

# INVESTMENT IN NEW ZEALAND

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In recent years, the New Zealand economy has undergone dramatic change, with moves designed to reduce inflation, increase international competitiveness and liberalise the economic environment. In the short term (1984-7) these policies, together with tight monetary control, led to high inflation, interest rates and unemployment and dramatically affected the productive/exporting sectors (farming and manufacturing). Over the same period there was a property and investment boom which ended with the October '87 sharemarket crash. The resulting recession was compounded by political uncertainty.

The government has committed itself to policies that are anti-inflationary and which will reduce the budget deficit. Despite this, and good economic indicators, until recently business confidence has been low and banks have been reluctant to invest. However, this trend is now reversing, with clear signs of a recovery from the recession: low inflation, lowering interest rates, a trade surplus and a projected budget surplus in the 1990-91 financial year.

Under a 1983 treaty, New Zealand has a special economic and trading relationship with Australia, known as CER (Closer Economic Relationship) which gives preferential access to the other country's markets. By mid-1990 each country's exports will have tariff-free entry.

All these factors, combined with low prices, have attracted overseas investment which is welcomed by the government and is subject to liberal approval criteria. Tax and interest rates are lower than Australia. Foreign investment has been welcomed into almost every area of the New Zealand economy. In recent times, energy production, forestry and fishing have been of particular interest, but others have also attracted interest. There are no foreign exchange controls; and all capital and profits can be repatriated to the investor's home country. Import controls are being eliminated and tariffs significantly lowered. The liberal business and regulatory environment encourages free competition. Overseas advisers and brokers are currently bullish on the New Zealand investment environment.

Agriculture is New Zealand's great strength and, with more realistic values than in the past, represents a very good long term investment, both directly and in the supporting infrastructure. Fishing is another important niche sector that offers good returns and has attracted many overseas companies into joint ventures with New Zealanders. The forestry industry is among the most efficient in the world; and the sale of the government's forestry assets offers excellent investment opportunities, possibly in partnership with local forestry companies. On a population basis, New Zealand is energy rich; exploration opportunities abound, and the sale of Coalcorp is an excellent chance to buy into a major resource.

Select manufacturing opportunities exist, but only in companies with a very strong domestic position and/or niche export markets or those that take advantage of freer access to Australia under CER. Tourism has considerable long-term potential and is attracting overseas investors.

The property market is at the bottom of a cycle and offers good yield investments in quality well tenanted CBD buildings and waterside residential properties. Industrial properties should be avoided. Sound farm land investments now show a good return.

The share market has recently been under-priced; but price levels have risen over the past two months. Because of small trading volumes, secondary stocks should be avoided even if they have attractive earnings. Major stocks, in companies with international earnings and/or which are traded on world sharemarkets, can be good long term investments. Opportunities exist for placements by larger or institutional investors<sup>2</sup>.

Some sectors (particularly leisure and tourism) will benefit if the America's Cup is sailed in Auckland in 1992; but overall reaction to the economic impact of this event has been justifiably cautious. The greatest benefits are likely to be the resulting international publicity and a further rise in business confidence to accompany the good economic indicators.

The overall investment climate is unlikely to alter adversely if there is a change of government at next year's election. It is the widespread view of economists that New Zealand is now entering a period of gradual economic recovery.

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## INTRODUCTION

New Zealand has always been attractive to foreign investors. It is a stable, democratic country; has a western culture and values; and is part of the world's fastest growing economic region, the Pacific Basin. Its people enjoy a high standard of living; it has a well educated work force; and, while its traditional wealth has been built on the export of primary produce, it also has major natural resources that can support industries in horticulture, fishing, forestry, energy, manufacturing and tourism; and has an increasing reputation for the export of services.

In recent years, the New Zealand economy has undergone dramatic change, with moves designed to reduce inflation, increase international competitiveness and liberalise the economic environment. A number of policy initiatives were undertaken to create a more competitive economic environment. With the overall objectives of reducing inflation, removing distortions from the local market, liberalising the business environment and increasing New Zealand's international competitiveness, major moves included:

- (a) Floating the New Zealand dollar (in March 1985) and the removal of all foreign exchange controls.
- (b) The removal of most tariffs and import controls.
- (c) The signing of the Australia New Zealand Closer Economic Relationship (CER) Treaty and a subsequent acceleration of the free trade arrangements under that treaty.
- (d) Major tax reform, including the introduction of a value added type tax known as Goods and Services Tax (GST).
- (e) Removal of farming/agricultural/horticultural subsidies; and the progressive removal of most other export subsidies.
- (f) Liberalised foreign investment policies.
- (g) Increasing competition in the financial services sector including licensing a number of new banks.
- (h) Deregulation of road, rail and air transport and reform of port operations.
- (i) Providing statutory independence for the Reserve Bank of New Zealand (the country's central bank) and giving top priority to the bank's role in combating inflation.
- (j) Reform of the public service.
- (k) Corporatisation and the subsequent privatisation of many state trading departments.

These policies were accompanied by very tight monetary control for the purpose of achieving the government's major stated objective of reducing inflation.

As in other countries, in the short term (1985-1987) these policies had a number of negative effects including substantial increases in interest rates, inflation and unemployment and an over-valued New Zealand dollar (NZD) - which rose by 33 percent between December 1984 and June 1988. Emigration rose with a consequent loss in job skills. Farm values fell very significantly (some by more than half) from levels that were widely regarded as inflated, and some debt-

<sup>2</sup> The material in this paper is for information only. It is not intended to provide formal advice on the issues covered, nor should it be used as the basis of any investment decision. It is intended only as background information. While every care has been taken in the preparation of the contents, no responsibility can be accepted for any errors. Any person contemplating investment or other action in the areas dealt with in this document must conduct his, her or its own inquiries and/or due diligence.

ridden farmers were forced off the land. A number of manufacturers, who had previously operated in a protected domestic environment, also went out of business or transferred some of their activities to importing, or even started manufacturing overseas (notably in Fiji or South East Asia). Overall, with both primary and secondary producers unable to overcome the disadvantages of an high interest rates and an over-valued dollar, profits in the export/tradeable sector dropped dramatically.

High interest rates constrained growth in the productive sector (and, indeed, caused many business and farming failures) and imposed real pressure on most other sectors of the economy.

Over this same period (1984-1987), and despite high interest rates, both the share market and property market entered a growth phase which was marked by rapid corporate expansion, particularly by property and investment companies, numerous mergers and acquisitions and substantial increases in the prices for commercial, industrial and residential properties. Outside of the export/tradeable sector, and away from rural and provincial areas, boom conditions prevailed.

## RECESSION

This boom ended abruptly with the share market crash of October 1987. The Barclays Share Price Index fell to nearly half its pre-crash high of nearly 4000; and all real property prices began to fall (see below). Substantially *overheated* before the crash, of all the share markets in western countries, the New Zealand market was the slowest to recover. All sectors of the property market suffered a significant downturn.

As a consequence, in late 1987 the New Zealand economy went into a recession which saw a drop in consumption, further rises in unemployment and the failure of a number of the publicly listed investment and property companies whose rapid growth had fuelled the earlier boom. Several banks that had made substantial loans to such companies reported heavy losses and/or bad debts, although none have collapsed. During this period many private companies also failed. There was a serious loss of business confidence. In 1988 these conditions were further complicated by the government's internal political problems.

## INFLATION DOWN

At the same time, by the second half of 1988, inflation had started to fall and interest rates were also tracking downward (although not as fast as many had hoped). The budget deficit for the 1988-1989 fiscal year had been reduced to only two percent of Gross Domestic Product (GDP), significantly lower than in many other OECD countries. Farming returned to profitability.

The New Zealand dollar exchange rate (particularly against the Australian and US dollars and the Japanese Yen, the currencies in which New Zealand conducts most of its trade) eased back to more realistic levels. Combined with improving terms of trade, which are at a fifteen year record level high (as a result of rising commodity prices, increased export volumes, reduced domestic consumption of imported goods and lower oil prices), there was a significant reduction in

New Zealand's balance of payments (trade deficit); indeed there is now a trade surplus, the first for many years.

In terms of broad economic objectives and management, the Government has committed itself to:

- (a) A reduction in the budget deficit of around NZ\$1.5 billion, to one percent of GDP in the 1989-1990 fiscal year; and a promised real budget surplus in 1990-1991.
- (b) expenditure reductions.

### GOOD INDICATORS

With the exception of unemployment, which (despite recent reductions is regarded as temporary<sup>3</sup>) is projected to continue to rise throughout 1989 and perhaps into 1990, all New Zealand's major economic indicators (summarised in Appendix 1) now point in the right direction:

- (a) At 4.4 percent, inflation is below that of New Zealand's major trading partners (including Australia).
- (b) The budget deficit is under control and should show a surplus in the 1990-1991 financial year.
- (c) The trade account continues to improve.
- (d) Contrary to the trend in New Zealand's major trading partners, interest rates (which, while still too high, are already lower than in Australia) are projected to move down.
- (e) Growth while not high (being projected at around three percent by March 1990, and rising to three to five percent in the early 1990s) is better than in many countries and is certainly an improvement over the negative growth of recent years.

The situation in the productive sector continues to improve. With current high commodity prices, in some sectors, farming can now show returns of more than ten percent. In 1988, manufacturing improved its competitiveness against Australia (its major market) by one third.

### CLOSER ECONOMIC RELATIONSHIP WITH AUSTRALIA

In 1983, New Zealand and Australia signed a Closer Economic Relationship Treaty (CER), a form of free trade agreement. Under CER, trade in goods (and most services) between the two countries will be completely free by 1 July 1990; thereby giving each country a market of 19 million people. A recent Australian government report projected that New Zealand would gain NZ\$1.1 billion annually from CER, whereas Australia would gain NZ\$855 million. Statistics show that, with its slightly lower wage rates and lower valued currency, New Zealand has benefited greatly from CER; which is now attracting foreign investment into manufacturing, thereby giving the investor free access to the Australian market. Moreover, some Australian manufacturers have established operations in New Zealand to take advantage of the complementary aspects of CER.

The prospects of even closer co-operation between the two countries cannot be discounted. For instance, last month, the New Zealand Prime Minister Rt. Hon. Geoffrey Palmer, acknowledged<sup>4</sup> that the issue of a common (or at least linked) currency would have to be addressed.

<sup>3</sup> Although a recent report by the Business Economic Research group (BERL) suggests that, following the Budget Statement, future rises may not be as great as previously expected: NZ Herald 11 September 1989.

<sup>4</sup> Interview Channel 9, Sydney, 27 August 1989.

### RECOVERY

As a result, economic commentators, including the country's central bank The Reserve Bank of New Zealand, believe that a recovery period has now commenced.

A very recent report<sup>5</sup> suggests that, by March 1991, investment will be rising by five percent per annum; and that "the rate of growth in domestic demand and activity is projected to increase through calendar 1990, and to close in conditions approaching a boom".

Surveys of business confidence<sup>6</sup>, which remained consistently low throughout 1988 and the early part of 1989, now show much greater optimism; and specifically that inflationary expectations have stabilised that business confidence has risen for the fifth consecutive month; that there is an expectation of increased business activity over the next twelve months; and that, with increased political stability and lowering interest rates, increased investment is also expected.

### OVERSEAS INVESTMENT

Thus, there are now clear signs of increased local investment in the New Zealand market. But surprisingly, the message about recovery in the economy was heard first by overseas investors rather than by local interests; this overseas investment activity was increased by local reluctance to invest which had held prices at artificially low, and therefore attractive, levels. One Australian broker<sup>7</sup> reported in June, that since 1987, foreign companies have invested more the NZ\$6 billion in New Zealand. Overseas takeover activity has more than doubled in the past three years; and overall foreign investment in New Zealand has trebled<sup>8</sup>. Since the beginning of 1989, overseas institutions have led the resurgence of the share market; the Stock Exchange estimates that this year alone overseas interests were responsible for 30% of all buying on the New Zealand market<sup>9</sup>.

Over the past two years, overseas investments in New Zealand have included:

- (a) Sale of Feltrax to BTR Nylex in Australia, and sale of New Zealand Steel to an Australian-led consortium.
- (b) Sale of Postbank to the Australia and New Zealand Bank.
- (c) Sale of Air New Zealand to a consortium with thirty five percent overseas interests (principally Qantas Airways).
- (d) A number of Japanese and Taiwanese investment in Auckland Central Business District (CBD) properties, and in other tourism properties.
- (e) Salomon Brothers (USA) twenty percent investment in the Development Finance Corporation;
- (f) Investment by US and UK financial institutions in the New Zealand bond market (particularly in anticipation of a fall in interest rates).
- (g) Sale of Barclays Bank New Zealand, NZ Shipping Corporation, NZI Corp and Cerebos Greggs to UK interests.
- (h) Bank of Scotland's forty percent investment in

<sup>5</sup> Business Economic Research group (BERL). NZ Herald, 11 September 1989.

<sup>6</sup> National Bank of New Zealand Survey, August 1989.

<sup>7</sup> New Zealand - Should You Invest There? Ord Minnett Securities (Sydney).

<sup>8</sup> Management Magazine, August 1989.

<sup>9</sup> Management Magazine, August 1989.

Countrywide Bank (with General Assurance taking a further 20%).

- (i) (Australian) Commonwealth Bank's acquisition of a 75% interest in ASB Bank.

[It should not be assumed that this activity is all one way. New Zealand companies such as Fletcher Challenge, Carter Holt Harvey, Goodman Fielder Wattie, Lion Nathan and Brierley Investments have all been on the international acquisition trail, and have very substantial investments, and therefore income streams, in other countries.]

## OVERSEAS ADVISORS BULLISH ON NEW ZEALAND

This interest has been compounded by recent favourable reports by overseas (mostly Australian) investment advisors regarding the New Zealand economy and its current suitability for investment.

For instance, improving economic fundamentals recently prompted Merrill Lynch (USA) to describe the New Zealand bond market as *one of the most attractive for United States institutions*<sup>10</sup>. With the exception of Canada, New Zealand was described as having the best fundamentals of a number of countries including Australia and Britain. And, in the same article, Salomon Brothers described the New Zealand sharemarket as being *very strong* and said that they expected it to *go up*.

A major firm of Sydney (Australia) brokers<sup>11</sup> reported on the recent bullish run on the New Zealand stock market which it attributed to:

- (a) The policy stance outlined in the July Budget Statement.
- (b) Increasing reports of a recovery in the economy.
- (c) A perception that, in relative terms, the NZ market was undervalued not having yet recovered from the October 1987.

And a June 1989 report<sup>12</sup> by another Sydney firm concluded that New Zealand is *slowly emerging from a deep recession (the worst they said is over)*; that *(t)here is a significant window of opportunity to invest in New Zealand now (their emphasis)*; and that this window could close *given continuing improvement of economic fundamentals*.

That report said that, despite restructuring, New Zealand, which, in its own right, is a small market, remained primarily an agricultural exporter; this sector and natural resources were the country's *natural advantage*. Noting that the market has most probably seen the worst of the corporate collapses which marked 1987 and 1988, the report recommended that certain basic investment principles should be observed, including recognition of shore-term risk and adoption of a long-term investment horizon.

Similarly, a paper by Mr D Chan (Managing Director of Fidelity International in Taiwan)<sup>13</sup> identified a number of reasons why overseas interests should consider investment in New Zealand:

- (a) Political stability, including the fact that *the political power base is seen to be supportive of industry and commerce*.
- (b) Economic freedom, describing New Zealand as now *'having one of the most open, least regulated economies and free business environments in the world.'*
- (c) Geographical position, particularly in financial

markets, where New Zealand's is the first market to open each day.

- (d) Resources, noting that, *'by international standards, New Zealand is endowed with rich resources'* particularly in the pastoral (agricultural), fishing, forestry, energy, horticulture, foodstuffs and tourism sectors.
- (e) Close links with Australia, under CER.
- (f) Business infrastructure, with good transport, communications, education, availability of labour, and industrial relations.
- (g) Business environment, where business is conducted in English, the international business language, and with an increasingly sophisticated financial sector.
- (h) A competitive taxation system.
- (i) A good living environment.

Overall, Chan predicted that *'as the economic performance of New Zealand improves there will be a substantial increase in foreign investment;*' and concluded that it *'provide(s) some perfect investment opportunities for foreigners.'* His final comment: *'I genuinely believe that New Zealand is one of the best places in the world to invest in if one takes a long-term view.'*

## ATTITUDES TO FOREIGN INVESTMENT

New Zealand welcomes foreign investment. Although most substantial investments by non-residents require some official approval (usually by the Overseas Investment Commission), liberal rules apply in all sectors (other than those involving broadcasting, commercial fishing and rural land).

Whereas, in some countries there has been a strong political or public reaction against such investment, particularly from Japan, that is not the case in New Zealand. Earlier this year<sup>14</sup>, the then Prime Minister David Lange said that, unlike some other countries, New Zealand welcomed Japanese investment<sup>15</sup>; similar but more general statements are contained in official publications outlining government policy on foreign investment.

There are no exchange controls; nor are there any restrictions on the repatriation of capital or profits.

A factor that could attract certain foreign investors is the government's business immigration policy<sup>16</sup>.

## APPROVAL FOR OVERSEAS INVESTMENT

In a move that reflects New Zealand's receptive attitude towards foreign investment, the rules regarding such investment have recently been liberalised<sup>17</sup>. The amendment establishes a new threshold of NZ\$10 million; below this level approval is not required. Certain sensitive areas (broadcasting, commercial fishing and rural land) remain subject to tighter surveillance.

<sup>10</sup> NZ Herald, 4 September 1989.

<sup>11</sup> Potts West Trumbull & Co (Sydney), 24 August 1989.

<sup>12</sup> New Zealand- Should You Invest There? Ord Minnett Securities (Sydney).

<sup>13</sup> Why Invest in New Zealand?; International Perspectives of the New Zealand Economy.

<sup>14</sup> Speech in Christchurch on 7 April 1989.

<sup>15</sup> NZ Herald, 8 April 1989.

<sup>16</sup> See the summary of this policy annexed to this paper.

<sup>17</sup> Amendment to the Overseas Investment Regulations 1985, gazetted on 27 July 1989 to take effect from 25 August 1989.

In summary, the effect of the amendment is that an *overseas person* wishing to invest in New Zealand will now only need to obtain the consent of the Overseas Investment Commission for the following transactions:

- (a) Investments by overseas persons to establish a new business (other than in the specified sensitive areas) where the total expenditure to be incurred in setting up the business exceeds NZ\$10 million); or
- (b) Investments by way of takeover or acquisition (other than in the sensitive areas) where either the total consideration payable or the total assets of the business exceed NZ\$10 million; or
- (c) Investments by overseas persons, regardless of value, in any of the specified sensitive areas.

Therefore, the effect of the amendment is that, while an infrastructure is maintained to monitor significant overseas investment proposals (and all investments in the sensitive areas), less significant proposals can now proceed unimpeded.

For those investments that still require approval, this is given if the proposal shows a net benefit to New Zealand as a consequence of any one of:

- (a) Added competition.
- (b) Lower prices.
- (c) Greater efficiency.
- (d) Introduction of new technology, or managerial or technical skills.
- (e) Development of new export markets or the earning of overseas funds.
- (f) Creation of new jobs.
- (g) The promotion of New Zealand's economic growth<sup>18</sup>.

These criteria (which are considerably more liberal than those that apply in many other countries, for instance Australia) can be applied to either active or passive investments.

## THE SECTORS THAT DRIVE THE NEW ZEALAND ECONOMY

It is useful for the overseas investor to understand the areas of major strength in the New Zealand economy, as these can differ quite significantly from other western/developed countries (thus affording an opportunity for investment in these sectors without the risks sometimes associated with third world countries).

### Agriculture and horticulture

New Zealand is one of the most efficient and successful producers and exporters of agricultural products in the world. Operating now without subsidies, it is the world's largest exporter of cross-bred wools (23% of the total) and lamb and mutton, and accounts for one quarter of the world's dairy trade.

Because it produces a wide range of horticultural products in the northern hemisphere's *off-season*, New Zealand has built important markets for many fruits and vegetables, most notably kiwifruit (half the world's production, although this share is likely to reduce) and apples.

Internationally, of course, agricultural markets are plagued by subsidies and protection of inefficient producers, result-

<sup>18</sup> Fuller details of the procedures and criteria for approving foreign investment are set out in the annexure to this paper.

ing in unfair barriers in many markets, including those of the European Community, Japan and even the United States. Therefore, under successive governments, much of New Zealand's diplomacy has been directed towards resolving these issues and liberalising agricultural access.

The agricultural sector is therefore very attractive to investors; and opportunities exist for the vertical integration of local production and processing into wholesale and retail markets in other countries. Investors would be wise to seek expert advice; and to stick to mainstream farming activities such as meat, wool and dairy and avoid smaller niche markets (such as goats, deer etc). Moreover, investors contemplating this area must be prepared to *ride out* variations in return caused by the inevitable fluctuations in world commodity prices. Farming, while a rewarding investment, is not for the short-term investor.

Also attractive is investment in infrastructure facilities such as processing plants (other than meat, killing/processing, works) and, with the recent reforms, ports.

### Fishing

New Zealand has the fifth largest Exclusive Economic (Two Hundred Mile/Fishing) Zone in the world. With improved management techniques, the resource is now much better controlled than in the past. It has enormous potential; and offers an exciting range of products, from the internationally recognised orange roughly through squid to all forms of shellfish. A number of overseas interests are licensed to fish in the zone; and others operate in joint venture with New Zealand companies.

The sector continues to be attractive to overseas investors, and again offers opportunities for vertical integration into wholesale and retail markets in other countries.

### Forestry

A unique combination of soil and climate, combined with some of the most sophisticated silviculture techniques available anywhere, means that New Zealand can grow radiata pine much quicker than most other countries, thirty years (less if it is intended for pulp). With a well developed infrastructure, New Zealand forestry products are internationally competitive and a substantial export earner. It is significant that four of New Zealand's better performing companies; Fletcher Challenge, Carter Holt Harvey, Elders Resources NZFP and Corporate Investments (through its Newmans subsidiary) are involved in this sector.

Overseas investors should particularly note the government's announced intention to sell off its state forestry assets. This will provide access to some of the world's most efficient producers of exotic softwoods. Local forestry companies are seeking international partners to bid for these assets. Seldom does such an opportunity become available.

### Energy

In recent years, the energy sector (along with forestry and fishing) has attracted some of the largest investment into the New Zealand economy.

In the early 1980s, New Zealand was assessed as the fourth most energy rich country in the world per capita. Its geography allows for the widespread and efficient use of hydroelectric power; and New Zealand was a pioneer in the generation of geothermal power. A study in the mid 1970s<sup>19</sup>

concluded that, in the foreseeable future, the country had no need for nuclear power generation. New Zealand has a one thousand year reserve of coal; and (while not self-sufficient) also has significant oil reserves<sup>19</sup>. There are three natural gas fields in production, including the large offshore Maui field.

The energy sector in general and petroleum in particular have made a significant contribution to the New Zealand economy. Caltex, Mobil, BP and Shell (along with, until recently, the local company Europa) have operated in the New Zealand petrol supply market for many years. Although oil resources were identified, particularly in the Taranaki region, more than a century ago, serious exploration did not begin until the 1960s, with the Shell-BP-Todd consortium leading the way. Since then there has been extensive overseas involvement in New Zealand oil and gas exploration, particularly offshore (the Great South Basin etc). By the late 1970s extensive gas and lesser oil resources had been found.

The second oil shock of 1979 brought home to New Zealand (and of course other countries) the danger of relying on oil supplies from politically vulnerable sources: in 1978 about 70% of our imported oil came from Iran; in 1979, nothing. Had the Saudis not moved to fill some of the production void, New Zealand would have been even harder hit. This prompted the government of the day to institute a major programme to make the country 50% self-sufficient in transport fuels by the mid 1980s. The measures, which involved very substantial investment, included: conversion of large numbers of vehicles to operate on CNG or LPG; building what is still the world's only commercial synthetic petroleum (gas-to-gasoline) plant; and expansion of the Marsden Point refinery (including a hydrocracker). While, more recently (with a lower price of crude than pre-vailed when the projects were implemented) this programme has attracted political criticism, its strategic purpose, to reduce New Zealand's dependence on vulnerable imported oil supplies, has been achieved.

With its extensive resources, the sector remains very attractive to investors. Exploration rights continue to be granted; over the past eighteen months, many new petroleum prospecting licences have been awarded, both on-shore and off-shore, in the Taranaki region. The government has already sold Petrocorp (to the New Zealand company Fletcher Challenge); and intends to sell Coalcorp, which again offers a rare opportunity to invest in a valuable resource.

### **Manufacturing**

In the mid 1980s the New Zealand manufacturing sector suffered considerably from high interest rates and an over-valued dollar. However, there is no doubt that those who survived this period are now much more efficient and internationally competitive.

A number of New Zealand companies have established niche export markets in particular products (such as specialised electronics). Such companies represent the best avenue for investment in this sector, along with those manufacturers that have a dominant position in the local market and/or

<sup>19</sup> Report of the Royal Commission of Inquiry into Nuclear Power in New Zealand, 1977.

<sup>20</sup> See New Zealand Petroleum Concessions Map annexed to this paper.

those who are taking advantage of preferential access to Australia under CER.

With New Zealand products (basically those with at least 50% local content) set to enjoy free access to Australia after mid 1990, overseas (i.e. non-Australian/NZ) investors should carefully consider the opportunities offered by manufacturing in New Zealand and exporting to Australia. In a number of fields this is more competitive than the alternatives of exporting direct to Australia from a third country and/or manufacturing in Australia itself.

### **Tourism**

With its magnificent and diverse scenery New Zealand has much to gain from tourism which, overall, is the fastest growing industry in the world. About half a million tourists visit each year, with just under 50% of these coming from Australia. However, Japan, North America and the UK are other major sources. With the opening of new air routes, numbers, particularly from Northern Europe, are on the increase.

Heavily reliant on Australia (from which the industry is seeking to diversify), tourism suffered a downturn in 1988 because of the alternative attractions offered by that country's Bi-Centennial and the Brisbane World Expo; this was compounded by the local recession. However, numbers are now increasing again, with a projected annual growth of 10%; and New Zealand's own 1990 Celebrations (150 years since the signing of the Treaty of Waitangi) and the 1990 Commonwealth Games, as well as (possibly) the America's Cup (1991-92) will give added impetus to this growth.

The industry is in need of considerable further investment; and overseas investors (particularly those already associated with the industry) have been active in recent times, particularly in Christchurch<sup>21</sup>.

### **SHARE MARKET**

The New Zealand share market is very small by world standards and has taken much longer than others to recover from the October 1987 crash. Trading volumes are low; which particularly affects the attractiveness and viability of smaller stocks (no matter how good their earnings). Therefore, smaller local companies, even those with good earnings prospects, do not attract overseas investors.

However, those larger New Zealand companies that do attract international attention are well regarded and include: Brierley Investments, Carter Holt Harvey, Corporate Investments, Countrywide Bank, Elders Resources NZ Forest Products, FERNZ, Fisher and Paykel, Fletcher Challenge, Goodman Fielder Wattie, INL, Lion Nathan, Mair Astley, Magnum, PDL, Sandfords, Wilson and Horton. Most of these companies are involved in multi-national business and some of their stocks are traded on overseas exchanges; many have also reported good results for the financial year ending 31 March 1990, with profit recovery from the previous year. International fund managers have been gradually increasing their exposure to such investments.

The interest of overseas brokers in the local market has already been noted and it is understandable. In the twelve weeks from 16 June to 8 September 1989, the Barclays Share

<sup>21</sup> For further information on this aspect of investment, see the review of the New Zealand property market annexed to this paper.

Index rose by 23.3% (from 1929.24 to 2378.45); the rise in the first 21 days of August alone was 'a massive 400 points or 20.1 %'<sup>22</sup>. One reputable broker has forecast a 'healthy' 11% growth in earnings per share in 1989-90; another expects the New Zealand equities market 'to post a solid 20% rise over the next twelve months, underpinned by a continued recovery in economic activity and a more stable economic sector'<sup>23</sup>. The New Zealand sharemarket was recently described as 'the hottest in the world for most of August'<sup>24</sup>.

For the larger or institutional investor, opportunities also exist for direct placements into New Zealand listed (and even unlisted) companies that are seeking further capital.

[Overseas investors, particularly from the United States, should not be concerned at the relatively low quotes - even for quality stocks (often only a few dollars per share). This is a feature of both Australian and New Zealand stocks where investors prefer to deal in lower valued units.]

### PRIVATISATION OF STATE OWNED ENTERPRISES

Privatisation offers another potentially very rewarding area for investors. The government has already sold of its interests in NZ Steel, Development Finance Corporation, NZ Shipping Corporation, Health Computing Systems, Postbank and Petrocorp; and has partially sold its interests in Air New Zealand (with the remainder being publicly floated at this time) and the Bank of New Zealand (with the balance likely to be sold in due course).

Other assets foreshadowed for privatisation include: forestry assets, the Tourist Hotel Corporation, Telecom, Electri-corp, Coalcorp, National Film Unit, the government's shares in the three international airport companies, the non-core assets of Railways Corporation, Government Printing Office, CommunicateNZ, the Travel Offices of the Tourist and Publicity Department, NZ Post and parts of Landcorp. These could represent a very attractive investment, either for those who already operate in these areas or (for smaller investors) in the public float of companies such as Air New Zealand.

### THE NEW ZEALAND PROPERTY MARKET

As in most other countries, the property market is inevitably cyclical in character. There is general agreement that, in New Zealand, all three major sectors of that market; commercial, residential and residential, are currently at the bottom of such a cycle. This is attracting the attention of overseas investors, particularly those interested in counter-cyclical investment.

#### Commercial

The recession has led to a flight to quality property investments. CBD investments in Auckland and Wellington (and, to a lesser degree, Christchurch) have held to their values much more than fringe properties.

#### Industrial

With the decline in manufacturing, and the consequent reduction in the number of available tenants and the uncer-

<sup>22</sup> Potts West Trumbull & Co (Sydney), 24 August 1989.

<sup>23</sup> Hendry Hay McIntosh (Auckland), July 1989.

<sup>24</sup> National Business Review, 30 August 1989.

tain financial strength of those remaining, industrial properties have shown a decline in value and a lengthening of yields. There is a shortage of well located properties with good tenants, which presently show a yield of around 10 to 10.5%; but for others (many being untenanted or not fully occupied, but also including properties of only average quality that are fully tenanted) the figure is much higher, with a reported (June 1989) median of 11.7%.

At present, with few exceptions (again, well located properties with good tenants, or keenly priced speculative investments), industrial properties do not represent a good investment. However, this situation could change. One large realtor has reported that, with little speculative building since mid-1988, there is a shortage of quality buildings, particularly in the NZ\$200 000 to NZ\$2 million range.

#### Residential

For buyers who are in a position to make cash/unconditional offers, very real bargains can be secured. However, in the past few months there have been reports of a gradual revival in this market; but it is still too early to say whether this will be confirmed by statistics. At the same time, despite the recession, the house building market has remained reasonably active, particularly at the lower end.

It is anticipated that, if the America's Cup is sailed in Auckland (see below), waterfront properties (and those on Auckland's North Shore and Hibiscus Coast, adjacent to the sailing area) will again increase in value.

#### Rural

As indicated earlier, farm properties, having undergone dramatic reductions in value, and reflecting good commodity prices, can now show returns of in excess of 10%, or even higher, without any subsidies or tariff support.

### TAXATION

As from 1 April 1989, the following taxation rates apply in New Zealand:

#### Personal

Income up to NZ \$30,875	24 percent
above NZ \$30,875	33 percent

#### Corporate

Resident Companies	33 percent
Non Resident Companies	38 percent

These rates are lower than in Australia. It is not difficult to obtain registration as a resident company.

From 1 April 1988, a dividend imputation scheme has operated, thus preventing the double taxation of company profits. The payment of moneys overseas can be subject to withholding tax.

#### Indirect taxes

With the exception of special taxes imposed on tobacco, liquor, petroleum products and motor vehicles, the only general sales tax is GST, which is imposed on all goods and services at the consistent rate of 12.5%. Only financial services are excluded from GST, and that is only for technical reasons; export goods, although subject to the tax, are zero rated. In effect, by a series of refunds, GST is only finally paid by the end-user of the goods (or services) in

question. A registered taxpayer can claim refunds on all other GST payments.

[The 1 July 1989 increase in the GST rate from 10 to 12.5% will have an effect on inflation over the next twelve months (and specifically on the mid 1988 quarterly increases in the Consumer Price Index). Even so, inflation is not expected to rise much above 6.5% (on a one-off basis) and should then revert to its downward trend, with the Reserve Bank still predicting a rate of between zero and two percent by the early 1990s.]

There is no Capital Gains Tax. While the Government has acknowledged that it has such a tax under consideration, it is specifically opposed by the Opposition National Party.

### IMPACT OF THE AMERICA'S CUP

The decision of the New York Supreme Court, delivered in late March 1989, to award the America's Cup to the Mercury Bay Yacht Club will, if confirmed on appeal, result in the next Cup Regatta being sailed in the waters of the Waitemata Harbour/Hauraki Gulf, in the immediate environs of Auckland. The appeal was heard by the New York Court of Appeals in early June 1989; and a decision is awaited.

Although originally projected to be sailed in April 1991 it now seems likely that (by agreement among the parties involved) the Cup Finals will take place early in 1992, with the preliminaries being sailed in the preceding six months. The last Cup Regatta, sailed in Western Australia, had a significant impact on the economy of that State. However, wisely, New Zealand in general and Auckland in particular have reacted with cautious optimism to the potential economic impact of this event. The experience of Perth and Fremantle has shown the dangers of building a boom on the Cup alone; and in any event, Auckland has a more substantial existing infrastructure than Perth, particularly directed towards leisure boating activities.

Nonetheless, with up to twenty four international syndicates and several local defenders, and of course substantial international attendance (both from the media and spectators), there will be heavy demand for Cup and tourism related services. This will increase pressure on facilities that will be already stretched by the 1990 Commonwealth Games (to be hosted in Auckland in January 1990) and other events associated with New Zealand's 150th *birthday* celebrations which will be marked throughout 1990.

The most direct impact will be on activities directly associated with the Cup regatta and the resulting tourism; boat building and repairs, charter and cruise operators, marina builders and operators and leisure and tourism. However, more indirectly waterfront residential properties (presently reduced in price) should increase in value and be a good investment.

Above all, the greatest overall benefit to New Zealand and its economy should be in two areas:

- (a) The major international publicity and prestige associated with such an event which will be broadcast live to a television audience of hundreds of millions of people.
- (b) A further rise in business confidence that should flow from the Cup and its related activities.

### RECENT EVENTS

Recent events of significance to the New Zealand economy have included:

- (a) Since the Government's annual Budget Statement delivered in late July, interest rates have eased. The present projection is for rates to continue to fall gradually.
- (b) With the strengthening of the US dollar, in mid year the New Zealand dollar dropped to its lowest levels for nearly three years. Since then, the dollar has settled at a level of around 58 to 59 cents to the US dollar (trading last week at around 58.9). This will have a further positive impact on overseas trade (making New Zealand products more competitive internationally) and investment (making local prices even more attractive to overseas investors); but could have a slightly negative effect on inflation (by increasing the price of imports).
- (c) New Zealand's trade account has moved into surplus; although there is still a deficit on movements of cash, reflecting debt service and other payments.
- (d) The Reserve Bank has warned financial institutions against manipulating markets to hold up interest rates.

### POLITICAL CHANGE

New Zealand must go to the polls at the latest by October 1990. In the event of a change of government, with one exception, it is most unlikely that any policy so far announced by the opposition National party would have an adverse effect on decisions by overseas interests to invest in New Zealand.

The one exception is National's announced intention to restrict (to 24.9%) the overseas ownership of six strategic assets presently operated as state owned enterprises: the Bank of New Zealand, Air New Zealand, Petrocorp, Transpower (the Electricorp subsidiary that controls the national grid), NZ Post and the monopoly areas of Telecom. This suggests an approach very similar to Mrs Thatcher's *popular capitalism*. Having given notice of this policy in advance of any sale, National has said that it reserves the right to require overseas investors to divest down to the required 24.9% (as the UK government did with BP and the Kuwaiti Investment Office).

Overall it is reasonable to assume that, under a National government, most of the economic reforms put in place by the Labour government would remain; although National has committed itself to a reform of labour markets based on voluntary unionism and has projected a more flexible style of economic management.

### SUMMARY OF PRESENT MARKET POSITION

Overall, the present position of the various New Zealand markets can be summarised in the following terms:

- (a) Agriculture is New Zealand's great strength and, with more realistic values than in the past, represents a very good long-term investment, both directly and in the supporting infrastructure.
- (b) Fishing is another important niche sector that also offers good returns.
- (c) The New Zealand forestry industry is among the most efficient in the world; and the sale of the government's forestry assets offers excellent investment opportunities, possibly in partnership with local forestry companies.

- (d) On a population basis, New Zealand is energy rich. Exploration opportunities abound, and the projected sale of Coalcorp is an excellent chance to buy into a major resource.
- (e) Selected manufacturing opportunities exist, but only in companies with a very strong domestic position and/or niche export markets or those that take advantage of the freer access to Australia under CER.
- (f) Tourism, which requires substantial further investment, has considerable potential and is attracting overseas investors.
- (f) The property market is at the bottom of a downturn. Quality, well tenanted CBD commercial properties in Auckland and Wellington can be purchased at lower prices and higher yields than in the past; and represent a good buy to those attracted to counter-cyclical investment. Industrial properties should be generally avoided. Residential property offers some excellent bargains to cash buyers; and suitable Auckland waterside properties should increase in value, at least over the period of any America's Cup Regatta. Farming property investment should only be undertaken with expert advice.
- (g) The share market has recently been under priced, both as to NTA and PE ratios; but price levels have risen over the past two months. Because of small trading volumes, secondary stocks should be avoided even if they have attractive earnings. Major stocks, in companies with international earnings and/or which are traded on world sharemarkets, can be good long-term investments. Opportunities exist for placements by larger or institutional investors.

With the exception of the property market, which is included because of the attraction to counter-cyclical investors, it is significant that, because of New Zealand's size, every one of these areas for investment is either:

- (a) Export driven (e.g. agriculture).
- (b) One that produces added value export products based on New Zealand primary products (e.g. the public manufacturing companies listed as sound stocks for investment).
- (c) An earner of overseas funds (e.g. tourism).
- (d) Has substantial overseas operations (e.g. the listed companies).
- (e) By import substitution, is a saver of overseas funds (e.g. energy).

The fact that these investments do not depend on a small local market for their long-term viability provides a substantial measure of comfort for overseas investors.

### FUTURE DIRECTION

As indicated earlier, economists are now suggesting that the New Zealand economy is entering a phase of gradual economic recovery.

The immediate future direction of the economy will depend on:

- (a) The extent to which the government can contain inflationary wage demands, particularly resulting from the recent increase in GST from 10 to 12.5%.
- (b) The inflationary (probably negative) and trade and investment (probably positive) implications of the recent downward movement of the New Zealand dollar

following the rise of the US dollar.

- (c) The impact of increases in overseas interest rates against the gradual drop in local rates; and the willingness of the government and Reserve Bank to maintain a tight monetary policy. [As indicated, both the government and the Reserve Bank have set an inflation target of between zero and two percent by the early 1990s, suggesting the likelihood of a continued tight money supply.]
- (d) The ability of the government to contain and reduce its own expenditure; and to deliver on its promises regarding the budget deficit/surplus.
- (e) The extent to which consumption grows over the next twelve months.
- (f) Continued, and rising, business confidence.
- (g) International events, including the mid-year unrest in China (New Zealand's largest buyer of wool) and the much predicted economic downturn in Australia (New Zealand's largest market).
- (h) Local political events, including any expectation of a change of government in 1990 or a continuation in recovery in the political fortunes of the government.

Assuming that the government delivers on its promised *fiscal responsibility*, it is reasonable to hypothesise that:

- (a) Recovery from the recession should be export led.
- (b) Depreciation in the NZ dollar since June 1988 (particularly over the past month), and the increase in GST (which will be a one-off effect), will result in a temporary increase in inflation in 1989. However, inflation is then expected to continue its downward trend in 1990-91. With inflation in the four to five percent range, and possible moves by the Government moves to discourage wage increases, a further reduction in inflationary expectations can be expected.
- (c) The Reserve Bank should be able to accommodate interest rate declines provided they do not produce more than a slow decline in the value of the New Zealand currency. One prominent analyst's most likely scenario suggests rates of 11.5 percent by the March 1990 quarter; the government decision, announced in the July Budget Statement, to utilise moneys from the sale of State assets to retire domestic (rather than foreign) debt, and therefore not to borrow on the domestic market for that purpose, has already had a positive effect and could take that figure even lower. Firming of monetary policy is expected with the recent passing of the Reserve Bank Act.
- (d) Despite improved economic fundamentals and the potential for some very limited Reserve Bank intervention, there is still some downside potential in the value of the NZ dollar, partly arising from the expectation of rising international interest rates but principally fuelled by rises in the value of the US dollar. Unemployment will continue to rise<sup>26</sup>.
- (e) Growth will be around 3% in 1989-90<sup>27</sup>.
- (f) With growth in the economy, the Government's accounts are projected to move into a real surplus in the 1990-91 financial year.
- (g) Export earnings should increase over the next two years. Import volumes will also rise, but not by a volume or value sufficient to offset export earnings; and the trade

<sup>26</sup> Although the recent BERL report (11 September 1989) suggests that this assessment may have to be revised downward.

<sup>27</sup> Confirmed by the BERL report of 11 September 1989.

account should remain in surplus. It can therefore be expected that repayments of overseas debt will help to contribute to a reduction in New Zealand's country risk premium. In addition, present low prices, moderate non-inflationary growth in 1989 and future prospects (including activity directly related to the America's Cup) should attract international investors.

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## APPENDIX 1

### NEW ZEALAND KEY ECONOMIC INDICATORS

(as at Friday 8 September 1989)

#### Inflation

Consumer Price Index for  
year ending 31 June 1989 4.4%

#### Interest rates

90 day bill rate 13.22%  
5 year bond rate 11.99%

#### Share market (Barclays Index)

2378.45

#### Exchange rates against

Australian Dollar .7707  
US Dollar .5900  
Japanese Yen 86.41  
Pound Sterling .3722

## APPENDIX 2

### FOREIGN INVESTMENT IN NEW ZEALAND

This section of this paper does not set out the law in any detail. Individual transactions must still be considered in light of the relevant legal provisions. Furthermore, because of the wide discretions vested in the approving bodies, the practice is subject to considerable variation; all applications are dealt with on a case-by-case basis. Any person contemplating investment in New Zealand must seek and rely on specific professional advice on the issues involved.

#### General policy

A statement of government policy is contained in a 1985 Department of Trade and Industry publication: *The New Zealand government welcomes foreign investment that contributes to New Zealand's social and economic well-being.*

This general statement must be read subject to the detailed comment below and also subject to more recent developments in government policy. For instance, overseas ownership of radio stations is restricted to 15% (increasable to 25%) and that of television broadcasters is restricted to 15%.

## Overseas Investment Regulations 1985

The rules relating to business investment in New Zealand by overseas persons are found in the Overseas Investment Regulations 1985 as amended in 1989 (made under the Overseas Investment Act 1973). The regulations are administered by the Overseas Investment Commission (OIC) whose secretariat is attached to the Reserve Bank of New Zealand.

**Definition of an Overseas Person** Under the regulations an overseas person is defined as:

- (a) Any body corporate that is incorporated outside New Zealand, or
- (b) Any company (as defined by the New Zealand Companies Act) in which 25 percent or more of any class of share is held by an overseas person(s) (in other words a 24.9 percent investment does not require approval), or
- (c) Any person not ordinarily resident in New Zealand (ordinarily resident meaning either domiciled in New Zealand, or who has resided in New Zealand as his/her usual place of residence for the preceding twelve months).

[It should be noted that, although it can be the trigger for determining whether a corporate investor is an overseas person, the level of equity participation is only a minor factor in the actual assessment of any investment proposal.] No distinction is made between different countries of origin; these rules apply to overseas persons from whatever country.

**Overseas Investment Commission** An overseas person wishing to invest in New Zealand need only obtain the consent of the Overseas Investment Commission for the following transactions:

- (a) Investments by overseas persons to establish a new business (other than in the specified sensitive areas) where the total expenditure to be incurred in setting up the business exceeds NZ\$10 million) or
- (b) Investments by way of takeover or acquisition (other than in the sensitive areas) where either the total consideration payable or the total assets of the business exceed NZ\$10 million or
- (c) Investments by overseas persons, regardless of value, in any of the specified sensitive areas.

The commission applies liberal criteria and considers factors such as whether the proposal would:

- (a) Create additional employment.
- (b) Contribute to the balance of payments.
- (c) Promote economic growth.
- (d) Where a sale is involved, would enable the vendor to realise the best possible price for his/her investment.

In general terms: investment in New Zealand by overseas persons is regarded as much more acceptable than it was in the past, and this is particularly reflected in the 1989 amendment to the regulations.

The commission deals with applications on a case-by-case basis and gives priority to those applications that show some net benefit to New Zealand. Where an overseas person seeks permission to commence business in New Zealand (including the ownership of income earning real property), only one such application is required (i.e. when the business is first commenced). Approval is invariably granted and appears to

be required for monitoring and statistical purposes rather than for regulation.

### **Purchase of land**

The procedure in relation to the purchase of land (other than where the land is owned by a company whose shares are being sold) differs somewhat from the above. Again, individual transactions must still be considered in light of the relevant legal provisions. Furthermore, because of the wide discretions vested in the approving bodies, the practice relating to approval of sales to overseas persons is subject to considerable variation; and each application for approval, particularly in respect of commercial and rural land, must be dealt with on a case-by-case basis.

**The Land Settlement Promotion and Land Acquisition Act** The rules relating to investment in New Zealand land by overseas persons are found in the Overseas Investment Regulations (see above) and the Land Settlement Promotion and Land Acquisition Act 1952. The Act is administered by the Valuation Tribunal which is attached to the Department of Lands.

**Residential land** Following the 1989 amendment to the Regulations, unless residential land is being sold/purchased for more than NZ\$10 million, OIC approval is not now required.

**Farm land** Purchases of farm land by overseas persons are the most politically and emotionally sensitive (attracting particular attention from both farming and environmental lobbies); and therefore receive close scrutiny. Nonetheless, the attitude is now more relaxed than in the past. For overseas investment purposes, farm land is either:

- (a) All land designated as such under an operative District Scheme or
- (b) Any land that is likely to be zoned in a District Scheme for reserve purposes or
- (c) Any land on an island.

Purchases of farm land require the approval of both the Valuation Tribunal and the OIC.

Under the Land Settlement Promotion and Land Acquisition Act, an overseas person is somewhat differently defined, as one who is not a New Zealand citizen and who is not ordinarily resident in New Zealand (i.e. who has not resided in the country for two and one half of the preceding three years). To obtain approval for a purchase of farm land, such a person must satisfy the Tribunal that either:

- (a) If the rural land is to be used for rural (i.e. farming) purposes by an overseas person who does not intend living in New Zealand, that New Zealand agriculture will gain a significant positive/net benefit from the activities to be undertaken; and that he/she has the finance and ability to undertake the operation, or
- (b) If the rural land is to be used for non farming purposes (e.g. tourism), that the use is, in some way, unique; and that the benefits accruing from that use would exceed those from normal farming operations.

In special cases, where the Tribunal cannot approve the application, there is provision for joint approval by the Ministers of Finance and Lands.

**Commercial land** All land that (under the above definitions) is not classified as either residential or farm land, is

dealt with as commercial land. In this instance, purchases by overseas persons only require the approval of the OIC if being sold/purchased for more than NZ\$10 million.

The commission deals with applications on a case-by-case basis and gives priority to those purchases that show some net benefit for New Zealand. Increasingly, however, approval is also being given to passive investments (i.e. those that promise no improvement and represent nothing more than an intention to purchase the land and/or its buildings and hold same as an income earning and/or capital appreciating asset). As with farm land, the OIC now acknowledges the need for a vendor to get the best possible price for his or her investment.

## **APPENDIX 3 BUSINESS IMMIGRATION**

Under its Business Immigration Policy, New Zealand welcomes immigrants with proven business skills who intend to establish and operate business enterprises in the country. Applicants are assessed according to their potential contribution to the New Zealand economy and society. Regard is had to the applicant's business background and credit worthiness as well as the nature of the intended business venture.

In addition to the capital necessary for investment in business enterprise in New Zealand, applicants must also have a minimum of NZ\$200 000 to meet initial housing, living and personal establishment costs. As a general rule, a business migrant would normally be expected to have a minimum of around NZ\$400 000 available for transfer to New Zealand.

If the application is favourably recommended on business grounds, the applicant must then still comply with the normal immigration requirements including facility with the English language, medical and character checks; and will normally be expected to take up residence within six months of approval. Once resident in New Zealand, the applicant may apply for a Returning Resident's Visa allowing him or her to leave and re-enter New Zealand. It should be noted that this policy is presently under review; and that some changes may result.

## **APPENDIX 4 THE NEW ZEALAND PROPERTY MARKET**

Internationally, the property market is inevitably cyclical in character. There is general agreement that, in New Zealand, all three major sectors of that market, commercial, industrial and residential, are currently at the bottom of such a cycle. It is this fact that is motivating overseas investors, particularly those attracted to counter-cyclical investment.

### **Commercial**

The recession has led to a flight to quality property investments. CBD investments in Auckland and Wellington (and, to a lesser degree, Christchurch) have held to their values much more than fringe properties. Quite apart from the shortcomings of their location, non-CBD properties and those of lesser quality tend to be smaller buildings, often reliant for their income on single major tenants who, in turn, tend to be more vulnerable to economic downturn.

At the height of the property boom, in the mid 1980s, yields on CBD commercial properties fell to as low as 5%, but normally (depending on precise location) ranged from 6.5 to 7.5%.

The downturn in the property market, and particularly the lack of activity by the major institutional investors (who have traditionally been strong players in this market) has had several effects:

- (a) Despite the downturn, according to a recent survey by a leading property consultant, demand for office space has "continued at a significant level". The same survey concluded that investors who have good quality buildings coming on stream at the right time should have a good investment.
- (b) A number of properties that might otherwise have been sold have been removed from the market, the vendors being under no pressure to sell and being unwilling to accept a lower price.
- (c) Some properties have been sold at lower prices and consequently higher yields, particularly where the vendor has been under some pressure.
- (d) Local financiers will usually not allow a developer to commence construction of a new office building until there is a sixty to seventy percent precommitment of tenancies - sufficient to provide debt coverage. [This contrasts with some other markets, notably the United States, where many buildings start with no precommitments and do not achieve a positive cash flow until Year Two or Three.] Therefore most of the commercial building presently under construction in the Auckland and Wellington CBD's should, when completed, be occupied at least on a break-even basis. This will, however, impose pressure on older and less attractive buildings that will lose occupants to the new buildings and may not be able to attract replacement tenants.
- (e) Recently a small number of CBD office building developments have been undertaken, financed from the developers own resources or from general rather than specific lines of credit, and without any precommitments as to tenancies. Despite their quality and location, some of these properties have proved very hard to lease. One newly completed building, so far largely untenanted, recently sold to a speculative investor for NZ\$22 million, a loss of at least NZ\$6 million.
- (f) Overall, sales of CBD office buildings have shown a lengthening of yields by between 0.5 and 1.75 percent (averaging about 0.75 for quality Queen Street Auckland properties and higher for fringe CBD); with the precise level of charge depending on some or all of the above circumstances. Average yields are now about 7% (or slightly higher) for Queen Street and 8 to 8.5% for fringe CBD.
- (g) Beyond these considerations, some excellent individual bargains can be obtained. For instance, recently an older CBD office building was sold at a mortgagees sale to the only bidder for just NZ\$1.75 million, which (even with two floors untenanted - previously occupied by the the now defunct owning company) showed a yield of 14%!

In New Zealand, office tenancies tend to be for longer periods (sometimes as long as twelve to fifteen years), with regular rent reviews and rights of renewal. Items such as rates (property taxes) and Land Tax are usually paid by lessees/tenants.

The down-turn in demand for office space has been the most marked in Auckland, with new space vacancies at around 5.33% and total space vacancies of around 10.2% (reported as at April 1989). It is anticipated that this market will be in oversupply for at least another twelve to twenty four months which (other than for purely speculative investments, which must be priced accordingly) reinforces the importance of acquiring well located buildings with good tenants and long term tenancies. Recently, agents have reported *a definite lift in commercial leasing activity*; and that *new buildings are now filling quite rapidly* although at the expense of older buildings.

Moreover, since early April 1989, there has been a reported upswing of interest in Auckland commercial property, partly fueled by a Taiwanese buying spree, particularly in the fringe CBD areas. So far this does not appear to have led to a significant raising of prices and/or a shortening of yields; although there have been reports of owners refusing low offers that, six months earlier, might have been accepted.

It should also be noted that there may still be a significant gap between a vendor's asking price on the one hand and the price at which they are prepared to sell on the other. Prospective buyers should be ready to bargain!

In Wellington, while there is some projected oversupply, the market is maintained by the large number of government departments, state owned enterprises and corporate head offices. New space vacancies, at around 4.88% and total space vacancies of around 9.16%, are lower than in Auckland (again, reported as at April 1989). As a result, rental rates tend to be higher, with slightly lower yields than in Auckland.

With a much smaller population than in the major North Island centres, Christchurch has a correspondingly lesser degree of CBD property activity. While there are some good investments, they do not compare favourably - particularly as to potential for capital growth, with those that are currently available in Auckland and Wellington. However, there has been recent Japanese interest in hotel and motel properties; probably because, with direct airlinks to Australia and the United States (and, in the near future, also Japan), the city is the gateway to major scenic and skiing destinations in the South Island.

### Industrial

With the decline in manufacturing, and the consequent reduction in the number of available tenants and the uncertain financial strength of those remaining, industrial properties have shown a decline in value and a lengthening of yields. There is a shortage of well located properties with good tenants, which presently show a yield of around 10 to 10.5%; but for others (many being untenanted or not fully occupied, but also including properties of only average quality that are fully tenanted) the figure is much higher, with a reported (June 1989) median of 11.7%.

At present, with few exceptions industrial properties do not represent a good investment. However, this situation could change. One large agent has reported that, with little speculative building since mid 1988, there is a shortage of quality buildings, particularly in the NZ\$200 000 to NZ\$2 million range.

### **Residential**

In the mid 1980s there were dramatic increases in the values of well placed residential properties, particularly in Auckland's Eastern suburbs. These values have slumped badly in the last eighteen months along with overall market activity. For buyers who are in a position to make cash/unconditional offers, very real bargains can be secured. However, in the past few months there have been reports of a gradual revival in this market; but it is still too early to say whether this will be confirmed by statistics.

At the same time, despite the recession, the house building market has remained reasonably active, particularly at the lower end.

### **Rural**

As indicated earlier, farm properties, having undergone dramatic reductions in value, and reflecting good commodity prices, can now show returns of 15-20%, or even higher. However, investors contemplating this area should probably aim for a more realistic and modest yield, still between 10-15%, and must be prepared to *ride out* variations in return caused by the inevitable fluctuations in world commodity prices. Farming, while a rewarding investment, is not for the short term investor.

Investors would be wise to seek expert advice; and to stick to mainstream sectors such as meat, wool and dairy (fringe activities including everything from goats to nashi pears can be profitable in the short term but are risky investments).