their rents, 65% of New Zealanders and 69% of landlords said yes. Just 17% of landlords said no and 13% did not know.

So what does this mean for property investors? Current levels of supply versus demand favour property investment. The future is bright for those who can afford to purchase investment properties to contribute to New Zealand's rental pool.

C O N T A C T N Z I N V E S T

Accounting/Taxation Queries: Kim Yeoh kyeoh@nzinvest.co.nz
Property Management : Debbie McKinnie debbiem@nzinvest.co.nz
Property Sales: Martyn Harries mharries@nzinvest.co.nz
Finance/Insurance: Tom Mail tmail@nzinvest.co.nz
General Enquiries: reception@nzinvest.co.nz