



NZ Residential Rental Market

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Rental Subsidies

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DATA SOURCE The private sector rental data is 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.

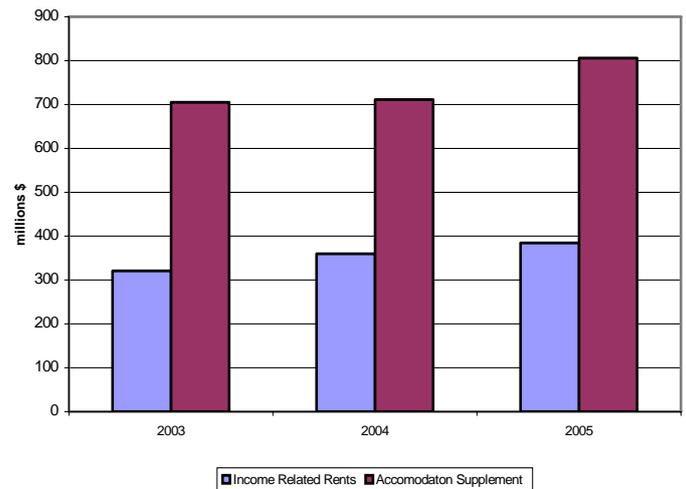
Should We Worry?

The recent death of Milton Friedman (perhaps the most influential economist of the modern era) serves to remind readers of his view that government intervention often aggravates the problems it was designed to solve. For example, take the case of taxpayer subsidised rental accommodation such as Income Related Rents (IRR) for State housing. Friedman's view on under pricing State house rents was this policy would simply create a queuing problem and an increased demand to build or buy more State houses.

Hindsight reveals this is exactly what has happened in New Zealand. Before the IRR policy was reintroduced there was a significant vacancy factor with State houses and now there are long waiting lists. These long waiting lists are being used as a justification to build more State houses. If a family can rent a State house for 25 percent of income and the equivalent private sector rental accommodation costs over 30 percent of income then naturally most people will opt for the cheaper option. Furthermore once a family moves into a State house there is not a lot of incentive to move on so the turnover rate slows down and as the tenants age there are increasing numbers of 3 bedroom houses occupied by single people.

The second form of government intervention in the New Zealand residential rental market is the Accommodation Supplement (AS). This subsidy applies to private sector renters who meet certain social welfare criteria. Friedman would probably have been much happier about the AS form of subsidy because it is a type of voucher system and is much more flexible than the IRR policy. Vouchers are transferable between houses and can be applied to mortgage payments, renting and boarding. About 60 percent of AS recipients are either private sector or Council renters.

The chart on the top of the right hand column shows the subsidy payments for both IRR and AS from 2003 to 2005. Interestingly the amount of the AS subsidy is more than double the IRR subsidy. Certainly a small part of the AS subsidy applies to homeowners mortgage payments and payments to boarders but there is a worrying trend towards increased subsidy dependence at a time when the economy has been robust and unemployment low. The consequence of a falling rate of home ownership and low savings rates are likely to mean increasing numbers of people will require rental subsidies into old age.



Critics of a previous time where there was exclusive use in New Zealand of the voucher system as a rental subsidy mechanism point to examples of overcrowding, poor health outcomes and the exodus of tenants from State houses. This was during a period when State house rents were set under a market related rents policy.

Overcrowding is regulated by existing local authority ordinances and is not necessarily a fundamental problem with vouchers. Similarly an exodus of tenants from State houses during the "market related rent" era may have been more of a valuation issue of failing to discount rents for a State house "stigma" effect.

No doubt the debate about the best form of intervention will continue. There is no easy answer. However, it is worth remembering that Milton Friedman believed that the disadvantaged would be better off with less government and by letting the market operate. Friedman recognised the need to help the poor and advocated the use of a negative income tax as the appropriate way of doing this.

The current level of rental subsidy in New Zealand is significant. To put this in context. The median private sector weekly rent in New Zealand is \$270. The IRR subsidy amounts to over \$100 per week (per State house) on average, without taking into account the ever increasing administration costs. Rental housing subsidies (IRR and AS) are costing the taxpayer around \$1.2 billion annually with the AS increasing more than four times faster than the rate of inflation.

It is more difficult to attribute an average amount of AS subsidy to private sector rental houses because the majority of landlords do not have State subsidised tenants.

Landlord Risks

There are also landlord risks when rental subsidies get capitalised into property values. At some point the subsidies might be capped at the current figure, reduced, or even withdrawn. Although a subsidy reduction scenario seems unlikely in the near future, it is a longer term possibility when the economy is facing difficulties. Perhaps the best New Zealand example of the effect of subsidy withdrawal occurred in agriculture during the 1980s when hill country farm prices fell by about a third.

Somewhat surprisingly there are a small group of tenants who argue that the AS has not benefited them because rental subsidies end up with higher rents being paid to the landlords who receive the subsidy. Thus the first group of landlords benefit from increased cash flow and by capitalising the subsidy into house prices when they sell. This line of argument assumes rents and house prices would drop if rental subsidies were withdrawn. More research is needed to test the validity of these various arguments.

Rental Levels on the Move

The weekly national level of median rent moved from \$260 in August 2006 to \$265 in September, \$270 in October and remained at \$270 for November. Prior to September 2006 the national median had been level at \$260 per week since 2004. A snap shot of rents in the main Territorial Local Authorities (TLAs) over the period November 2005 to November 2006 is shown in the table at the top right. The median national weekly rents increased by 3.8% over the last 12 months, marginally ahead of increases in the consumer price index. Increases in rents over the last quarter are most likely attributable to demand pressure from strong net migration figures. Also record high house prices are thought to be keeping potential first home buyers in the rental market for longer and adding to demand.

Strongest annual rental increases occurred in Gisborne (24.7%), Palmerston North (14.2%), Invercargill (13.3%) New Plymouth (12.5%), Wanganui (11.1%) and Wellington (10%). With the exception of Wellington City rental increases in the larger centres were generally in the 0-5% category. No cities recorded a decline in rents.

From time to time this publication also tracks Auckland and Wellington apartment rental levels because this sector of the market appears to be more volatile than the typical suburban rental house. The first table below compares Auckland City apartment rents over 12 months and the second table Wellington City apartments over the same period.

Auckland	Nov-05	Nov-06
1 bed	290	285
2 bed	350	370
3 bed	400	450

Wellington	Nov-05	Nov-06
1 bed	290	300
2 bed	362	382
3 bed	450	470

The one bedroom apartment market in Auckland City shows a small annual rental decline but all the other apartment types above recorded rental increases.

Median Rents	Nov 05	Aug 06	Nov 06
Whangarei	220	240	245
North Shore	345	350	350
Waitakere	300	300	300
Auckland	320	330	330
Manukau	300	300	320
Papakura	280	290	285
Hamilton	255	252	265
Tauranga	260	265	280
Rotorua	190	200	200
Gisborne	170	195	212
Hastings	220	225	220
Napier	240	250	260
New Plymouth	215	240	242
Wanganui	162	170	180
Palmerston North	210	220	240
Kapiti	235	240	250
Porirua	235	270	240
Upper Hutt	210	222	210
Lower Hutt	240	240	250
Wellington	300	320	330
Nelson	240	247	250
Christchurch	250	260	260
Dunedin	235	190	245
Invercargill	150	160	170
All NZ	260	260	270

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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:

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- 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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