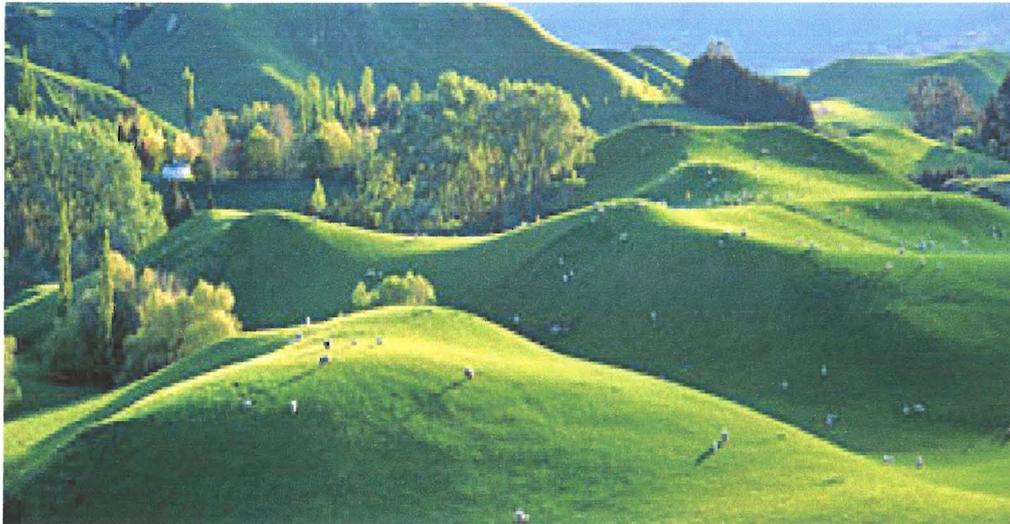


The NZ Rural Property Market –

Where to from here ?



Prepared by *Bruce Wills* for Primary Industry Council /
Kellogg Rural Leadership Programme 2006.

Executive Summary:

Between 1990 and 2000 the price paid for rural land doubled. Between 2000 and 2005 the price paid for most types of rural land has almost doubled again.

In recent months it is generally noted that farms are taking longer to sell. Many properties going to auction are now failing to reach their reserves and recent evidence suggests values have and are continuing to ease for most farm properties.

My contention is that rural land values in most areas of NZ appear increasingly overvalued against a slowing economy and diminishing farm gate returns.

Analysis of the key property price “drivers” points to the property boom having peaked and a correction to more rational levels being underway.

As always in property cycles this correction will affect individual farms and farm types differently. Some will not lose value others could have their values pegged back quite strongly.

My report concludes that the national median farm price could fall by as much as 20% - 30% over the next few years. This downwards correction exists because prices have been bid up to levels not justified by prospective farm incomes.

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References:

Kevin Wilson – NBNZ Rural report - March '06

Rodney Dickens – ASB Industry Research – Nov'05

Alan Bollard – RBNZ Ag. Monetary policy and the Economy – July '06

Quotable Value

Morice & Assoc - Registered valuers

1. Introduction:

1.1 The Issue

Recent newspaper headlines –

“Supercharged Waikato property prices showing signs of cooling” 2/06

“Farmers the sacrificial lambs” 3/06

“Will history repeat in property boom?” 4/06

“Sales plummet amid falling confidence” 4/06

“Farming talent drifting offshore” 5/06

“Brave faces as farmland sales stutter” 7/06

“Bollard warning on farm prices” 7/06

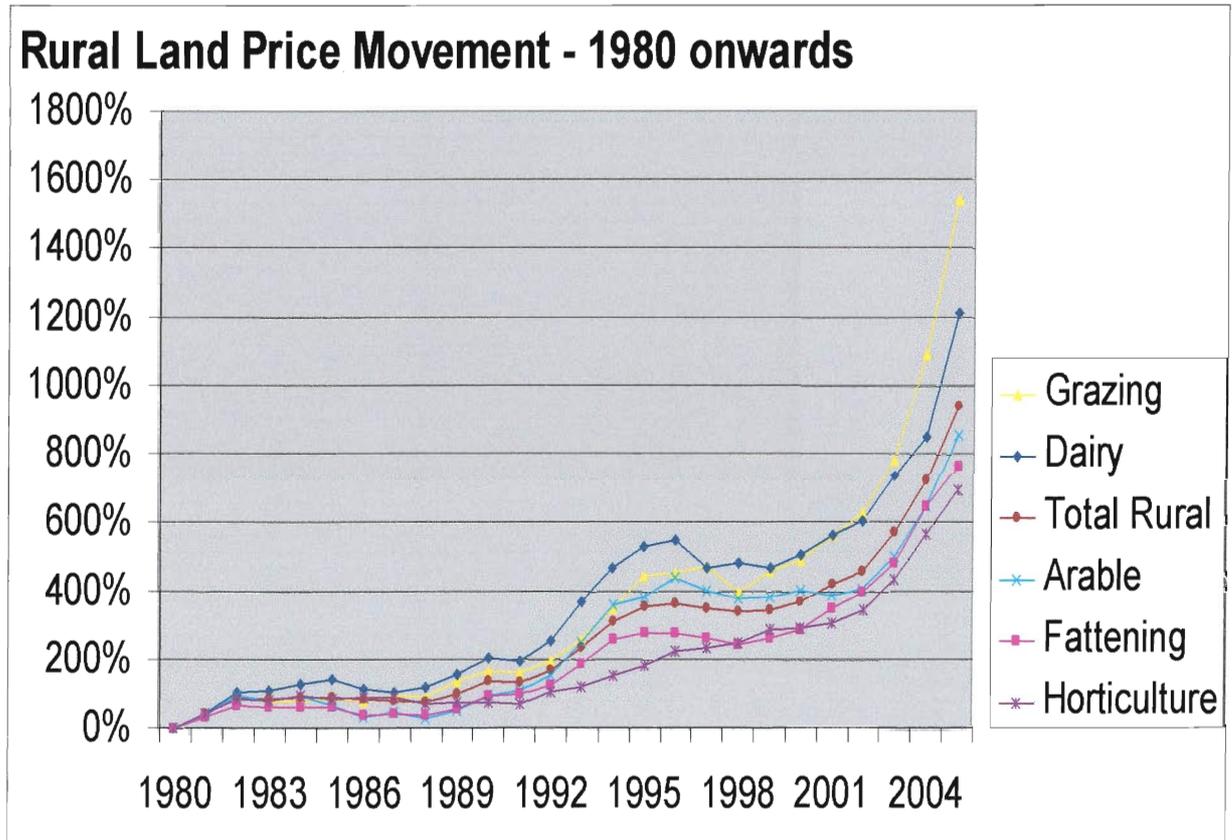
“Debt driven boom about to go bust” 10/06

Most people in the industry would now agree that rural land prices have risen by more than can be justified by economic returns. The average annual cash return from using land for most farming activities is now very low at around 2% return on capital. P/E's (Price earnings ratio) for farming are now at record levels reflecting both the very low earnings from farming and the extremely high rural land values.

1.2 “Irrational Exuberance” - alive and well in rural NZ

The objective of this report is to understand why farmland values have almost quadrupled since 1990 and perhaps more importantly analyse and try to predict where prices paid for farmland are likely to go from here.

The consensus of numerous discussions with Economists, Real Estate agents, Bankers, Valuers and the people making the final decisions, Farmers, is that prices have risen too far too fast, cannot be justified by sensible rational financial parameters and that an overdue correction will happen. It is the *extent and timing of this correction* that causes most debate.



Above graph uses data based on the QV Rural Price Index up to 31/12/05.

Points to note:

- Sales data based on **nominal** figures and clearly shows dip in property prices in the late 90's particularly for "dairy" and "grazing".
- Graph also shows a nominal value drop in late 80's - in **real** terms this reduction was quite substantial with inflation at the time running at double - digit levels.(QV figures show that in inflation adjusted terms the average value of a NZ rural property fell 42% from the beginning of 1984 to the end of 1987)
- Huge growth in values from early 2000's to end of available data in Dec'05
- How will graph look when figures to 31 Dec'06 are added? – I suspect they will show a flattening off, particularly for the two highfliers grazing and dairy.

1.3 Questions

Is it a good time to buy a farm ?

How much should I be paying ?

Is it a good time to sell ?

Is the value of my farm going to increase to decrease ?

2. THE GUTS OF THE MATTER

What has driven farm prices to these levels?

The Key Drivers:

2.1 Improved Profitability.

Returns to farming were very good in the early 2000's with the mix of high international commodity prices and a low \$NZ combining to make farming more profitable than at any time in the past 30 years.

Returns were also boosted by a strong uptake in farming technologies i.e. more su/ha, more ms per cow, heavier lambs etc as well as continuing farm amalgamations giving greater economies of scale.

This period of good profitability fed on itself i.e. more money led to the financial ability and confidence to take on new technologies which boosted production and returns leading to more money to invest.

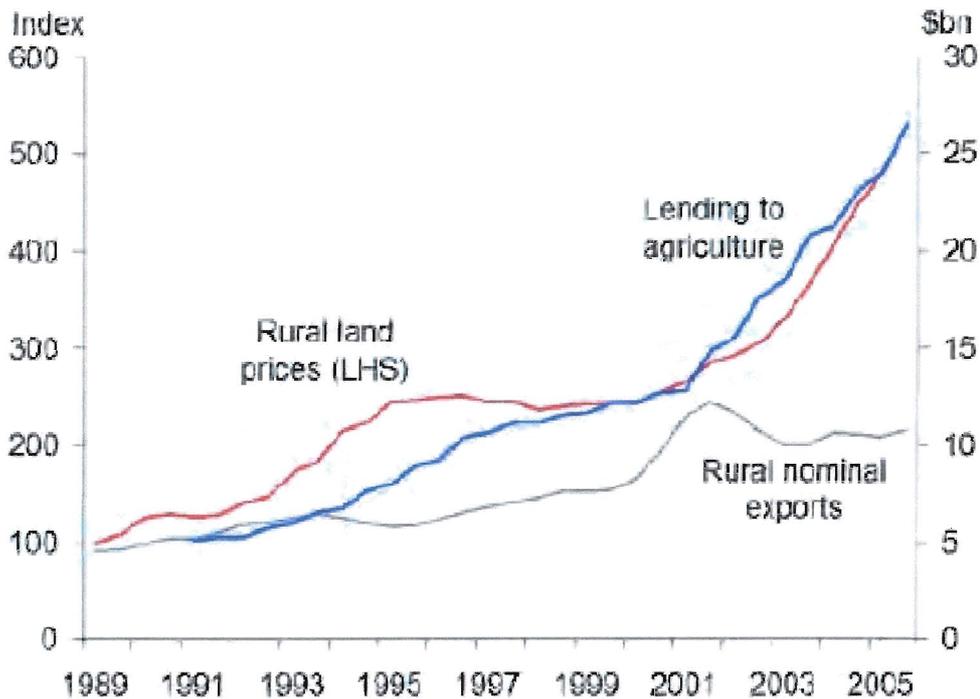
All good news ...except, as is often and unfortunately the case, these better returns were soon capitalised into land values which soon negates any chance of farmers getting a decent cash flow return on their business and also severely hampers the ability of younger farmers to enter the industry. The irony of all this is that NZ farmers regularly complain that there are not enough young people coming into the industry and that it is hard to get a decent cash flow return from farming ! And who's to blame for all this!!?

2.2 Availability of Credit / Interest Rates

In the early 1980's our main Trading banks had a very minimal exposure to rural debt. During the 1990's, particularly spurred on by conversions to dairying, farm debt grew rapidly and reached \$16bn by the year 2000. Now in 2006 total rural debt has ballooned to \$30bn!

Dairy farms in NZ now have a staggering average debt of \$1.18m each!

Rural land prices need to reflect future earnings potential



(Source – QV, Statistics NZ, RBNZ)

The red line and blue line (Rural land prices and Lending to Agriculture) show strong correlation in the above graph but seemingly little correlation to nominal rural exports.

As an ex Banker and Valuer of 20 years I am convinced that this explosion of debt (largely driven by a sustained level of low interest rates and a keen appetite by the banks to vigorously increase market share) has been a prime driver of the boom in property prices. The question now is how much more debt is sustainable and what happens when the Banks decide they have too much exposure to the rural sector?

2.3 Farm Amalgamations / Production increases

Much of the sales activity over the last 15 years has come from existing farmers striving to improve their viability through scale. Bigger farm businesses have led to all sorts of production and financial advantages. The premium for this is now well built into land values. For some time now the average price paid per ha for a large farm has been more than the average per ha price for a smaller unit even though the value of the improvements on a per ha basis is usually higher for smaller farms.

The following table shows how farm size and production has changed over recent years.

Average Owner – operated Dairy Farm

	1988/89	2003/04	% change
Production (kgms)	39,968	98,570	146.6
Effective ha's	67	105	56.7
Cows milked	158	286	81.0
Cows / ha	2.36	2.72	15.4
Production per cow (kgms)	253	345	36.2

(Source: Dexcel's Economic survey of NZ Dairy farmers)

2.4 Spill over from the Lifestyle & Coastal property boom

The lifestyle and coastal property markets have outperformed rural property in recent years. This has led to “premium” prices being paid for rural land with subdivisional potential. A number of these farmers with “premium” dollars in their pockets have headed inland away from coasts and cities and used some of this premium to push up prices paid for bigger inland properties.

The impact of this should not be underestimated. According to a MAF study (Source: Bayleys Lifestyle Property trend report 8/05) some 37,000^{HA} or approx. 247 average sized dairy farms are lost to subdivision each year!

2.5 The shift to better land use.

There has been a significant shift from traditional Sheep & Cattle farms to dairy and lifestyle subdivisions in recent years. These higher returning uses justify higher prices for land which sets in motion a “domino” affect of higher prices being paid for other land types.

The current trend of clearing forestry land for pastoral farming is also adding to this affect on farm values.

Changing land use requires new money to be brought in to the farm sector, normally borrowed money, adding value to the total farmland sector.

2.6 The Off-shore and Off-farm investor.

Most property sales in NZ are made by existing farmers although as a proportion this is declining.

When migration figures were higher in the early 2000's and the \$NZ lower than where it is today the number of farms purchased by foreigners was significant. Many of these new arrivals came with British pounds and made a number of high profile purchases of premium land (and could afford to pay premium prices) in places like the Waikato.

Likewise for the city investor NZ farms offered a good investment choice in the early 2000's, the impact of this outside buying having a noticeable upward influence on rural land prices.

Equity Partnerships in Dairy particular have provided an avenue for significant amounts of "urban" capital to flow into the farm sector. Not only have these partnerships added to buyer competition pushing up land prices but the influx of outside money has added to the whole "capital" available to the rural sector boosting the value of rural land.

Forestry Partnerships in the '90's did the same thing.

It has been estimated that outside investors own approximately 1% of the \$80bn to \$100bn rural sector assets. This will continue to increase. As NZ is a small country with only limited Agricultural land even modest interest / purchase by off shore buyers can have quite an impact on values.

2.7 Capital Improvement.

A combination of most of the above key drivers, particularly improved profitability, has seen most land owners carry out considerable property improvements in recent years. Whether it be capital fertiliser, fencing, upgrading farm buildings or work on environmental sustainability - all add to the property asset value.

The profitable years of the early 2000's allowed a large amount of deferred property maintenance to be completed. Farmland now is generally in far better shape than 5 or 10 years ago and this has been built into the price of farmland and its improvements.

2.8 “Land Emotion” and the “lifestyle” factor

This continues to be a very important driver in rural land market. The influence of this emotive buyer behaviour should not be underestimated. Many farm buyers still put very little weighting on the equity or capital returns of a prospective purchase, rather, it is more about sentiment “I have always admired that bit of land – if I can afford it (meaning the Bank Manager says I can have the money!) – I’ll have a crack at itjust look at the value of that bit of dirt I bought a couple of years ago”. Sound familiar!

Owning land is something admired and regularly pursued by many NZ's. Many farmers remain uncomfortable about putting money into city investments and continue to plough any surplus funds back into their own farms or additional rural land purchases.

Farmers are their own worst enemies bidding up the price of land to *what they can afford* rather than *what it can earn*. On top of this when farmers buy land they have a habit of being eternally optimistic – every farmer that I have ever met always thinks they can do better production than the previous owner and bids up the price accordingly!

3.IMPLICATIONS OF OVERPRICED LAND

- land purchase will require increased borrowing and equity (meaning higher risk).
- Farmers will be forced to increasingly look “off-farm” for other income sources that give a much better cash flow return.
- Existing farmers will have to be in an increasingly sound financial position before expanding.
- A higher level of equity would need to be maintained to insulate the business from cash flow risks.
- Will hasten the amalgamation of land.
- Will prompt faster change to alternative land uses i.e. dairying, lifestyle subdivisions etc.
- Low cash returns from overpriced land makes it difficult to implement efficiency and productivity gains.

Overall - few economic benefits apart from “wealth creation” for those fortunate enough to already be land owners.

4. WHY HAVE FARM VALUES STALLED IN 2006?

4.1 Farm Returns Dive.

Most international commodity prices have fallen sharply. The Meat & Wool Economic service reports that sheep farm returns are down by a 1/3 for the '06 year. Fonterra recently announced a forecast payout price of \$4.05/kgms for the 06/07 season to howls of anguish from many. (this forecast is based on a \$US/\$NZ 61c dollar (as at 11/06 is \$NZ is 67c against \$US) with only counter to this being very favourable milk powder returns).

Returns at these sorts of levels leave little margin over cost of production.

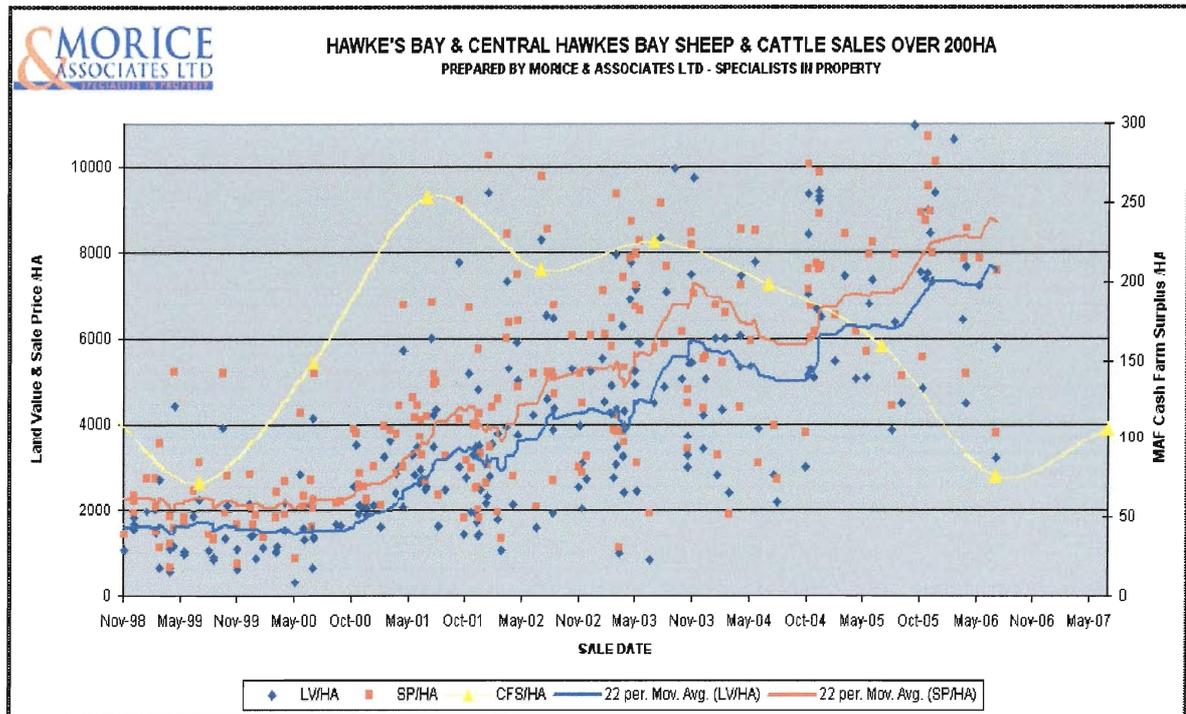
According to a recent MAF study the combination of poorer returns and the already very high land values has reduced the average return on land for sheep and cattle farms to a meagre 1.5% with dairy farming not much better.

On a Price/ Earnings (P/E) basis investment in rural land looks even worse.

As at 28/10/06 the P/E's (and Dividend yields) for three of NZ's larger listed companies were -:

	<u>p/e</u>
Fletcher Building	11.4 (yield 6.46%)
Contact Energy	14.9 (yield 5.36%)
Auckland Airport	23.9 (yield 6.06%)

An analysis of several recent sales of good Sheep & Cattle properties in Hawkes Bay puts current P/E's somewhere between 40 - 50 with cash yields of under 2%..... and this makes economic sense !!!?



(Source – Morice & Assoc. Reg. Valuers)

Key points from above graph:

- yellow line (cash farm surplus) clearly shows declining profitability since peak in 2001 and the steep fall during the 05/06 year. Upward lift in farm surplus line largely based on a softening on \$NZ currency?
- Orange and blue lines are the average actual sale prices of HB sheep & cattle properties of over 200ha. (dots represent individual sales – note wide variance)
- Strong rise in farm profitability 00/01 followed by strong rises in values to end of '03. If correlation runs true to form we should expect sales data to show response to sharp dip in yellow line (farm surplus) the next time this graph is updated!

4.2 Oh Boy ...just too much debt!

As previously mentioned rural debt now stands at almost \$30bn up from \$16bn in 2000 and **up a staggering \$23bn in the last 20 years!** Add to this the interest rates rises of 2006 and the concern that rates may not yet have reached their peak?

The pain is beginning to bite – just what Mr Bollard ordered !

Very high debt levels and higher interest rates on top of falling returns is having a very significant impact on what farmers can afford to pay for land.

The higher the debt level the smaller the margin left to cope with things like external economic shocks, weather events and the like.

Farmers with big debt levels need look no further than a \$NZ/\$US at 67c and much of Australia experiencing 100 year droughts (doesn't our weather come from that direction ?!) to start feeling very uncomfortable.

Banks now vigorously compete to grow their rural books. Frontline bankers have now become salesman rewarded by the amount they lend and many of those that borrow rely solely on their bankers analysis. Too many farmers are still telling me that their main criteria for property purchase is if they can borrow the money then it must be ok! A dangerous situation that has bitten us in the past (DFC, BNZ, Westpac in the early 90's) and will surely do so again in the future.

The sustainability of current rural debt levels has got to be a very real concern.

Dairy farms in NZ now have a staggering average debt of \$1.18m each! This is 3 times as large as the average Australian dairy farmer, our major Banks are all Australian owned, these Australian Banks are increasing their bad debt provisioning for their Australian rural books and you think they might not just be a little worried about their debt exposure to NZ farmers ?!

4.3 Farm running costs through the roof.

On farm inflation continues to exceed the overall economy's inflation rate with costs up 4.9% for the 2005 year according to figures released by Meat & Wool NZ's Economic service. The impact of significant rises in fuel costs, labour, local body rates and fertiliser are biting hard into farm profitability.

We haven't seen farm costs go up at this rate since the late 80's and some of us know how that impacted on land values over that period !

4.4 It's the weather

It's been called the winter from hell. Snowstorms in the south, flooding and slip damage in the north and now talk of a possible El Nino in the east. After several years of rather benign weather the recent events have impacted on returns and clearly have had an effect on farmer's confidence to continue to pay top dollar.

The risk "ante" has been pushed up and this must be factored into rural property prices going forward.

4.5 The Grass is Greener...

There is now a steady stream of farmers, mainly dairy, heading offshore to the like of Australia and South America. The reality is that land prices in these countries are considerably cheaper and returns are far better. It is believed that up to 3 dairy farmers a week are heading to Australia. The momentum is picking up. NZ has a great farming intellect but a constraint of capital whereas globally there appears to be a deficit of intellect and entry prices are considerably cheaper.

A sign of this change is the recent launching of **NZ Farming Systems Uruguay** (NZFSU), it has three farms already and intends purchasing at least seven more.

It is drawn by Uruguay's low cost system, the potential to expand production and the temperate climate. PGG- Wrightson believe they can triple production by using NZ systems and intensive grazing management thereby achieving a higher return than in NZ.

A previous bank client of mine sold his top class Waikato dairy farm several years ago and invested in a farm almost 3 times the size north of Melbourne. He now gets a 15% return on capital compared with the previous 3% and he doesn't have to buy shares !

A top price for land in Victoria is about \$15,000/ha compared with \$50,000 in the Waikato.

With migration numbers down and the economics of land clearly not what was on offer 5 years ago off-shore interest in our commercial farms has waned . The drift of farmers away from NZ seeking better returns elsewhere must have an impact on property prices here.

Off farm investors have traditionally been happy to pay a rural "lifestyle" premium for agricultural land - but within reason !

Like the off-shore investor the city investor has lots of choice as to where to spend his or her capital. With bank deposit rates at over 7%, good commercial properties offering 6 – 8 % and the average dividend yield on the NZ sharemarket at about 6% why on earth would you buy NZ rural property offering a return of less than 2%!!

The premium that has traditionally been paid for rural land is starting to look very unrealistic !

4.6 'Lifestyle' and coastal subdivision demand eases.

There is increasing concern that we are heading for a major oversupply of both coastal and lifestyle sections. This implies that demand for farmland for these purposes will slow meaning the premiums that we have seen paid for this land type will reduce/disappear resulting in lower demand therefore lower prices.

Farmland is a productive asset and in productive valuation terms the price of farmland reflects future expected earnings or profit that will be generated from the land. The combination of the above 6 concerns has lead to an overall more conservative outlook and thereby a more conservative approach by buyers as to what they are prepared to pay for land.

5. IS IT TIME FOR A CUPPA OR A DECENT SORT OUT?

In general the pundits on this are divided into two camps. The younger set (those who haven't experienced a decent downturn and were still in naps when Douglas did his thing in the late eighties !) view the current situation as a pause and believe that farmland values will stay about the same for a while and then increase again as they always have done !

Then there is the older set (the ones that who regularly quote interest rates of 25 – 30% to the younger fella's !) who are more convinced that values are due for a downward correction.

5.1 What can we learn from history?

QV statistics show that in the 24 years up to the end of 2004 the medium dairy farm index increased by 850 % or 9.8% p.a compound which compares with a 800 % or 9% p.a compound for QV's median urban house price. This sounds impressive but Over the same period compound inflation was 4.5% p.a so in inflation adjusted terms dairy farms have increased by nearer 4.5% p.a compound since 1980.

Analysis of these figures highlights two important points:

- i) The surge in property prices since 2000 is well above the average trend line and ..
- ii) Contrary to myth believed by some *property prices can fall and have fallen in the past* i.e. after increasing 60% between 1980 and 1983 the inflation adjusted QV median farm fell 42% from the beginning of 1984 to the end of 1987. More recently property prices showed a smaller decline in '97 & '98.

I well remember as a young banker in the late 1980's numerous rather distraught Farmers showing me their "new" farm GV's which in many cases were close to **half** their old Government valuations !. Now wouldn't that set panic among a few Bankers if this was to happen again !

Those that believe farm prices never fall and that when the going gets tough, farmers just "hang in there" until prices improve and then sell at a better price need to be aware that a) in inflation adjusted terms while farmers are "hanging in there" their "real" property values can be going backwards quite quickly and b) this time around most farmers have considerably more debt. Nervous Bankers won't be comfortable letting highly geared farmers just "hang in there" if farm values are going backwards.

I read recently that there is an apparent relationship between the value of a lamb and the price of grazing land. On average between 1992 and 2003 grazing land (measured on a stock unit basis) sold at 4.8 times the value of a lamb. At this rate, hill country land should be worth around \$315/su or conversely a lamb would need to be worth \$135 to justify the current price being paid for land!

Here we go again!

For those of us who have been around for a while the feeding frenzy that catapulted prices in property markets in the 1980's almost mirrors that of the past few years.

Well known property investor Ollie Newman pointed out in his book "Lost Property" in 1994 that the banks were largely to blame for the crash. Their willingness to lend huge sums of money to all and sundry is what he said was the underlying cause of the whole mess that unfolded in spectacular fashion on October 20th 1987.

Now where have I seen Banks following this same old pattern again in slightly more recent times!?

Farmland prices exceed farm profitability.

For much of the past 47 years since 1960-61 farm profitability and land prices have tracked each other. However there have been three notable periods of exception when farm land prices exceeded the farm profit trend;

- (i) The last 4 years has seen an increasing gap between land price and profit trends – this being due to the capitalisation of the previously mentioned key drivers into rural land now over-running today's profitability. Collective market wisdom also capitalises into the price of land future values such as the common belief that the \$NZ is overvalued and will soon fall boosting product prices and profitability. The current softening of land prices could be the market re-evaluating this factor.

The only reversal in rural land values of note occurred in the mid to late '80's when the blanket removal of subsidies and deregulation were abruptly introduced.

- (ii) For much of the '90's farm profitability was poor. The \$NZ was high, farmland sales decreased but land values held reasonably well helped by new money buying land for land use change, most notably "dairy conversions".
- (iii) The late '70's and early '80's were a period of Government subsidies and price support to expand farm production. These subsidies were capitalised into the price of farmland up until their removal in Nov'84.

5.2 What can we learn from outside NZ?

It is interesting to note that the recent rapid appreciation of land is a largely NZ thing.

Perhaps because of our very small land mass and as NZ is increasingly being seen as a “lifestyle” destination the upward movement in our rural land prices is significantly higher than most other countries. This is one of the reasons we are seeing so many farmers now purchasing land in Australia and South America.

There may also be an element of “Good luck” built into our property prices. In recent years we have seen the European Foot & Mouth outbreaks, the North American BSE outbreak and devastating Australian droughts. What used to be seen as NZ’s tyranny of distance has been helpful in limiting biological incursions and underlying our environmental image.

A recent article in the UK Farmers Guardian states that the number of rural land sales in Britain has dropped to its lowest level in more than 20 years. Farmland is now worth 5% less than this time last year at a weighted average price of £9370/ha.

The article also states that non farming buyers now outnumber farmers with a large proportion of the buyers being families escaping to the rural life, while land prices are starting to reflect the general financial pressures of farming, the returns from which have been steadily declining.

Sound familiar!?

5.3 What are the Experts saying?

Murray Cleland - President of the Real Estate Institute 7/06

“the amazing thing is the strength of the rural market – we have probably seen the top of it now – I’d be surprised if we saw real values go higher”

Gareth Morgan – Economist 3/06

“the farm sector depends, as it has done for decades, on windfalls from currency collapses to restore profitability, without that occurring this time expect a collapse in farm prices”

Alan Bollard – Reserve Bank Governor 7/06

“It is becoming increasingly hard to rationalise prices paid for land”

5.4 The likely outcomes

Recent sales data has already confirmed that we are experiencing a slow down in the rate of appreciation in the value of rural land. (Same trend also taking place in housing market)

The most likely outcome from here is that we will see this trend continue towards a gradual correction/reduction in values as buyer’s factor in the changing key drivers and vendors begin to accept that the prices of a year ago are no longer achievable or indeed realistic.

A “decent sort out” would require a major shock like a prolonged weather event (Australian drought), \$NZ going back over US70c, Foot and Mouth or the like. To predict a “bust” requires a prediction of a major shock which takes a very brave call!

6. STOCK TAKE NOVEMBER 2006

Real Estate agents advise that properties are still selling but most are taking longer to sell. (a well known early indicator of a slowing market). They also advise that many rural properties going to Auction are failing to reach their “reserve” and that their greatest challenge is now to manage vendors expectations.

A 1/11/06 REINZ report noted that “**farm sales are *significantly down*** as cooling confidence hits the rural sector”. REINZ figures show that farm sales fell markedly in September (126 sales compared with 173 in 9/05 and 184 in 9/03). REINZ pins falls in sales on gathering concerns about the stubbornly high \$NZ, interest rates and declining profitability in the rural economy.

There is no doubt that farmers are being much more conservative in their outlook and intentions than they were 12 months ago.

Another notable and interesting trend over recent weeks is both the number and quality of new rural listings that are appearing in magazines/papers and billboards around the country. This wave of new listings, including many larger properties, has been prompted by ongoing profitability concerns and the realisation by many that the rural land cycle has peaked and that historically high prices can still be achieved by selling now rather than later.

7. THE ANSWERS TO THOSE QUESTIONS

Q Is it a good time to buy a farm property?

A It depends! If it's next door and you have waited 30 years for the opportunity to buy and it improves the economies and viability of your existing property then you may just have to swallow hard and meet the market.

Otherwise the answer is no - I believe the analysis and conclusions from this report strongly suggest that a property purchased in 12 to 18 months time will on average be better buying than today.

Q How much should I pay?

A This also depends! But one thing is for certain – buyers would be well advised to ensure that the prospective purchase price achieves better than the 1.5% to 2% return that many farms are currently struggling to achieve!

The average 9.8% compound increase in rural property values since 1980 has to date been the saviour of many overly optimistic purchasers. Do not expect this sort of increase to continue in the next few years.

Pay a sensible rational price that gives a reasonable cash flow return on capital spent. Treat capital gain further down the track as a bonus.

That said, for many farm buyers the “family” and “lifestyle” factors outweigh the “economic” factors. It is concerning that all too often these emotive drivers (particularly in this easy credit environment) are moving some buyers to pay prices that are difficult to comprehend. This is leaving many farmers with an absurd level of debt which for many I fear will ultimately prove unserviceable.

Q *Is it a good time to sell?*

If your time in farming is up then yes – it is a good time to sell. Great capital gains aren’t realised until “the money is in the bank”. And of course the normal determinant to this question is “as long as you get an awful lot more than you paid”! The **timing** of any asset purchase or sale is crucial. To sell at the top of the market is always the ideal wish but is certainly not easy and we only know if we achieved this with benefit of hindsight!.

My advice would be that if you have made the decision to sell, then the sooner the better.

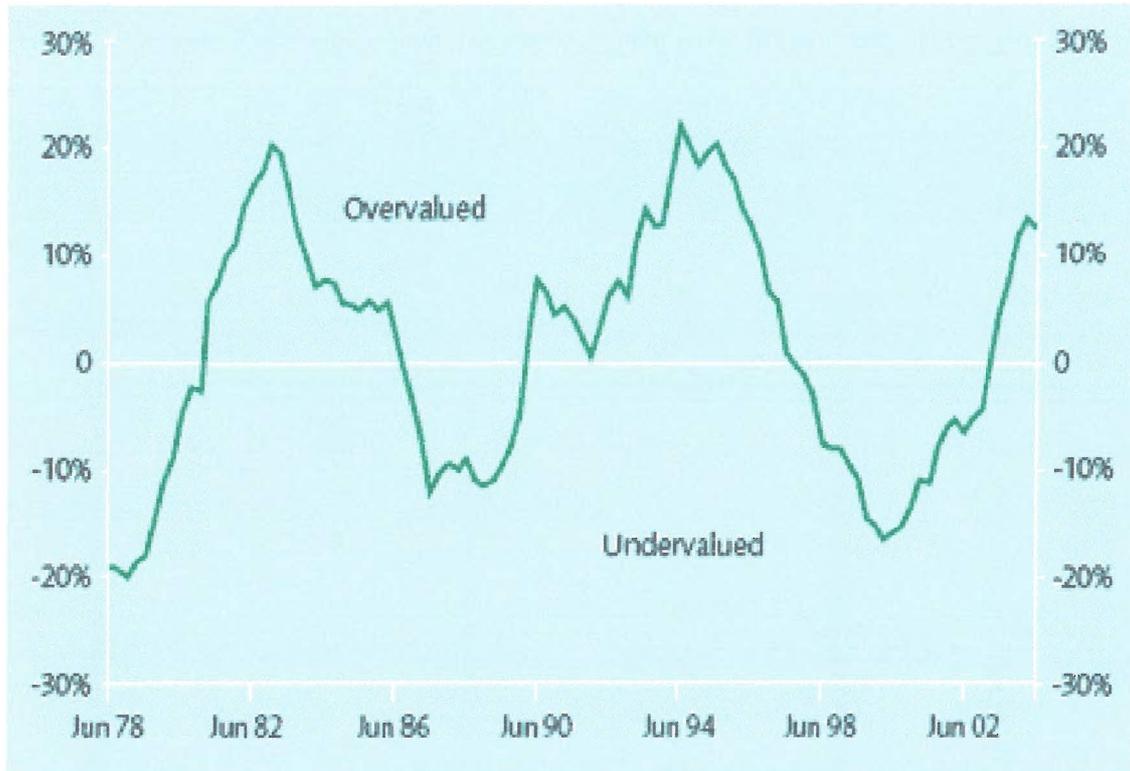
Q Is the value of my farm going to increase or decrease?

Over the long term most will agree that the value of rural property will continue to increase. But like all asset classes always do, rural property values will move in cycles.

There is strong evidence to suggest that we have now passed the property cycle peak and are now in a period of property price decrease. The length and extent of these cycles is of course pure conjecture, however, based on analysis of the key drivers and two decades of valuing experience my best guess as to where the property market goes over the next year or so (barring any unforeseen major external event) is a correction or reduction of up to 20% to 30% from the property highs of 2005.

This will of course not happen to every property. The better located properties generally retain value more than the isolated. Those with potential, those with something special, those with a neighbour keen to expand will hold value better than most. Conversely some farm types will correct more than others.

Deviation of Rural Land Value from Fair Value



(Source – National Bank Rural Report – March 2006)

This graph uses an indexed measure of land prices to GDP and includes productivity, economic growth and interest rates and clearly shows land to be overvalued. It is based on the premise that the growth in the value of land should generally mirror growth in the economy as a whole – especially when NZ's economic growth remains so closely tied to the rural sector.

Points to note:

- the two corrective (downward) phases mid 1980's and late 1990's match the reduction in farm sale prices as per the previous QV figures.
- I believe that once figures become available to Jun 06 we will see the "overvalued" line sitting somewhere close to 20% having already come off its peak. This graph (and history) tells us that the corrective phases normally tend to overshoot....

.....thus my contention that the rural property market is headed for an overall 20% to 30% downward correction in value.

8 SUMMARY

- Rural land prices have risen to more than can be justified by economic returns.
- The landscape has changed for the “key – drivers” of rural land i.e. there are now less buyers earning less money with less confidence but more debt!.
- Many of the recent prices being paid for property are back on what would have been expected 12 months ago.
- On average we should expect prices to continue to ease back until *earnings* and *land price* are better aligned.
- Some farm values will not fall at all, others may suffer significant falls, overall I think we will look back on 2006 to 2008 as a period when the rampant increases of the early 2000’s gave way to moderate corrections of 20% to 30% across the average farm value indices.

After all, with rural land values having doubled from 2000 to 2006 that still gives a pretty decent return on investment!