RURAL

property Research

Annual 2015
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BAYLEYS RESEARCH

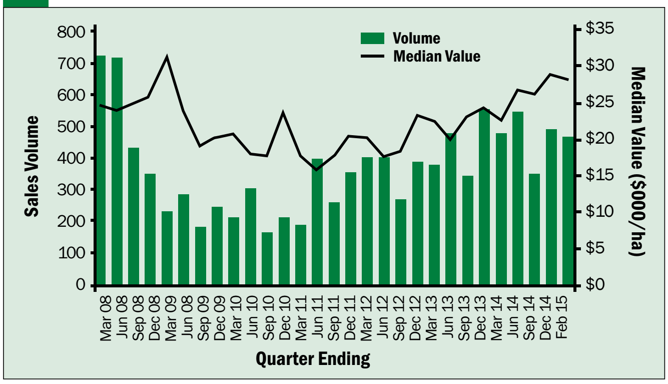
NATIONAL RURAL REPORT

VALUES FIRMING, ACTIVITY EASING

Despite a recent dip in activity, confidence in rural property remains high with values continuing to show solid growth.

The median "All Farm" sales value for the three months to February 2015 was $28,009 per hectare, up a very strong 24% over the same period last year. Values have continued to trend higher since mid 2011 and are now close to their pre GFC peak reached in early 2009 supported by the low interest rate environment which now seems likely to persist through 2016.

NEW ZEALAND FARM SALES VOLUME vs MEDIAN SALES VALUE

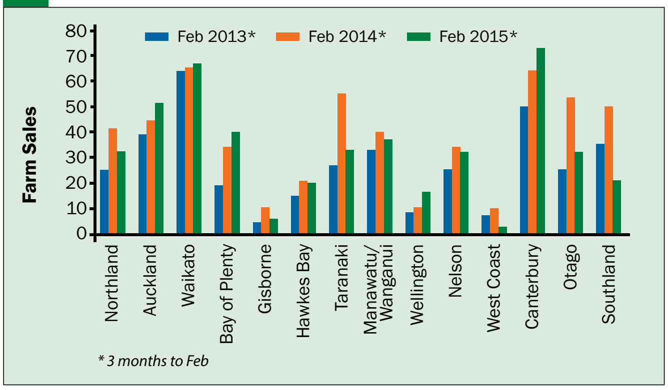


Source: REINZ, Bayleys Research

Prices across all the main farm types have increased when compared to the same period in 2014. Horticulture and arable land values over the past 3 months to February were up 99% and 76% respectively from the same period the previous year.

Five regions saw increases in sales volume for the three months ended February 2015 compared to the same period the previous year. Canterbury recorded the largest increase in number of sales followed by Auckland, Bay of Plenty and Wellington with an increase of six sales each. Recent sales across the country have seen rural prices surge for top grade farms. By way of example a buoyant market for top-of-the-line kiwifruit orchards in the Bay of Plenty saw median sales values for horticultural properties spike to $300,000 per ha compared to $131,250 per ha a year earlier. Busy localised activity in Taranaki saw a particularly strong dairy farm sale reach $77,000 per ha (excluding shares), while Waikato continued to record high levels of activity in the dairy sector.

NUMBER OF FARM SALES BY REGION



Source: REINZ, Bayleys Research

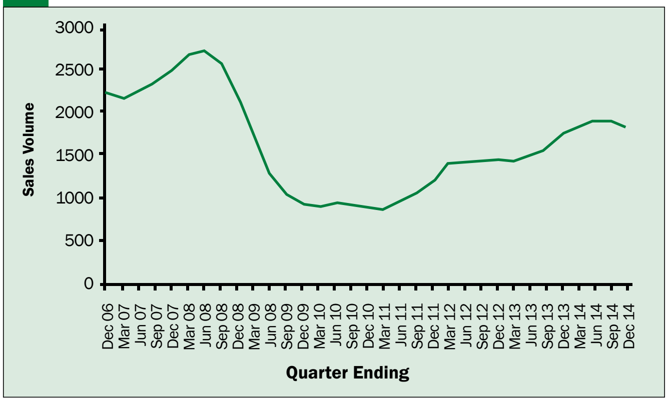
A shortage of listings is adding to the upward pressure on values. This is reflected in sales statistics released by the Real Estate Institute of New Zealand (REINZ) which show that since the second half of 2014 activity has eased. For the 3 months to February 2015 the total annualised number of All Farm sales dipped 13.9% to 1,779 compared to the same period in 2014. The tight market conditions are benefitting second tier properties which are experiencing an increase in activity.

NZ MEDIAN SALES VALUE PER HECTARE (3 MONTHS TO FEB)

Farm Type	Feb 2013	Feb 2014	Feb 2015	% Change Feb 14 to Feb 15
Arable	$30,452	$25,591	$45,000	76%
Dairy	$33,254	$34,499	$45,105	31%
Finishing	$19,029	$20,720	$22,186	7%
Grazing	$12,900	$14,444	$16,161	12%
Horticulture	$118,371	$133,125	$264,745	99%
Total All Farms	$21,951	$22,644	$28,009	24%

Source: REINZ, Bayleys Research

NEW ZEALAND FARM SALES - ROLLING ANNUAL TOTAL

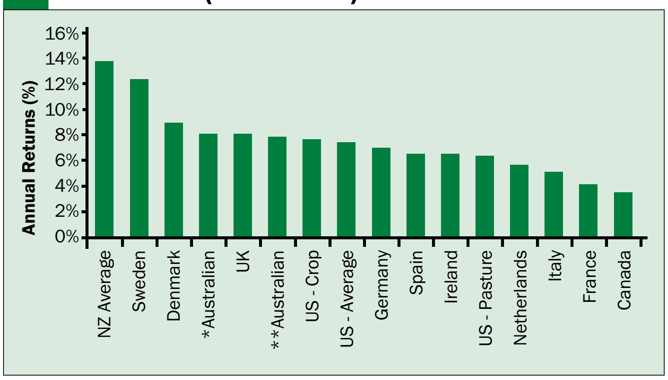


Source: REINZ, Bayleys Research

NZ FARMLAND PRICES OUTPERFORM OTHER COUNTRIES

Since 2000 NZ farmland prices have recorded an impressive 13.6% annualised growth rate based on research done by the ANZ. This is the strongest growth amongst a basket of 12 similar export competing countries and reflects a combination of factors including productivity improvements, conversions of land use to dairy/viticulture, irrigation developments, offshore interest, restricted supply of quality properties and low interest rates.

ANNUAL FARMLAND PRICE TRENDS SINCE 2000 (USD TERMS)



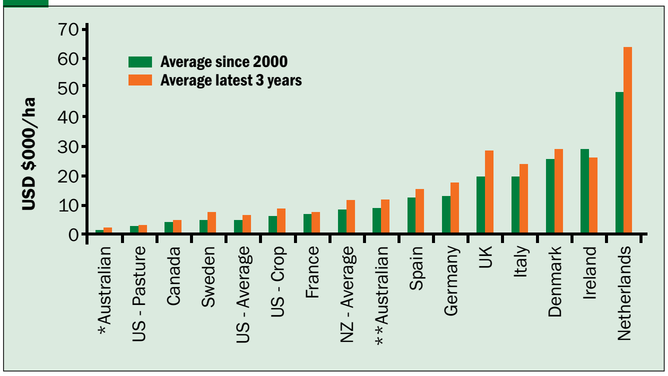
**Broadacre **Dairy* *Source: ANZ and various other*

Despite levels of value growth having outperformed other international locations New Zealand farmland prices remain in the middle of the pack. The most expensive country to buy farmland was the Netherlands with prices averaging US$48,000 per ha since 2000 followed by Denmark (US$25,200/ha), Italy (US$19,400/ha) and the UK (US$19,200/ha). New Zealand's average over this period was US$8,150 per ha. More recently, over the past three years, New Zealand's average moved to US$11,000/ha and currently prices reflect an average closer to US$15,000/ha.

Anecdotally the ANZ noted that quality properties recorded much higher rates of growth than the average, typically with price premiums of between 20 to 50%. Key attributes of better quality farmland included water access, excellent soil types, low pest/disease issues, favourable climatic conditions and good access to services and infrastructure.

On a risk/return basis New Zealand scored very well with the highest average returns since 2000 and only marginally extra risk

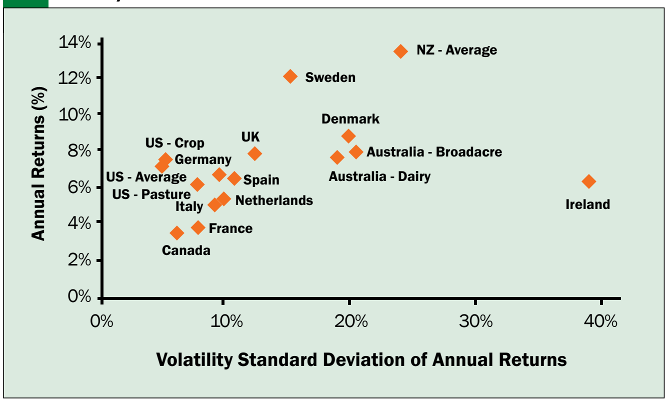
AVERAGE LAND VALUES



**Broadacre **Dairy* *Source: ANZ and various other*

when compared to the other countries. Ireland experienced the greatest volatility of returns reflecting the magnitude of the pre GFC property bubble in that country.

RISK/REWARD FOR FARMLAND SINCE 2000



Source: ANZ & various other sources

DISCONNECT BETWEEN VALUES AND FARMER CONFIDENCE

Despite higher farm values the latest Confidence Survey issued by Federated Farmers in January 2015 points to a continued deterioration in farmer sentiment regarding prospects for their own businesses profitability. Not surprisingly the worst affected were dairy farmers who are coping with a dramatic fall in international dairy prices from record highs achieved in the 2013/14 season. After dropping a significant 87 points in last July's survey, the dairy sector experienced a further 36 point fall in profit expectations to -71.4% at January 2015, the lowest level since the depths of the GFC. The negative sentiment has also spread beyond dairy. Confidence for Meat and Fibre weakened as sheepmeat and beef prices eased late last year and more recently the dry weather forced farmers to send stock to slaughter earlier thereby increasing supply and weakening prices. Grain and seed dropped 45 points reflecting growing concern about dry weather affecting production and dairy farmer woes impacting demand for supplementary feed. The pessimism about profitability flowed through to farmers spending intentions, with more expecting to reduce rather than increase spending.

There is no doubt current conditions remain very challenging for dairy farmers. Cashflows will come under increasing pressure following recent sharp falls in dairy prices, but there are some

CONFIDENCE SURVEY, OWN FARM PROFITABILITY BY SECTOR

	Jan-15 Improve	Jan-15 Stay the Same	Jan-15 Worsen	Jan-15 Don't Know	Jan-15 Net	Jul-14 Net	Trend Jul-14 to Jan-15
All Farms	16.3%	27.5%	54.8%	1.3%	-38.5	-4.3	▼
Dairy	6.4%	14.0%	77.8%	1.8%	-71.4	-35.2	▼
Meat & Fibre	27.1%	40.2%	32.2%	0.5%	-5.1	23.2	▼
Grains	9.1%	39.0%	51.9%	0.0%	-42.9	2	▼
Other	19.6%	41.2%	37.3%	2.0%	-17.6	46.5	▼

Source: Federated Farmers, Bayleys Research

mitigating factors. There has been a significant amount of capital investment by dairy farmers over the past few years which has increased productivity, improved efficiencies and allowed for a greater deal of flexibility to alter cost structures during leaner times. Importantly over-gearing is not a big issue. Farm leverage is heavily concentrated with around half the debt held by 20% of farmers as noted by the ANZ. Furthermore many of the larger corporate operators tend to have more balance sheet flexibility. Lower interest rates have also reduced interest costs. The upshot, so as long as dairy prices continue to recover and farmers remain forward looking to next season's profitability, they can expect to ride through this challenging period just as they did during the GFC and the severe drought of 2012/2013.

RECENT RAINS EASING DROUGHT FEARS

Recent dry conditions are affecting a number of regions around the country. Drought was declared in February 2015 on the east coast of NZ's South Island including parts of Otago, Canterbury and Marlborough, a region which accounts for just over a fifth of NZ's dairy production. The drought is compounding the challenges dairy farmers are already facing with weak international prices and is likely to lead to further downward revisions in nationwide milk production in the short term. The meat sector has also responded to the drought by bringing forward some slaughtering of stock which is flowing through to weaker prices.

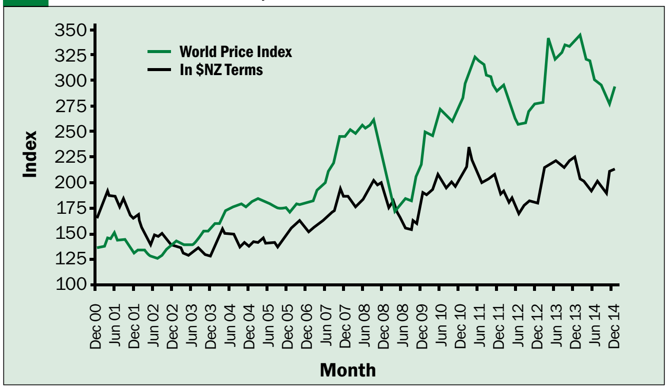
Thankfully rain has come to many parts of New Zealand, easing fears around the worst impacts of the drought. Although milk production continues to slow there is no evidence of a sharp contraction. In fact since the rains Fonterra has increased its auction volumes at its annual auction supply.

The increasing regularity of dry weather events will add urgency to water storage and irrigation schemes that are either underway or on the drawing board. In the North Island the controversial Ruataniwha Water Storage Scheme in Central Hawkes Bay is awaiting the outcome of a board of inquiry following a successful challenge by three environmental groups against the boards earlier findings to allow the scheme to proceed. In the South Island, the Lee Valley Dam in Tasman has gone to a consent process. In the key grape-growing region of Marlborough, which produces around 75% of New Zealand wines, there is the proposed Flaxbourne Community Irrigation Scheme. Should this scheme proceed it could potentially open up vast tracks of land south of Seddon for additional grape growing. Further south, in Canterbury there is the Hurunui Water project near Culverden which aims to build a weir in Lake Sumner to trap 27 million cubic metres of water and in mid-Canterbury plans to create a lake to hold an estimated 30 million cubic metres of water on Ruapuna farm land next to the Rangitata River (10km downstream from the RDR canal intake) are likely to move to resource consent stage by the end of 2015.

COMMODITIES – DAIRY FINDING A BASE

The latest ANZ Commodity Price Index rose by 4.5% in March 2015. This is the second monthly increase in a row following 10 previous months of negative price growth and was driven largely by an improvement in dairy prices, led by milk powders which were up 9.2%. However much of this improvement was a carryover effect into early March from the February rally in the global dairy trade (GDT) auction most of which has subsequently unwound. A more negative picture may come through in April's Commodity Price Index. On an annual basis the Index is down 12%, but remains high by historical standards. Outside of dairying, meat and fibre products improved while the other major sectors remain either flat or marginally softer.

ANZ EXPORT COMMODITY PRICE INDEX WORLD PRICE vs $NZ



Index (July 1986=100) *Source: ANZ Bank, Bayleys Research*

After rising almost 43% since the start of 2015, whole milk powder prices are now just 11% higher than as at the end of 2014 following the sharp price falls at the most recent GDT auction in early April. Lower dairy prices are expected to trigger lower dairy supply growth over 2015. Fonterra remains cautious and has retained its 2014/15 $4.70 milk price forecast citing continuing global oversupply, subdued China demand and flow-on from Russia's ban on dairy imports from 28 countries. The removal of EU milk quota's from 1 April 2015 will also be felt through 2015 and beyond. Although not a trade barrier any herd expansion in Europe will have an impact on New Zealand via higher global milk supply and increased competition.

On a more positive note moves within the dairy sector to speed up implementation of value-add strategies have the potential to deliver higher and more stable returns if executed well. Fonterra, in particular, has moved actively over the past 12-18 months to restructure a number of businesses and redirect joint ventures towards growing its consumer branded and food service products.

AGRICULTURAL EXPORTS: BOUNCING BACK FOLLOWING DOWNTURN

The latest Ministry of Primary Industry (MPI) Situation and Outlook for Primary Industries report points to a decline in overall primary industry export earnings to $34.6bn in 2015, 9.5% lower than a year earlier and due largely to an expected 23% or $4.2bn decline in dairy export earnings. This current weakness is expected to flow into the 2015/16 season with forecasts revised down to $36.1bn.

GROSS AGRICULTURAL REVENUE

YEAR TO JUNE 30 ($M)	ACTUAL 2014	FORECAST 2015	FORECAST 2016
Dairy	18,068	13,830	14,560
Meat and Wool	8,093	8,611	8,811
Forestry	5,144	4,822	5,021
Seafood	1,427	1,525	1,619
Horticulture	3,709	3,865	4,120
Other	1,790	1,951	1,973
TOTAL	**38,231**	**34,604**	**36,104**

Source: MPI, Bayleys Research

Beyond the dairy sector most other sectors prospects look solid. Beef prices, in particular, look set to remain relatively high for the next two years as a result of increased US demand following severe droughts in 2014. Opportunities also exist to increase beef exports in other markets such as Australia where extensive herd culling occurred last year. A recent Meat Industry Excellence (MIE) report which came out heavily in favour of a single co-operative business model similar to Fonterra's to deal with issues such as overcapacity and too much competition for stock has the potential to generate significant cost savings for the industry if the recommendations in it are implemented.

The seafood sector is expected to show further growth in both price and volumes over the next two years, especially for top earners such as rock lobsters , mussels and salmon with China the largest market for New Zealand seafood products, followed by Australia, the EU, and the USA. Although the forestry sector commodity cycle is expected to soften over 2015 it is likely to recover in 2016 led by a shift in product mix targeting higher value markets and expected increases in demand from China.

MPI is forecasting horticulture export revenue to rise by $156m to $3,865m in 2015 led by the recovery of the kiwifruit sector with a big pick up in Gold production. The swift rebound from a devastating Psa virus outbreak in 2010 underscores the industry's sound management and rapid response to the problem. With over 4,000 ha of Gold3 maturing, large production increases can be expected over the next few years. MPI numbers suggest production volumes in the order of 50 million export trays by 2017, compared to 11 million in 2013. The challenge will be to maintain high prices as export supply rapidly increases.

Lower 2015 yields are likely to prove a blessing for the wine industry where concerns that excess stock from a bumper 2014 vintage could lead to capacity issues have been allayed. This has helped improve sentiment for bulk wine prices and means grape pricing for 2015 is likely to be similar to 2014. Statistics NZ estimates that between 2002 and June 2014 the area of land planted in grapes almost doubled from 17,300ha to 34,130ha with most occurring in Marlborough. Grape growing and wine making accounted for a significant $428 million or 19.9% of Marlborough's GDP for the year to March 2014.The wine industry is now the country's sixth-biggest exporter with earnings up 8.2% last year to $1.37 billion.

Historically the prospects for rural property closely track those for commodity prices and longer term these remain very positive. A growing global population, increasing urbanisation and rising incomes will ensure strong demand for agricultural products going forward, especially high value animal protein. The recently concluded free trade agreement (FTA) with our fifth largest trading partner, South Korea, should provide a further boost to the long term prospects of the rural sector. The agreement will put New Zealand on a level playing field with its competitors in this fast growing North Asian market. The main winners are exporters of kiwifruit, wine, beef and dairy as follows:

- 15% tariff off wine immediately
- 45% off kiwifruit over 6 years
- 89% off butter over 10 years
- 36% off cheese over 12 years
- 10% off wood products within 10 years
- 40% off beef over 15 years
- 20% off salmon in 4 years

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