

NZ Residential Rental Market

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Will there be tears?

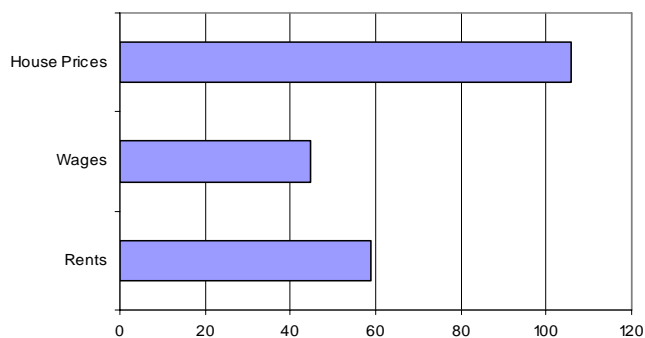
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DATA SOURCE This index has been developed from private sector rental data supplied by the Department of Building and Housing (Bond Centre). Information on wage rates, demographics and the structure of the rental housing stock is drawn from Statistics NZ data. House price information has been extracted from Real Estate Institute and Quotable Value NZ statistics.

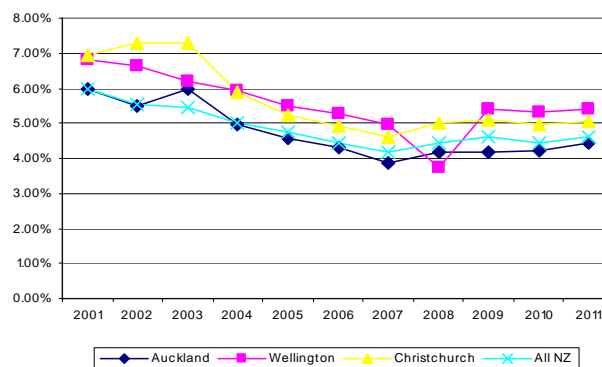
The disparity between what people are paying for houses currently and the fundamental relationship between rents, incomes and house prices was highlighted in the November 26th edition of the Economist magazine. New Zealand featured in the nine countries where housing was thought overvalued by at least 25% in relationship to rents and income. The article went on to explain that in relation to rents New Zealand house prices were overvalued by 66% and in relation to income by 4%. Averaging these ratios puts New Zealand house prices 35% above the fundamental price. Surprisingly, a week later figures released by both Quotable Value and the Real Estate Institute showed house prices in Auckland at a record high and national house prices continuing to rise. This author has observed the Economist is seldom wrong in forecasting the direction of house price movements, but their timing can be off, sometimes by years. So what is a fundamental price?

Fundamental prices in the housing market are based on the long term average relationships between house prices, rents and incomes. On the other hand the market price is what a property will transact for at a particular point in time. The reality is market prices often diverge from fundamental prices, sometimes higher sometimes lower, but are seldom equal. There is a whole body of theory in the field of behavioural economics explaining this phenomenon. Some of the theory relates to how the property market is driven by the actions of individuals who don't always act entirely rationally. There can be a herd instinct operating in some markets which tends to overprice property in boom times and under price it in hard times.

The chart below shows the percentage national movement in nominal house prices, wages and rents over the 11 year period 2001-2011. Clearly house price increases over this period cover the boom (2002-2007) and the positive expectations by owner occupiers and investors of ongoing capital growth in house prices.

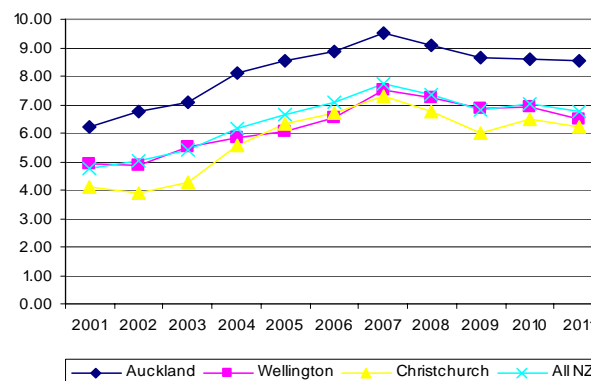


But will there be tears later from people buying now instead of waiting until later? Is a return to the fundamental price inevitable? Both hard questions to answer without the benefit of hindsight! Certainly tears can probably be avoided by the “wait and see” strategy demonstrated by many New Zealand home owners since 2007. Given most participants in the housing market are already home owners then they are not compelled to sell in a down market. The first chart below shows how the relationship between rents and house prices (as measured by the percentage yield on gross income) has started to improve, after reaching a low point in 2007/2008.



The second chart below shows the ratio of annual average wages to house prices has improved since 2007, both nationally and in the main cities. However, this ratio has some way to go before returning firstly pre boom levels and secondly the historical average.

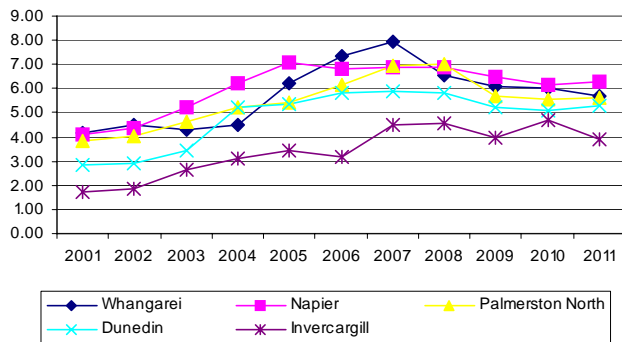
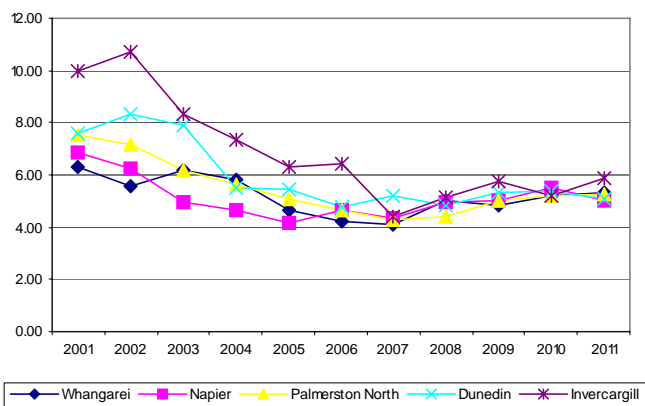
One of the problems with the fundamental price concept is that it is sometimes difficult to compare like with like. For example, over time New Zealand houses have become considerably larger and more elaborate with features such as en-suite bathrooms being the norm.



Furthermore these days many families have more than one income and can service large mortgages. Decreasing levels of home ownership may also be acting to keep house prices above the fundamental price based on long run averages. Investors using leverage and taxation benefits can typically outbid first time buyers. Record low mortgage interest rates, combined with a very low level of new housing construction and government rental subsidies are additional factors underpinning current house prices. From a political perspective stable house prices are preferred to falling house prices. This means inflation may be eroding house prices in real terms while maintaining them in dollar terms.

Smaller Cities

The ratios of wages and rents to house prices for a sample of smaller cities shows a similar pattern to those for the larger cities. The first chart below maps the ratio of rents to house prices and the second chart the ratio of annual wages to house prices. In both cases the ratios have improved since 2007 but still have a long way to move to get back to 2001 levels.



Rental Levels

The national level of rent increased to \$310 per week in November 2011. This was up by \$10 per week since the August 2011 and a return to the level seen in May 2011. Over the last 12 months the national level of median rent increased by just 3.3%. A snapshot of rents itemised by the main urban local authorities is shown in the table in the right hand column.

In the larger cities the strongest demand pressure on rents was in Auckland (up 11%) and Manukau (up 8.5%) over 12 months. Dunedin median rents also increased by 5.5% over the last 12 months. Wellington city median rents showed a small annual reduction (3.8%) while Christchurch remained about the same. Nelson median rents increased by 5% over the year perhaps a consequence of people relocating from Christchurch.

Median Rents	Nov-10	Aug-11	Nov-11
Whangarei	280	270	295
North Shore	420	420	420
Waitakere	350	360	360
Auckland	360	385	400
Manukau	350	370	380
Papakura	330	340	350
Hamilton	295	295	300
Tauranga	315	320	320
Rotorua	240	250	250
Gisborne	250	260	270
Hastings	250	260	280
Napier	280	290	280
New Plymouth	290	280	300
Wanganui	200	185	192
Palmerston North	275	260	260
Kapiti	300	300	320
Porirua	330	335	340
Upper Hutt	257	310	310
Lower Hutt	300	300	300
Wellington	390	375	375
Nelson	300	295	315
Christchurch	295	300	297
Dunedin	270	260	285
Invercargill	210	210	200
All NZ	300	300	310

Massey University Property Foundation

The Foundation is established to sponsor research and education in property related matters in New Zealand. Funding is obtained through sponsorship from corporations and firms within the property industry. The Foundation has established a Real Estate Analysis Unit to operate out of both Massey University's Palmerston North and Albany campuses.

Massey University Real Estate Analysis Unit

The primary objective of the Massey University Real Estate Analysis Unit (MUREAU) is to provide reliable property information to the property industry, the land related professions and the public.

The Director of MUREAU is Professor RV (Bob) Hargreaves. MUREAU also offers a consulting service for individual clients. MUREAU publications available on the internet are:

- 1 The Home Affordability Report (Quarterly)
- 2 NZ Residential Rental Market Report (Quarterly)

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