

property Research

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RESEARCH

Commodity boom assists rural
debt pay down

Farm sales activity rebounding

Rural confidence on the rise

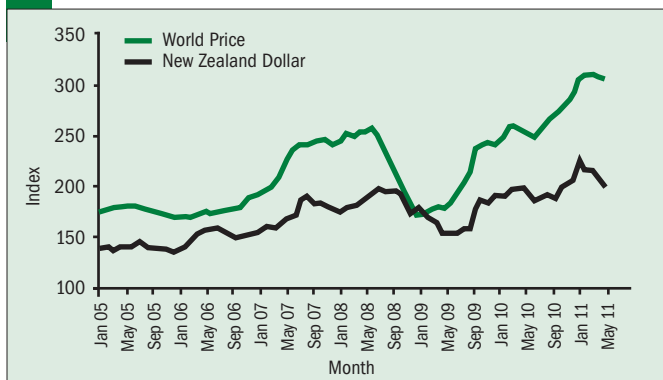
NEW ZEALAND

COMMODITY BOOM BOOSTS INCOMES

Commodity prices at record levels have seen farm gate incomes rising providing a timely fillip to the sector.

The recovery in commodity prices began in early 2009 as illustrated by the ANZ Commodity Price index. The index monitors the value of a basket of agricultural commodities with movements in values reported in terms of both the New Zealand dollar and a world price index.

COMMODITY PRICE INDEX WORLD PRICES v \$NZ



Source: Bayleys Research

From its cyclical low in February 2009 the index appreciated in value by 82%, in world terms, over a 27 month period. During much of this period the New Zealand dollar has held at high levels on the foreign exchanges which has limited the increase in prices when denominated in terms of the New Zealand currency. Despite this, the New Zealand Dollar index appreciated by 45% between June 2009 and March 2011.

The impact of higher commodity prices is most clearly illustrated in the dairy sector with multinational dairy giant, Fonterra, having made the announcement that its final payout for the 2010/11 season, which closed at the end of May, hit another record high payout of \$8.25 per kilogram of milk solids. With production being increased by 5% over the previous year, the total payout will be approximately \$10.8 billion.

The latest commodity price boom is however, broader based than that which was experienced in 2007 and 2008. At that time the index was driven almost exclusively by spiralling dairy prices. On

TRENDS IN DAIRY COMPANY PAYOUTS

Season	Average Payout (\$/kg milk solids)	Payout (Inflation adjusted)
2000/01	\$5.01	\$6.29
2001/02	\$5.35	\$6.54
2002/03	\$3.66	\$4.41
2003/04	\$4.25	\$5.00
2004/05	\$4.58	\$5.24
2005/06	\$4.10	\$4.51
2006/07	\$4.46	\$4.81
2007/08	\$7.67	\$7.96
2008/09	\$5.14	\$5.23
2009/10	\$6.37	\$6.37
2010/11	\$8.25*	\$8.25
2011/12	\$7.20*	\$7.20

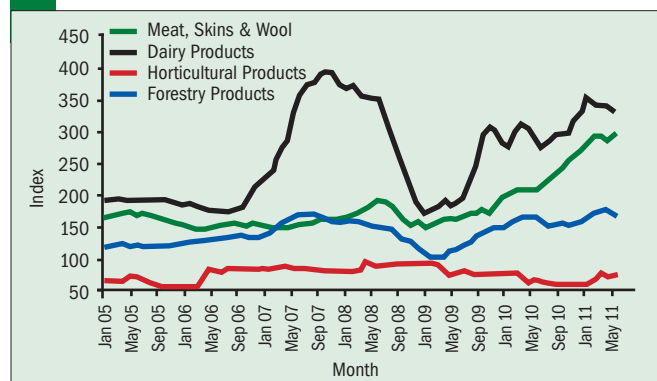
* Fonterra figures only

Average dairy co-operative payout (Fonterra, Tatua, Westland)

this occasion meat and wool prices have also risen sharply while forestry products also reached a new record high.

As a result lamb and beef producers have also experienced a lift in

COMMODITY PRICE INDEX BY SECTOR



Source: Bayleys Research

earnings. Beef and Lamb New Zealand has reported that the value of exports this year rose by 9% to \$5.8 billion and this despite the fact that lamb volumes were the lowest for half a century.

The value of beef exports totalled \$2.5 billion in the year to June, an increase of 14% on the previous year while volumes edged down 3%. The reduction in lamb volumes was far more pronounced, down 15%, however export values rose by 3.4% to \$2.7 billion.

The latest rise in commodity prices is driven by a combination of

factors, one of which is speculative buying by investors which, as with other investment assets, can lead to volatility in prices, and indeed recent months have seen a slight moderation in prices. However, underpinning the increase are structural changes to demand which seem likely to further increase demand over the longer term. The most fundamental drivers are world population growth and rising incomes particularly in emerging nations such as China and India.

There is therefore a high degree of confidence that, whilst there will always be volatility in the markets, higher prices for New Zealand agricultural profits are here to stay. This view is supported by both Fonterra and the Ministry of Agriculture and Forestry (MAF). Fonterra, for example, has issued an opening forecast for the 2011-2012 season of between \$7.15 and \$7.25 per kilogram of milk solids. Although clearly below this year's record level, a payout in this range would still be the third highest recorded.

The upbeat view on the future is likely to be further enhanced following the issuing of MAF's latest Situation and Outlook for New Zealand Agriculture and Forestry which forecasts that "In a six year period, from 2010 to 2016, gross agricultural revenue is forecast to expand by some 45 percent from \$22 billion to \$32 billion."

NZ AGRICULTURAL EXPORT VALUES 2011-2015

	Actual 2011	Forecast		% Change 2011-2015
		2012	2015	
Wine	1,104	1,139	1,488	▲ 34.8%
Kiwi Fruit	944	1,027	1,337	▲ 41.6%
Deer	223	239	310	▲ 39.0%
Lamb	2,693	2,727	3,734	▲ 38.7%
Wool	728	631	827	▲ 13.6%
Beef	1,969	1,996	2,637	▲ 33.9%
Dairy	13,042	14,576	18,287	▲ 40.2%

Note: All figures \$Millions

Source: MAF SONZAF

FREE TRADE AGREEMENT STARTS TO PAY DIVIDENDS

The latest figures released by Beef and Lamb New Zealand clearly indicate the benefit to the agricultural sector of the Free Trade Agreement (FTA) entered into with China in 2008.

The export value of sheep and beef products to China totalled \$687.4 million in the year to 31 December 2010 with tariff savings of \$24.8 million. As tariff reductions are being phased in over a number of years further benefits will ensue with Beef and Lamb NZ estimating that China will deliver a further \$21 million by the time tariffs are fully eliminated in 2016.

VALUE OF EXPORTS TO CHINA

	2007	2010
Sheep Meat	\$62,800,000	\$119,700,000
Beef	\$290,000	\$9,200,000

Source: Beef and Lamb New Zealand

The value of exports to China in 2010 showed an increase of 104% compared with 2007, the year prior to the FTA coming into operation.

CONFIDENCE ON THE RISE

The combination of the above factors has resulted in a lift in confidence across the agricultural sector. The more positive sentiment is reflected in the results of the latest Federated Farmers survey of farm confidence published in July. The latest survey is the fifth in the series with two surveys a year being conducted, in January and July.

The key findings of the latest survey are set out below.

- A net 16.4% of respondents are expecting improvement in the general economy over the coming 12 months, up 11.6 points on January. Confidence has increased for all industry groups and regions, but that of dairy farmers increased by somewhat less than that of meat and grain farmers.
- As has been the case in previous surveys respondents, are considerably more positive about the profitability of their own farms. A net 45.8% of respondents are expecting improvement in their profitability over the coming 12 months, up 20.3 points on January. Optimism about profitability was up for all industry groups, although again the increase for dairy farmers was less than the other groups. After lagging in January, North Island respondents have caught up with those from the South Island.
- Production is expected to increase with few concerns at this stage about adverse weather conditions. A net 50.4% of farmers expect to increase production over the coming 12 months, up 25.6 points on January. In January the weather was the major concern of farmers and this was impacting on production forecasts and on farm profitability.
- More farmers are expecting to increase spending. A net 33.3% of farmers expect to increase spending over the coming 12 months, up 11.7 points on January. In part this reflects improved confidence but there is also a price effect with many farmers concerned about increasing input costs

CONFIDENCE SURVEY, OWN FARM PROFITABILITY BY SECTOR

	July 11 Improve	July 11 Stay the Same	July 11 Worsen	July 11 Don't Know	July 11 Net	Jan 11 Net	Trend Jan - Jul
All Farms	54.00%	35.50%	8.20%	2.30%	45.80%	25.50%	▲
Dairy	50.70%	37.50%	9.30%	2.50%	41.40%	29.20%	▲
Meat & Fibre	55.30%	34.80%	7.70%	2.20%	47.60%	24.10%	▲
Grains	66.70%	23.80%	7.90%	1.60%	58.70%	15.80%	▲
Other	51.10%	42.20%	4.40%	2.20%	46.70%	24.40%	▲

Source: Federated Farmers

DEBT REDUCTION A PRIORITY

A period of rising farm incomes, coinciding with an extended period of low interest rates has provided farmers with an opportunity to reduce their debt burden. Agricultural sector debt soared after 2002 when the previous commodity boom drove a huge increase in sales activity and in turn farm values.

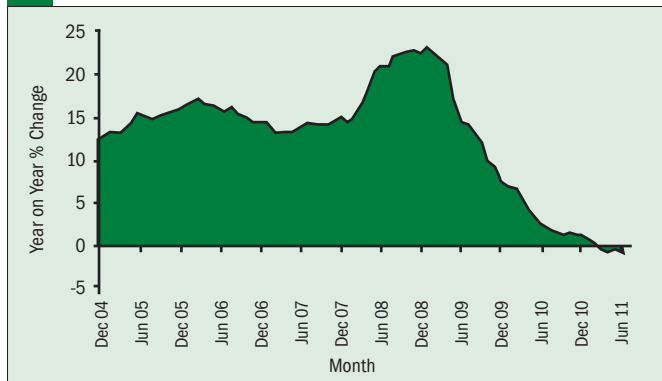
In January 2002 total farm debt reached \$15 billion for the first time. Over the eight years to December 2009 the figure increased to \$47 billion

Additional loans were taken by many to purchase farms for conversion to dairy, given the sector's strong performance. This move however occurred at the top of the commodity price cycle. The changing economic environment saw farm incomes being cut , and, as land values fell, the banking sector became increasingly concerned about debt levels in the industry. New loans were approved primarily on the basis of a strong business case as opposed to asset values and as a result finance became more difficult to obtain.

The combination of the tighter credit criteria being exercised by the banks and a general desire by the industry to lower debt has resulted in a profound change in the sector's propensity to borrow. As the graph below illustrates, year on year debt growth, which had been running at approximately 15% through the early part of the decade, rose sharply during 2008. By October 2008 annual debt growth had reached 22.5%.

As stated above the recessionary environment which prevailed during 2008 and 2009 changed the business environment profoundly. The rate of debt growth has slowed significantly since mid 2009 and has, since March 2011 ,actually fallen year on year. Having peaked at \$48 billion in September 2010 the figure has fallen back to \$47.25 billion as at June 2011.

FARM DEBT GROWTH



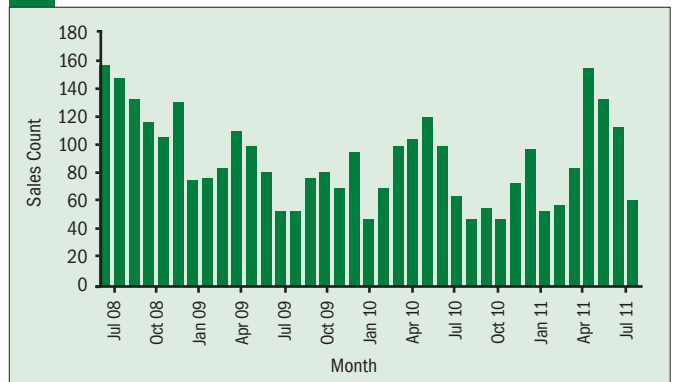
Source: Bayleys Research

ACTIVITY SET TO RISE

Unsurprisingly during a recessionary period when debt reduction has been the priority within the farming industry sales activity has been at low levels since mid to late 2008.

Recently, however, there have been signs of renewed interest in the market. Farmers have had an opportunity to shore up their balance books, commodity prices, while off recent highs, remain at elevated levels and there has been a significant adjustment in land values. As a result farm purchases have become more financially viable both in terms of cost and business viability.

NEW ZEALAND FARM SALES



Source: REINZ, Bayleys Research

Recent sales statistics released by the Real Estate Institute of New Zealand (REINZ) indicate that we may have entered the early stages of the recovery phase in terms of sales activity.

Total farm sales in the year to the end of July 2011 are running 8% ahead of the same period in 2010, a result of sharply increased activity in the June quarter. Total sales in the second quarter reached 393, the highest quarterly total since the September quarter of 2008. While these figures are still well below the 700+

NATIONAL FARM SALES

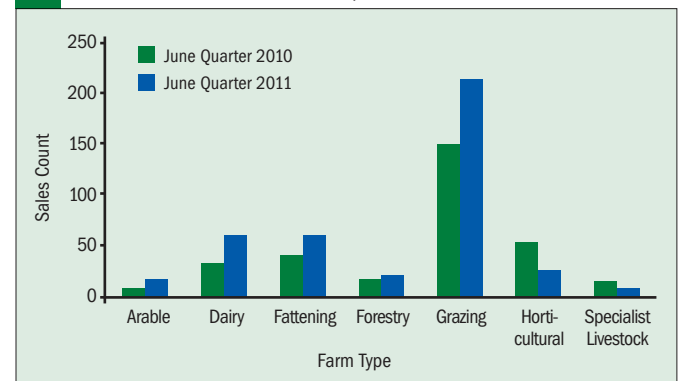
	2010	2011	% Change
March Quarter	213	190	▼ 10.8%
June Quarter	319	393	▲ 23.2%
Year to date (July)	595	643	▲ 8.1%

Source: REINZ

sale per quarter recorded in the first two quarters of 2008 they are a marked improvement on the 164 sales reported by REINZ in the three months ending September 2010.

The latest June quarter sales statistics show that sales across a majority of the farming sectors increased compared with the same period in 2010. Sales of arable, dairy, grazing, forestry and fattening

FARM SALES BY SECTOR, NEW ZEALAND



Source: REINZ, Bayleys Research

farms all increased while only the horticultural and special livestock sectors experienced declines.

The extended period of low sales activity has continued to impact upon values. The latest quarterly statistics released by the REINZ show median values to have reached their lowest level since July 2004.

As discussed above it appears that at this new price point farms are again becoming attractive to purchasers. Bayleys Research

REGIONAL LIFESTYLE STATISTICS - JUNE QUARTER

	2009		2010		2011	
	Sales Volume	Average Sales Price	Sales Volume	Average Sales Price	Sales Volume	Average Sales Price
Northland	99	\$372,356	95	\$416,689	111	\$361,542
Auckland	219	\$830,324	193	\$773,308	267	\$822,418
Waikato	172	\$439,035	152	\$459,207	151	\$495,927
Bay of Plenty	102	\$512,060	92	\$539,087	94	\$530,483
Taranaki	53	\$405,613	43	\$420,331	55	\$405,591
Gisborne	21	\$446,164	10	\$313,998	9	\$365,444
Hawkes Bay	58	\$504,898	53	\$470,481	40	\$649,575
Wanganui/Manawatu	100	\$336,958	88	\$327,394	105	\$391,526
Wellington	88	\$453,195	76	\$498,244	76	\$419,783
Nelson/Marlborough	55	\$708,316	47	\$521,011	81	\$560,747
Canterbury	253	\$480,717	159	\$517,553	228	\$479,393
West Coast	12	\$190,792	8	\$346,500	14	\$263,643
Otago	76	\$381,242	54	\$426,250	88	\$688,180
Southland	46	\$361,605	43	\$388,413	67	\$390,124

Source: REINZ

forecasts that following the normal winter season hiatus in activity, sales will resume the upward trend of the June quarter. The increase in activity is likely to be slow and steady as opposed to marked and therefore unlikely to place upward pressure on values in the short term.

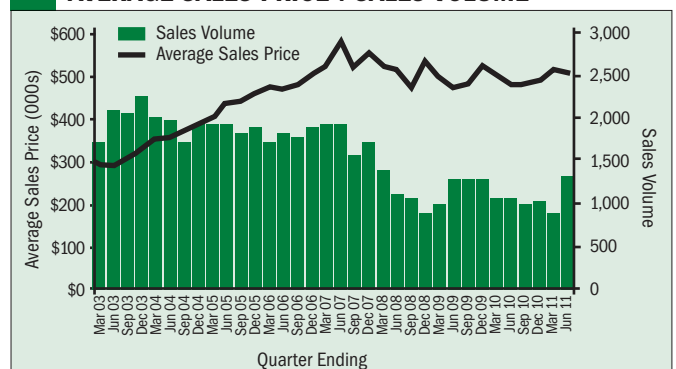
MEDIAN SALE PRICE PER HECTARE, JUNE QUARTER

Farm Type	2009	2010	2011
Arable	\$31,224	\$19,059	\$20,144
Dairy	\$29,720	\$32,609	\$30,828
Forestry	\$15,784	\$8,262	\$10,377
Finishing	\$13,138	\$3,632	\$7,591
Grazing	\$15,973	\$12,904	\$12,892
Horticulture	\$157,548	\$148,221	\$132,401
Special	\$55,846	\$14,923	\$23,684
Total All Farms	\$23,802	\$17,772	\$15,568

Source: REINZ

market a number of the major drivers are pointing towards a lift in activity, however from the current low volumes it is unlikely that this will have an inflationary impact on prices in the short term future. It is more likely that annual price movements will fluctuate between around -5% and 5% per annum, until such time as there is a sustained and significant lift in sales activity.

NEW ZEALAND LIFESTYLE MARKET AVERAGE SALES PRICE v SALES VOLUME



Source: REINZ, Bayleys Research

LIFESTYLE PROPERTY REVIEW

The benefits associated with investing in lifestyle property have held true throughout the economic downturn, with prices in this sector of the market holding up well, relative to other sectors of the rural market. Lifestyle property market trends indeed have tended to follow more closely those of the wider residential market.

The average sale price for national lifestyle property has held in a fairly narrow band since the September quarter of 2007. At that time the average sales price stood at \$555,230 and as at the end of the June quarter 2011 was sitting at \$544,130

The lack of value appreciation is a result of the low activity levels which have been prevalent in the market since March 2008. In the first quarter of 2007 total sales recorded reached 2,004 while over the next three month period 2,048 transactions were completed. Subsequent to that time sales volumes fell away and since mid 2008 quarterly sales volumes have fluctuated between approximately 1,000 and 1,300 transactions.

The June quarter of 2011 saw 1,386 properties change hands, the highest quarterly total since March 2008. As with the housing

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