

focus

The House Doesn't Always Win



For a long time, many New Zealanders viewed owning property as a sure thing. Historically, strong price growth, the ability to use debt, and the comfort of bricks and mortar drew both homeowners and investors. In recent years that allure has been dented. Nationwide, house prices are down around -16% since the 2021 peak, while costs such as rates, insurance, and interest have soared. Despite this challenging period, many believe property prices will recommence their steady upward climb in the years ahead. We are less convinced. The landscape in 2025 looks very different from the one that fuelled the previous decades-long boom. We suspect that those expecting house price growth at levels seen in the past will be disappointed.

...Many New Zealanders have successfully invested in the housing market... In recent years, however, the housing market has been more challenging...



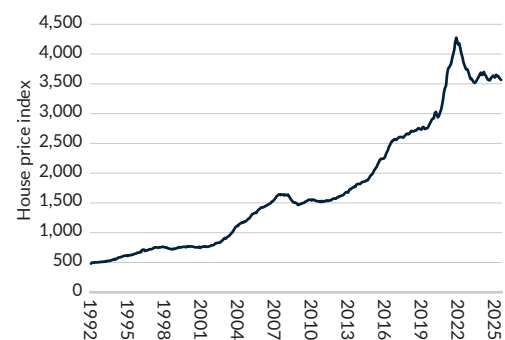
Largely a one-way bet...until recently

Many New Zealanders have successfully invested in the housing market. Prices have largely boomed for decades, rising by more than 6% per year since the early 1990s.

The ability to use leverage is one of the attractions of property investment. If you'd financed part of your investment with debt, your return on equity would be better still. At a loan-to-value ratio (LVR) of 50% your equity would have grown by around 9% per annum; at 70% LVR it would have been more than 11%. These differences may sound modest, but the power of compounding makes them significant over time. Over 20 years, a 6% annual return increases equity by roughly 3.2 times, 9% by 5.4 times, and 11% by an impressive 8.4 times.

While there have been occasional downturns—the most notable being an -11% decline during the Global Financial Crisis in 2007/08, where it took until 2012 for prices to fully recover—long-term investors in residential property have typically fared very well.

NEW ZEALAND HOUSE PRICES: DECADES-LONG BOOM (UNTIL THE LAST FEW YEARS)



Source: REINZ, Forsyth Barr analysis

In recent years, however, the housing market has been more challenging. Since the 2021 peak, national house prices have seen a meaningful correction, falling by -16%, with the steepest declines in Wellington down -26% and Auckland -22%.

Leverage amplifies both losses and gains. For the average investor, with a 50% LVR, a 16% fall in property prices translates to an equity decline of around -31%. At a 70% LVR the loss is roughly

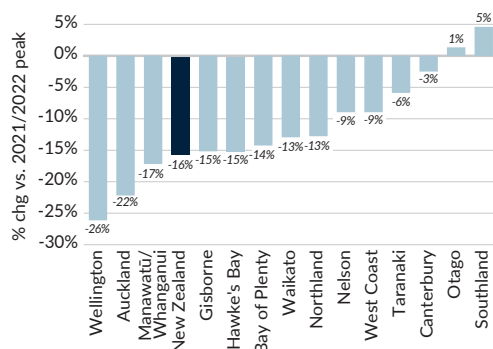


...when compared to most other countries, housing in New Zealand remains relatively expensive...

-52%—and for an investor geared at this level with a property in Wellington, their equity has plunged by about -87%!

Many view property as a safe, low-risk investment; however, the experience of the past few years highlights that, if the market moves the wrong way, the wealth destruction can be considerable.

NEW ZEALAND HOUSE PRICES: SHARP CORRECTION SINCE THE 2021 PEAK

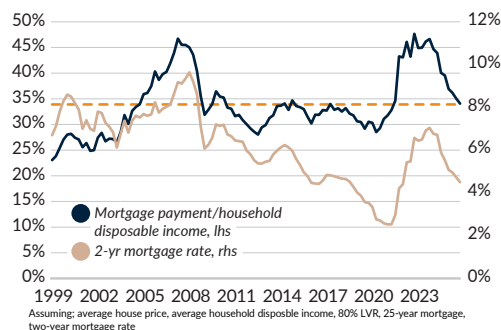


Source: REINZ, Forsyth Barr analysis

Affordability has improved but it's still not great

Sitting here today, the good news is that the combination of lower house prices and the reduction in interest rates has improved housing affordability. The chart on the right illustrates the share of income required by the average household to service a mortgage on the average house.

MORTGAGE SERVICEABILITY IS BACK AROUND THE LONG-RUN AVERAGE: COST OF SERVICING A MORTGAGE (% OF INCOME)



Source: REINZ, RBNZ, interest.co.nz, Forsyth Barr analysis

The less encouraging reality is, however, that even after a significant decline in both house prices and interest rates, affordability has only just returned to around its long-term average. What is more, when compared to most other countries, housing in New Zealand remains relatively expensive, and affordability continues to be challenging for many households.

Where to from here?

Stepping back, house prices can be broadly viewed as a function of two key factors:

1. The level of household income, and
2. The ratio of house prices to household income.

...construction of new dwellings has been outpacing demand...



Over the past 30 years or so, the growth in New Zealand house prices can be roughly attributed 60–65% from annual household income growth of around 3.5–4%, and 35–40% from an increase in the house price-to-income ratio—that is, houses becoming more expensive relative to household disposable incomes.

BREAKDOWN OF NEW ZEALAND HOUSE PRICE GROWTH SINCE 1992

	Total increase	Multiplier	Annualised growth (CAGR)
Incomes	213%	3.1x	3.5%
Price-to-income ratio	139%	2.4x	2.6%
House prices	648%	7.5x	6.2%

House prices relative to household disposable incomes climbed dramatically, from around four times in the early 1990s to about eight times immediately before COVID. This escalation was driven by generally tight housing supply and a long-term decline in interest rates.

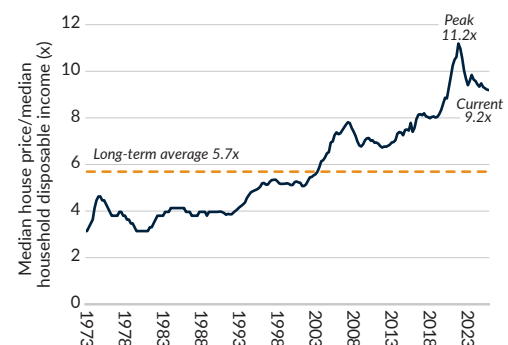
One of the first things any economics student learns is that when demand outstrips supply prices typically rise. Over the past three decades, the steady fall in interest rates amplified this

impact. Mortgage rates dropped from double-digit levels through much of the 1990s to below 4% by 2019. These lower borrowing costs significantly increased the amount that buyers could afford to pay.

It ultimately then took the extremes of a global pandemic—record-low housing supply and the lowest interest rates in history—for that ratio to peak at 11.2 times.

As both housing stock and interest rates have normalised that ratio has eased back to about 9.2 times today.

HOUSE PRICES REMAIN EXTREME RELATIVE TO INCOMES: HOUSE PRICES VS HOUSEHOLD DISPOSABLE INCOME

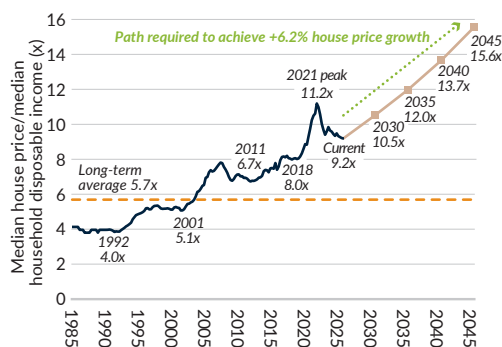


Source: REINZ, RBNZ, Forsyth Barr analysis

A key question for property investors is: what's the likelihood of history repeating?

Assuming income growth continues at around 3.5% per year, to achieve 6.2% annual house price growth over the decades ahead would require house prices relative to disposable income to climb back to 10.5 times in 2030, 13.7 times by 2040, and 17.7 times by 2050—well beyond the peak seen during COVID.

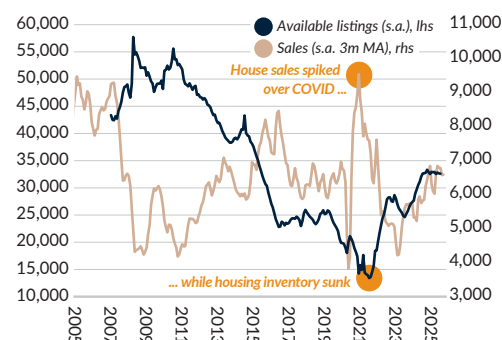
UNAFFORDABILITY WOULD NEED TO CLIMB EVER HIGHER FOR HISTORIC HOUSE PRICE GROWTH TO BE REPEATED: HOUSE PRICES VS HOUSEHOLD DISPOSABLE INCOME



Supply has improved

One factor that has helped rebalance the market is the marked improvement in supply of housing. The number of houses available for sale is at its highest level in a decade, while construction of new dwellings has been outpacing demand, contrasting with the acute lack of supply during COVID.

HOUSING INVENTORY PLUNGED DURING COVID, BUT HAS RECOVERED SHARPLY SINCE: HOUSE SALES VS INVENTORY AVAILABLE FOR SALE



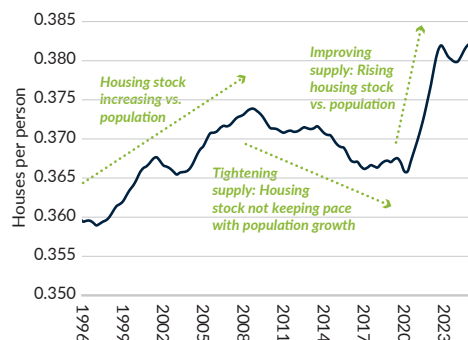
One way to compare the balance between housing demand and supply is the ratio of houses to people.

After the Global Financial Crisis, New Zealand's houses per person declined for more than a decade—new housing construction lagged our

strong population growth. Since 2020 that trend has reversed. During the pandemic construction boomed, but with borders shut net migration fell to near zero. Although migration spiked once borders reopened, it has dropped sharply since, particularly over the past year or so. Meanwhile, construction activity, while slower than its pandemic peak, has remained relatively solid by historical standards.

At first glance, the lift in houses per person may appear modest, but it's meaningful. Relative to 1996, the increase equates to around 130,000 houses (about 6%). From the 2020 low alone, the improvement is more than 90,000 homes (around 4%).

NEW ZEALAND'S HOUSING SUPPLY HAS OUTPACED DEMAND OVER THE PAST FIVE YEARS: HOUSING STOCK PER PERSON



Improved supply versus demand has also been reflected in the rental market. The stock of rental property listings is elevated and rent growth has fallen sharply. Depending on which data you look at, it is either growing only modestly or even falling.

SUPPLY IS ALSO WEIGHING ON THE RENTAL MARKET: RENT ON NEW TENANCIES



The challenge for investors

Successfully investing in residential property looks more challenging today than in the past.

Rental yields alone typically fail to deliver adequate returns for investors. In recent years,

...Successfully investing in residential property looks more challenging today than in the past...



achieving even a cash-flow breakeven investment has become more difficult due to higher interest rates, rising costs—such as rates, insurance, and maintenance—alongside changes to tenancy laws and tax rules. Investors have become increasingly reliant on capital gains to generate satisfactory overall returns.

Looking forward, we expect those capital gains will be harder to come by. High starting valuations and housing supply having improved significantly relative to demand, may mean future capital growth is modest. Rather than a repeat of the strong growth rates seen in the past, we believe a more realistic path is that house prices rise broadly in line with household income growth—historically around 3.5% per year—or potentially more slowly if the ratio of house prices to incomes continues to revert toward pre-COVID levels.

Be careful extrapolating past performance into the future.

No longer a one-way bet

New Zealand's property market is not a one-way bet. We don't doubt that, for those willing to do the work, opportunities for successful property investment remain—particularly in more affordable regions, and for properties with strong long-term demand or rental appeal. But investors need to take a realistic view of both upside and downside risks. The costs, risks, and hurdles for achieving a successful property investment have risen significantly. Leverage remains a powerful tool but, as recent years have shown, it can result in painful outcomes if prices don't lift as expected, or if interest rates rise significantly. A lesson of the past few years is that the house doesn't always win.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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