

NZ Residential Rental Market

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More on Rent v Buy

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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.

This edition takes historical information on rents and house prices and uses hindsight to calculate if a household would have been better off to rent or buy a house during ten, seven year periods, commencing in 1993. The calculations ignore many of the benefits attributed to home ownership such as security of tenure, ability to modify the house, compulsory savings when principal reductions are made on the mortgage, the educational benefits of stability for childrens schooling and the pride of ownership.

There are also some important assumptions included in the rent versus buy model. The most important assumption relates to the investment behaviour of the renter household. For example, if a household chooses to rent then they do not have the financial burden of paying off a mortgage and can save some money. The way that this has been analysed was to use the discounted cash flow approach to compare the internal rate of return from owning with a safe investment such as a government bond. Cash flows in the buy model included changes in property values and the opportunity cost of equivalent net rents. The proxy for the return on a more risky investment was taken as the mortgage interest rate. For simplicity the calculations have been done on an unleveraged basis and ignore taxation. The advantage of this approach is that it shows property performance without the distortion of ever changing interest rates and changes to taxation legislation.

The rental data is private sector rentals for houses. The house price information is from Quotable Value and is based on the average between the lower quartile and average house price for each territorial local authority. Three local authorities were analysed and the results from the Auckland analysis are included in the table below.

	Actual	Static	Mortgage	Bond	Compound
1994	10.25	6.95	8.46	7.55	1.78
1995	9.52	7.02	8.34	7.86	1.6
1996	9.95	5.42	7.97	7.97	3.05
1997	9.86	4.86	7.48	7.2	3.04
1998	10.02	4.37	7.25	6.38	3.62
1999	12.73	4.91	7.17	6.27	2.68
2000	14.46	5.25	7.43	6.85	2.64
2001	14.08	5.26	7.58	6.26	2.74
2002	14.03	5.61	7.91	6.4	2.8
2003	12.78	4.84	7.74	5.68	3.39

The dates above show the start of the investment period. Column one is the actual % composite internal rate of return, column two is the % internal rate of return with static property values, column three is the % average mortgage interest rate on a one year fixed loan over the seven year holding period, column four is the % average government bond rate over seven years and column five is the % compound growth in the house price needed to equate the mortgage interest rate.

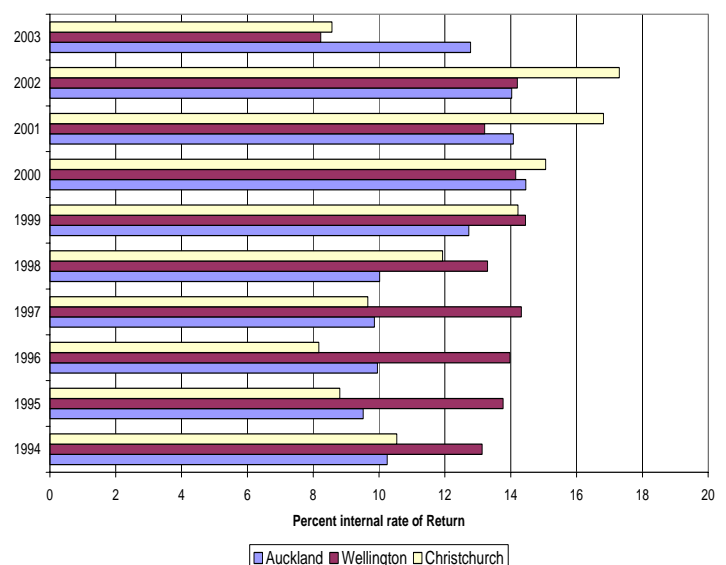
The results for Wellington city, using the same analysis are shown in the first table below.

	Actual	Static	Mortgage	Bond	Compound
1994	13.13	7.19	8.46	7.55	1.61
1995	13.77	7.29	8.34	7.86	1.34
1996	13.98	7.45	7.97	7.97	0.65
1997	14.32	6.99	7.48	7.2	0.61
1998	13.3	5.82	7.25	6.38	1.16
1999	14.45	5.82	7.17	6.27	1.57
2000	14.15	5.36	7.43	6.85	2.47
2001	13.21	5.35	7.58	6.26	2.66
2002	14.2	5.52	7.91	6.4	2.87
2003	8.23	3.84	7.74	5.68	4.46

The third city to be analysed was Christchurch and these results are presented below.

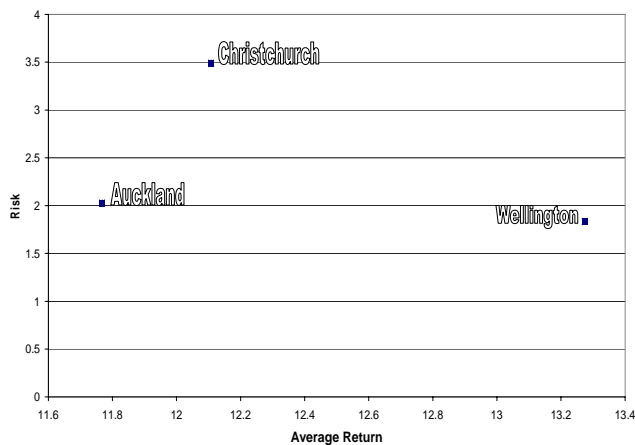
	Actual	Static	Mortgage	Bond	Compound
1994	10.54	6.66	8.46	7.55	2.26
1995	8.81	6.16	8.34	7.86	2.66
1996	8.17	6	7.97	7.97	2.37
1997	9.66	6.03	7.48	7.2	1.77
1998	11.93	5.59	7.25	6.38	2.03
1999	14.22	5.87	7.17	6.27	1.59
2000	15.06	6.01	7.43	6.85	1.77
2001	16.82	6.42	7.58	6.26	1.46
2002	17.3	7.01	7.91	6.4	1.17
2003	8.57	4.43	7.74	5.68	4.04

The chart below shows the internal rates of return for the three cities, compared against each other, over the ten periods. When averaged over the ten periods Auckland was 11.7%, Wellington 13.2% and Christchurch 12.1%.



One of the reasons why the periodic returns for the three cities varies over time was they were all at different stages on the property cycle. Christchurch was the last of the three to experience the boom and this is reflected in the higher returns for the period 2001 and 2002. On the other hand Auckland was the first city to show a recovery from the slump commencing in 2007.

Christchurch also showed the most volatility of returns as measured by the standard deviation of returns with Wellington the least volatile returns. The trade off between risk and return for the cities is shown on the chart below.



Discussion

Timing real estate decisions plays an important part in the overall returns shown in this analysis. Clearly, investors who entered the market before the recent property boom showed the highest seven year returns in all three cities. However, investors entering the market from 1994-1996 still achieved returns in excess of the government bond and mortgage interest rates. Capital gain was an important component of overall returns, particularly where the initial investment period was prior to the property boom.

Of course past performance is not necessarily a good guide towards future investment performance. During the property boom investors traded low yields for capital gains which were at historically high levels. It seems unlikely that capital gain during the next decade will equate that of the past decade.

Rents

The national level of rent remained static at \$310 per week over the quarter ending May 2011. Quarterly rental increases were mainly in the Auckland region with North Shore (2.3%), Auckland (6.7%) Manukau (8.5%) and Papakura (6.0%). Nelson was also up 6.6% over the quarter, possibly due to people relocating from Christchurch. On an annual basis the increase in the national level of weekly rents was 3.3%. The table in the right hand column compares current rents with the previous quarter and the same period last year.

Median Rents	May-10	Feb-11	May-11
Whangarei	280	280	280
North Shore	410	420	430
Waitakere	350	370	360
Auckland	370	370	395
Manukau	360	350	380
Papakura	330	330	350
Hamilton	295	305	300
Tauranga	310	320	320
Rotorua	230	247	230
Gisborne	240	250	250
Hastings	260	285	275
Napier	300	297	300
New Plymouth	280	285	280
Wanganui	200	195	200
Palmerston North	250	260	270
Kapiti	295	295	300
Porirua	305	340	310
Upper Hutt	260	300	290
Lower Hutt	310	300	310
Wellington	395	400	390
Nelson	300	300	320
Christchurch	290	310	300
Dunedin	250	280	250
Invercargill	210	200	210
All NZ	300	310	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. Donna Dowse is the Secretary/Treasurer. She may be contacted on 06 357-4032

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, free on request are:

- 1 The AMP Banking Home Affordability Report (Quarterly)
- 2 Rural Real Estate Market Outlook (Quarterly)
- 3 Auckland Commercial Market Outlook (Quarterly)
- 4 Christchurch Commercial Market Outlook (Quarterly)
- 5 Wellington Commercial Market Outlook (Quarterly)
- 6 Auckland Residential Market Outlook (Quarterly)
- 7 Christchurch Residential Market Outlook (Quarterly)
- 8 Wellington Residential Market Outlook (Quarterly)

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