Erskine + Owen Quarterly Update September 2021
Forecast like Federer

Why Analyse the Property Market?
Federer I am sure practises visualisation – in his minds eye he creates a video of himself returning a smash, a drop shot, a volley…and gracefully placing it down the line in the back corner of the court. The key is that he focuses on visualising his own actions, because that is what he can control. What he can't control is where Jokovich or Nadal hit the ball. So he won't spend time visualising the opposition action. Once on the court, he will anticipate, but he won't charge off until he is pretty sure where it is going.

Economists seem to get caught up with telling us you can't predict what the property market will do, and that it's an art, and there are a range of factors you have to think about and weigh up, and then there are large unpredictable events that can blow any prediction out of the court.

No kidding. Isn't that like saying it is very difficult to predict where Jokovich is going to hit the ball because of a bunch of different variables? Duh.

I think they are missing the point. The purpose of analysing the property market, in our opinion is not to predict where the market will go. History tells us that that over the long term property prices largely go up and sometimes there are corrections of usually no more than 10%, then a flat period, and then another period of price rises. We personally bought two properties just before the GFC for about $350k each. We sold them years later and were not dissapointed. If we were holding them now – would we be unhappy?

Rather, in our opinion the purpose of analysing the market is to understand

1. If there are any majors that we need to be aware of so we can adjust the sails accordingly. We don't ignore a storm, we analyse it to decide if we should fundamentally change our strategy to protect against damage, loss, doom.
2. Or…does it present some opportunity that we should take advantage of?

What is success? Having a goal, knowing where you are and moving towards it. All clients we buy for, the first question is what is your goal. The goal informs the strategy. Your property goal (you do have one don't you) will be about achieving X amount of wealth or passive income….or should be. So let's remind ourselves of the goals so we are focused on the right things, so we don't get caught up in analysis for analysis' sake.

And now the strategy – is there anything about your property investment strategy that should be adjusted given current market conditions? Again – over the long time we are very confident about the market in general – so let's forget about predicting where prices will go. Right – let's go:

Residential

	Driver	Commentary/ Consideration	Action
Demand	**Population growth**	Immigration is obviously all but shut off at present – but that is temporary. And…we know that demand has come from other quarters – e.g. Kiwis returning with big bonuses. If New Zealand doesn't open up when rest of world does – will we lose the expats that returned – and will that dampen demand. Probably impacts higher end property more. Prices may not slide, but the growth may taper in this event.	**Defensive** Consider not investing in higher end property for investment purposes if NZ COVID strategy out of step globally **Opportunity** Property in areas HNW individuals want to buy…e.g.Queenstown, Hawkes Bay
	Interest rates	On the rise…probably…but many think not by much more than 1.5%. Still a whole lot cheaper than the days of 6% - 8%, which did not by itself shut off demand. Not a massive threat in our opinion.	**Defensive** Consider fixing for longer term? **Opportunity** Buy now to borrow more and lock in what may in 3 years time be a cheap rate?
	Tax	Bright line test to 10 years and non deductibility of interest (see other article in this newsletter about interest non-deductibility). We think it has already had an impact and investors are pausing. However, remember how depreciation used to be allowed as a tax deduction – but National ruled it out? I only vaguely remember. I moved on like most investors and don't even think about it. That will happen to brightline and non deductibility of interest as well. People will just move on and start doing their analysis without thinking about it. So medium to long term not a game breaker.	**Defensive** Check tax structure appropriate **Opportunity** Read our article on buy new versus existing

	Global Event	Starting a property business in the exact month the GFC hit gave us a firm view on global crises. They will bring about a lot of change, some carnage and a lot of opportunity. However, fundamentally things will not change. This lock down could be the straw that breaks the camel's back for some businesses – it may finally result in a lift in mortgagee sales. It may flatten off the exuberance for property. However the sky is not falling. During the GFC it felt like the sky was falling – both globally and in my house. Dark times. Almost 15 years later the business has grown astronomically from what it was, my wife still loves me, our property portfolio has grown. This too shall pass. I will certainly not be selling in fear of falling house prices. I am a long-term investor. If prices fall – it could be 10% - so what, I am confident the recovery will be there.	**Defensive** Make sure you can weather a 10% drop in prices. Don't need to sell – just make sure you are not so highly leveraged that a 10% drop in prices will put you outside bank covenants **Opportunity** Vendors looking to lighten the load quickly. To take advantage of that you need to have buying power. So get buy ready. Talk to us if you need finance sorted.
	Affordability	More unaffordable than 12 months ago. However the question really is what is more unaffordable and for whom? A 3 bed weatherboard home on Great South Road in Manurewa with Terraced house zoning has become unaffordable for any home owner in that suburb I would imagine. But not really relevant – that house will become 6 or 8 or 10 and each terraced house may well be affordable, and more appealing for first home buyers. Talking about affordability at a national or even broader range.	**Defensive** Are there properties you have held for a long time that have become unaffordable for most? Only sell if you are looking for optimal capital growth so you can reinvest in higher capital growth assets **Opportunity** Fish where the fish are – first home buyers. Talk to us for more info.
Supply		Chance of over supply that will eclipse demand and flatten or depress prices for years until demand catches up? E.g. Ireland during GFC? It almost seems ludicrous asking that question. RMA, rapidly rising building costs. In our opinion, no chance.	**Defensive** Can't see the need for any defensive action here **Opportunity** Buy where the next supply constraint will occur. Talk to us for more.

Commercial

Aspects of the residential analysis is useful to consider for commercial investment. This analysis is focussed on types of commercial

	Commentary	**Consideration**
Industrial	Still the darling of commercial property. However, COVID shows that simply buying industrial does not mean risk free.	**Defensive** Adjust for properties in industries that are negatively impacted longer term from COVID? What is cost to sell now versus a reconfiguration? Auckland A grade industrial properties are eyewatering but perhaps not on an international stage and don't buy in Auckland out of desperation. If you are going to pay sub 4%, do thorough tenant DD and make sure that there are very good rent review mechanisms. **Opportunity** Compromised tourism properties that can be easily repurposed?
Office	We don't think office is dead. It is like saying people won't want to meet face to face any more – ever. We are humans. What COVID has done is perhaps accelerated flexi working…but perhaps not as much as people think	**Defensive** Stay in touch with tenants. Who is looking to downsize? Who is in trouble? **Opportunity** B grade offices that can be reconfigured to suit post COVID working styles?
Retail	If you can afford to build or own a brand-new shiny mall in Newmarket you probably aren't reading this. Big box retail…not going to fall over, I don't think…but needs to be compelling. Tenants are probably quick to put hand out for rent abatement in lockdowns.	**Defensive** High street retail – any tenant better than nothing? **Opportunities** Distressed sale of vacant high street. Has it got future development potential – e.g. apartments?

To conclude, Federer does not try to forecast where Jokovich will hit the ball before he goes on court – he plays the ball in front of him. So should we – let's not sit on the side lines, let's get on with playing the game and simply deal with what is in front of us. Federer will visualise and feel the feeling of winning. Let's feel what is like to have conquered our Covid fears and chosen to have acted powerfully, with civic purpose and wisely.