

# NZ Residential Rental Market

## December 2010

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### To Rent or Buy

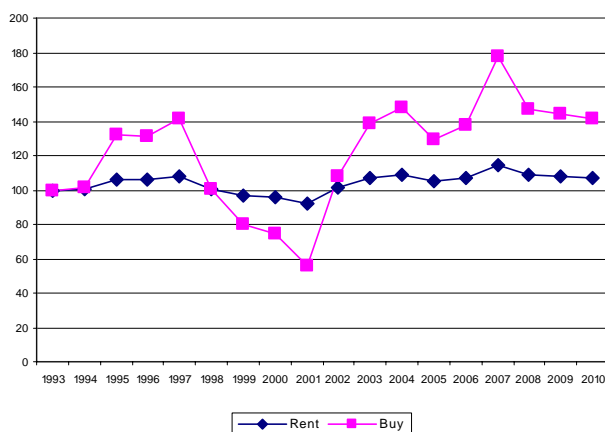
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**DATA SOURCE** This index has been developed from private sector rental data supplied by the Department of Building and Housing (Bond Centre). Information on wage rates, demographics and the structure of the rental housing stock is drawn from Statistics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

One of the challenging questions faced by new households is the decision to rent or buy a house. During the period 2002 to 2007 house prices doubled in most parts of New Zealand and the big winners were home owners. However, given current economic conditions and a flat housing market it seems very unlikely that the sort of price increases seen during the property boom will repeat themselves, at least during the next few years.

For some people with a fairly short term time horizon renting may be the best financial option. While for others with a longer time horizon history shows that buying is usually the best financial option. Of course the decision is not just about the financial implications of renting or buying. Typically the benefits of ownership include, stability for children's schooling, investment in the local communities activities, pride of ownership, the ability to alter the property within the planning rules, the satisfaction associated with a savings discipline resulting in paying off a mortgage and creating equity in the property. On the other hand renters are more flexible because they have the ability to move at relatively short notice and do not have the high transaction costs faced by owners when buying or selling a house.

The chart below compares national home ownership affordability with national rental affordability. Ownership affordability is calculated by multiplying the mortgage interest rate by the median house price and dividing this by the average wage rate. Rental affordability is calculated by dividing rental costs by average wage rate. Both ownership and renting are indexed to a common base in 1993. This chart shows the cost of ownership is considerably more volatile than the cost of renting.



The discounted cash flow methodology is a useful tool in weighing up the financial benefits of renting versus buying. The tables below set out a hypothetical situation based on a medium income family in a northern suburb of Auckland. The 'base year' box below itemises the ingoing costs and rent and the 'at sale' box shows the net sale proceeds. The five year cash flows are set out at the bottom and assume a 3% annual increase in rents and costs and a 3% annual increase in house prices. The after tax discount rate is set at 5% and shows the ownership option achieves an internal rate of return of 6.4%. This means that if the householder could invest the \$191,100 equity at an after tax rate greater than 6.4% then they would be financially better off renting. The spreadsheet allows the user to test various scenarios including changing interest rates, property values and expenses. Extending the period of ownership minimises transaction costs and favours the buying option.

Base Year		At sale	After 5 years
weekly rental	\$400	% increase value pa	3%
repairs & maint.	\$1,500	Sale price	\$440524
insurance	\$650	R/E fees	\$15418
rates	\$1,800	Legal at sale	\$1000
required return	5%	Residual	\$424106
property cost	\$380,000	Repay Mortgage	\$146519
mortgage	\$190,000	net	\$277587
interest rate	7%		
loan term	15		
legal costs to buy	\$1100		

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
<b>Income \$</b>						
Rental		20800	21424	22067	22729	23411
<b>Expenses \$</b>						
Repairs & Maint.		1500	1538	1576	1615	1656
Insurance		650	666	683	700	717
Rates		1800	1845	1891	1938	1987
Debt serv		20,861	20,861	20,861	20,861	20,861
Total expenses		24811	24910	25011	25115	25221
Net Income		-4011	-3486	-2944	-2386	-1810
Cash Flow	-191100	-4011	-3486	-2944	-2386	275777
IRR	6.40%					
NPV @ 5%	13490.2					

## Scenario Analysis

Spreadsheets are a useful tool allowing the user to consider a variety of scenarios. The tables below consider the impact on the return to equity by simultaneously changing the main variables in the rent versus buy decision. The period of investment has been kept constant at 5 years and a 15 year term is assumed for the table mortgage which is 60% of the purchase price in the first scenario and 80% in the second scenario. The most attractive scenarios favouring owning rely heavily on the assumption that property value increases will be greater than the rate of escalation in costs. Furthermore leveraging a house purchase (by taking on a larger mortgage) to increase the return on equity works, so long as the interest rate on the mortgage is less than the return on equity. Of course as the degree of leverage increases so to does the riskiness of the scenario because of the volatile nature of mortgage interest rates.

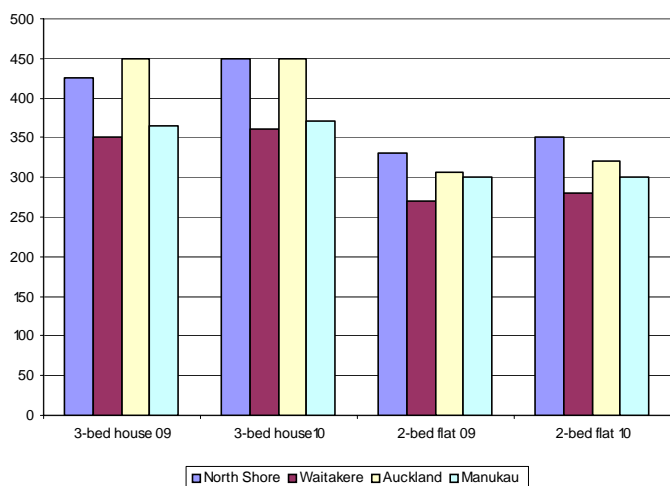
Scenario (60% loan)	% change pa		
Rent	2	3.5	5
Operating costs	3	4	5
Property value	2	3	6
Interest rate	7%	8%	9%
Net % return	4	5.2	10.1

Scenario (80% loan)	% change pa		
Net % return	2.2	3.5	10.7

### Overall Rents Remain Flat

The national median weekly rent remained at \$300 per week in November, the same level where it has been at November 2009. However, on an annual basis rental increases above 5% were recorded in Papakura, North Shore, Rotorua, Palmerston North and Invercargill. The Christchurch earthquake did not appear an appreciable effect on rents up to November 2010. The table in the right hand column compares current rents with the previous quarter and the same period last year.

The chart below shows snapshots of the rent for Auckland regions 3 bedroom houses and 2 bedroom flats in November 2009 and November 2010. This shows weekly rents for houses and flats in North Shore increasing at about 6% compared with Waitakere at 3%. In Auckland house rents were static and the rent for flats increased by 4%. Rents in Manukau for both houses and flats remained flat over the period.



## Median Rents

	Nov-09	Aug-10	Nov-10
Whangarei	272	270	280
North Shore	390	390	420
Waitakere	345	350	350
Auckland	360	375	360
Manukau	355	365	350
Papakura	300	330	330
Hamilton	290	290	295
Tauranga	300	315	315
Rotorua	225	230	240
Gisborne	240	245	250
Hastings	260	262	250
Napier	280	280	280
New Plymouth	280	290	290
Wanganui	192	200	200
Palmerston North	260	260	275
Kapiti	300	300	300
Porirua	330	325	330
Upper Hutt	250	260	257
Lower Hutt	300	295	300
Wellington	382	380	390
Nelson	300	300	300
Christchurch	285	290	295
Dunedin	260	247	270
Invercargill	197	210	210
All NZ	300	300	300

### 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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