



INVESTMENT RETURNS AND EXCHANGE RATES

Timing is everything for foreign investors

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SUMMARY For local investors the property market is forever challenging and difficult to predict with market conditions changing within a time frame of just a few months. However, the challenge is even greater for foreign investors who have to factor exchange rate risk into their investment decisions. Historic trends suggest that timing is everything when dealing with this added risk.

INTRODUCTION

Historic trends show that exchange rate fluctuations have substantial impacts on returns from New Zealand property investments by foreign investors; periodically either negating or enhancing returns in NZD terms.

In this report we analyse the investment performance of the New Zealand market from the perspective of a number of major currencies with current and historic exposure to the New Zealand property market.

We have based our analysis on Auckland Prime CBD office data and although this is aimed at the top end of a particular market sector, the trends shown apply to the broader property market. Currently, the Prime CBD office market is comprised of a majority of local owners, with foreigners owning 10 of the 31 Prime CBD buildings dominated by German and Australian entities.

MARKET VS EXCHANGE RATE PERFORMANCE

Yields provide a good indication of investment market performance. A graphical comparison and statistical test between historic yields and exchange rates for various currencies indicate that there is a negative correlation between these two variables.

This negative correlation means that when the dollar is down, yields are up and vice versa. Therefore, when foreign investors are getting the benefits of a weak New Zealand dollar they are also purchasing property at cheaper prices with high yields. However, when the dollar is strong, yields are down and therefore foreign investors find it expensive to invest in the New Zealand market.

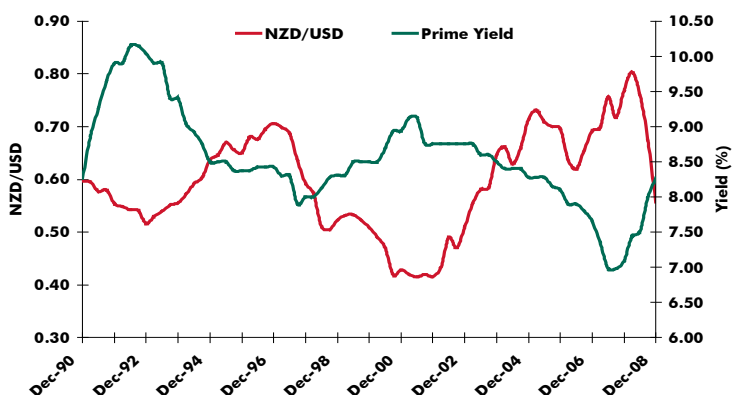
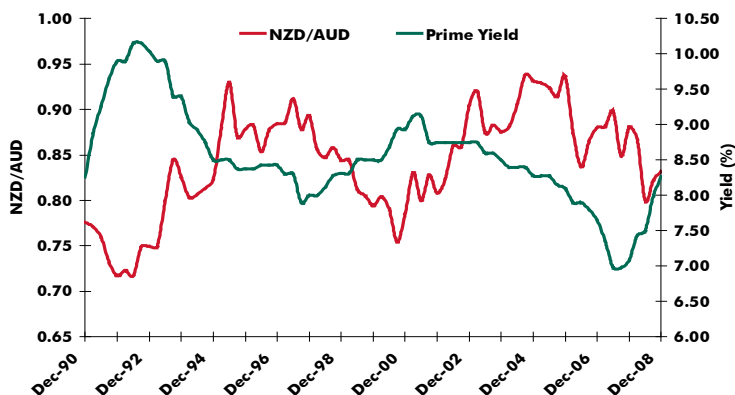
The Australian Dollar and US Dollar show the strongest negative correlation so therefore will follow the trend more closely although, compared to the US dollar, the Australian dollar has shown more volatility against the New Zealand dollar.

Exchange Rate and Yield Correlation Coefficient

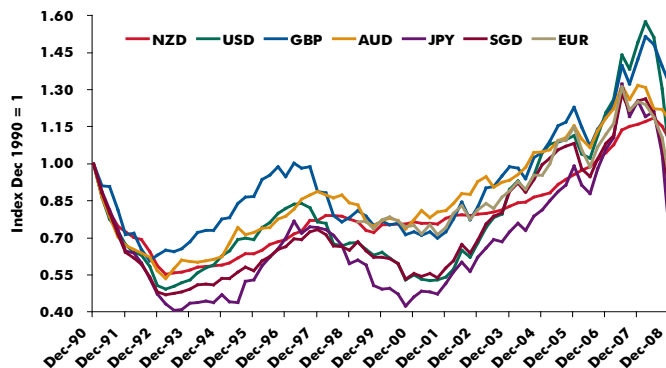
	Correlation*
NZD/USD	-0.62
NZD/GBP	-0.37
NZD/AUD	-0.71
NZD/JPY	-0.55
NZD/EUR	-0.51
NZD/SGD	-0.57

*Correlation is based on a smoothed yield and exchange rates

Historical NZD/AUD & NZD/USD Versus Yield



Foreign Investor Capital Values In NZ Property



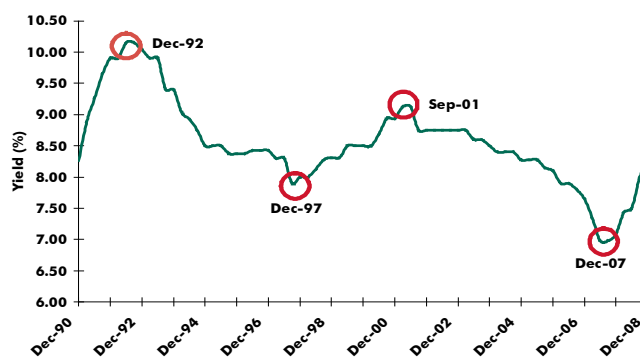
The value of each currency relative to the NZD at the above chart's start date influences the actual values for the duration of the chart's time frame, therefore more attention should be made to the slope of the lines than the actual values. NZD returns show a relatively flat line compared to the foreign currencies. The steepness of the foreign currency lines show that larger gains are made during a growing market, however larger losses are made during a declining market. Detailed analysis at smaller time frames shows how large the gains and losses can be.

A COMPARISON OF CAPITAL GAINS FOR FOREIGN AND LOCAL INVESTORS

For foreign investors, the compounding effect of currency and yield means that the timing of market entry and exit is more important than for local investors. Bad timing can not only mean capital depreciation, but also currency depreciation, resulting in a heavier loss. But on the upside, a good or fortunate timing will mean capital appreciation as well as currency appreciation.

We can compare the capital value gains and losses that foreign investors have experienced historically compared to local purchasers to show the elasticity of their movements. The charts are hypothetical as the prime CBD office sector's ownership profile hasn't included all currencies shown, but it provides a valid comparison and can be applied to other sectors. Please note the euro was introduced in 1999.

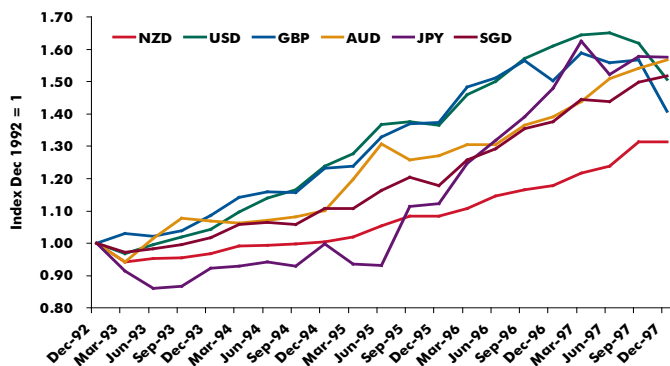
Auckland Prime CBD Yield Turning Points



The following examples provide an indication of how prime CBD property performed if purchased at the start of each yield turning point during a property cycle. Auckland CBD prime yields peaked around June-September 1992 and started to decline in December 1992. The market gradually improved until December 1997 when

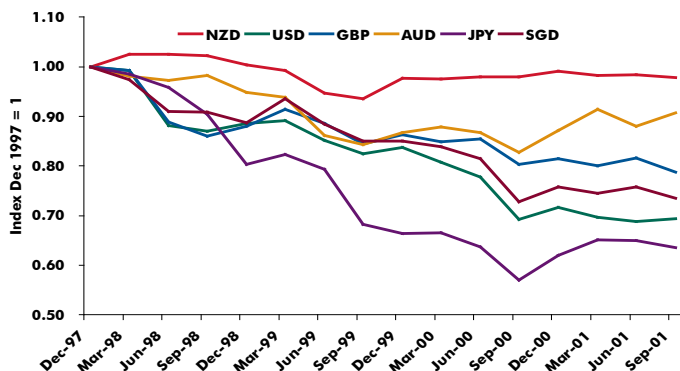
yields started to soften. During this 5 year period Japanese purchasers would have outperformed all other currencies in terms of capital growth, with 9.5% compounded capital value growth per annum. Closely followed were Australian purchasers with 9.4% capital value growth. Local purchasers performed the lowest with 5.6% compounded capital growth per annum.

Capital Gains In NZ Property Dec-92 to Dec-97



Yields started to soften in December 1997 and the market declined until September 2001. Throughout this period, locally based owners suffered moderate declines in capital values. Far worse were foreign investors, with Japanese purchasers in particular losing 11.4% of their investment's capital value annually during this period if they had invested at the peak of the market.

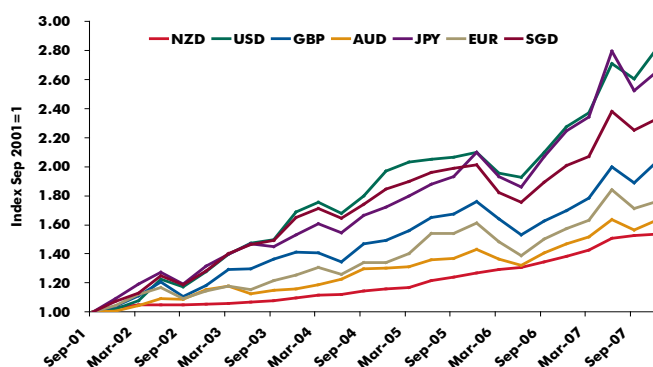
Capital Losses In NZ Property Dec-97 to Sep-01



THE CURRENT CYCLE

The most recent surge in the market began in September 2001 and continued through to December 2007. During this period capital values in NZD terms increased by 7.1% compounded per annum. However, foreign currency based investments in local property greatly out performed this. US investors would have made an 18.0% per annum capital gain over this period, closely followed by Japanese investors with 16.9% capital gain per annum.

Capital Gains In NZ Property Sep-01 to Dec-07



The market reached its peak in September/December 2007 and by March 2008 the New Zealand Dollar also began to fall against the other currencies. The table below shows the relative returns for NZD and foreign currency based investors through the overall cycle as well as the boom and bust parts. Over the whole cycle to date this indicates that investors in USD terms would have done the best.

Summary of Gains and Losses Over the Most Recent Property Cycle Sep-01 To Dec-08

	Sep-01-Dec-07		Dec-07-Dec-08	Sep-01-Dec-08
	Capital Gain p.a*	Total Capital Gain	Total Capital Gain	Total Capital Gain Over Cycle**
NZD	7%	53%	-6%	45%
USD	18%	181%	-32%	92%
GBP	12%	103%	-7%	89%
AUD	8%	62%	-11%	46%
JPY	17%	166%	-44%	48%
EUR	9%	76%	-26%	30%
SGD	14%	133%	-30%	63%

*compounded annually

**these capital gains are to Dec-08, however the cycle is still continuing

FUTURE IMPLICATIONS

From historical trends we can see the inverse relationship between property market trends and some exchange rates which amplify risk and return from New Zealand property for foreign investors. The New Zealand Dollar is currently low and yields have been climbing steeply which indicates that the market is moving towards a good time for foreign investors to buy into the New Zealand market.

For buyers entering the market, accurately predicting peaks, troughs and when the market turns is important, and for foreign buyers timing is even more vital. Precisely timing the market is difficult given the dual uncertainties associated with forecasting property values as well as exchange rates. Any further deterioration to these will cause greater grief to foreign owners than local owners. However, when the market rebounds, foreign owners could benefit from exceptional capital gains.

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