



NZ Residential Rental Market

June 2005

Quarterly Survey Volume 8, Number 2

Total Returns for Investor Houses

Prepared by
Bob Hargreaves*

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.

Total Returns

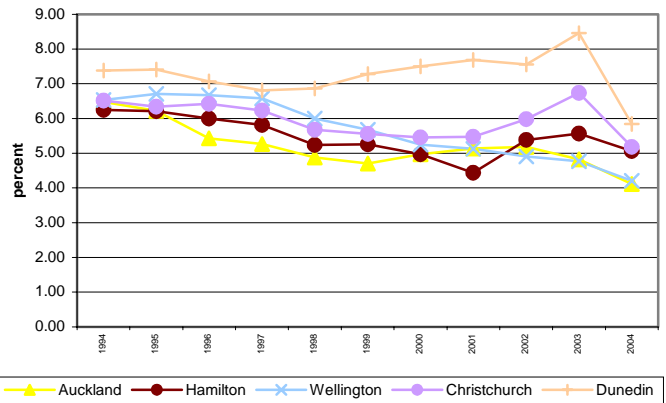
The returns on rental housing investments come from annual cash flow generated by rents (less expenses) and changes in property values over time. In New Zealand the DBH Bond Centre is a good source of information on gross rents. Quotable Value NZ has reliable information on changes in property values over time. The Quotable Value information on changes in house prices relates to single family homes and the analysis in this paper is also based on single family homes.

Combining the rental and sales data bases offers one way of estimating the total returns on housing. However, before the data bases can be combined there are two research questions that need to be answered. Firstly, what is the relationship between gross rents and net income? Secondly, does the median house price or the lower quartile house price best represent typical investor housing? Survey work carried out by the author in 2004 and reported in the last issue of this publication indicated that expenses (including management but excluding debt servicing) are approximately 23% of actual gross rents (after allowing for vacancy).

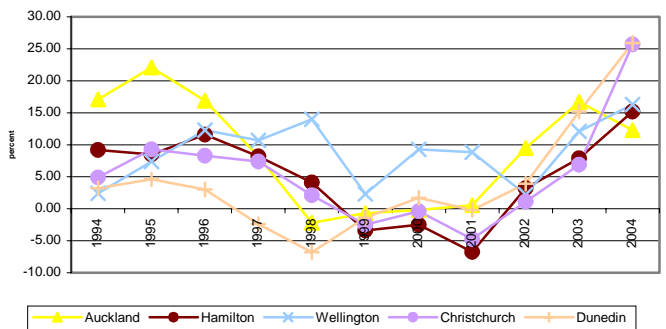
The 2004 survey also showed that the value of a typical private sector rental house is the average of the median and lower quartile house prices for the relevant territorial local authority. One reason why private rental houses is not represented by the lower quartile housing statistic is related to the fact that both State and TLA rental housing is generally located in lower value neighbourhoods. Another reason is that rental housing has an increasingly share of the total housing stock, currently around 30%. Rental housing is even more extensive in the Auckland TLA (over 45%).

The top graph on the right hand column shows the net yields for a cross section of main cities over the period June 1994–June 2004. Net yields were generally declining over this period but there was upward movement in 2003 coinciding with increased net migration. Offsetting the decline in yields are the increases in property values. The middle graph to the right shows the annual percentage changes in house prices from the Quotable Value indices. Decreasing yields have been more than offset by increasing property values as shown in the bottom graph to the right which charts percent total returns for the same group of cities. The returns shown in the graphs are pre-tax returns and ignore the effects of using borrowed money to leverage the returns. This means that actual returns may be higher than those shown on the graph. The average un-leveraged returns over time are set out on the second page and these illustrate the overall profitability of investor housing.

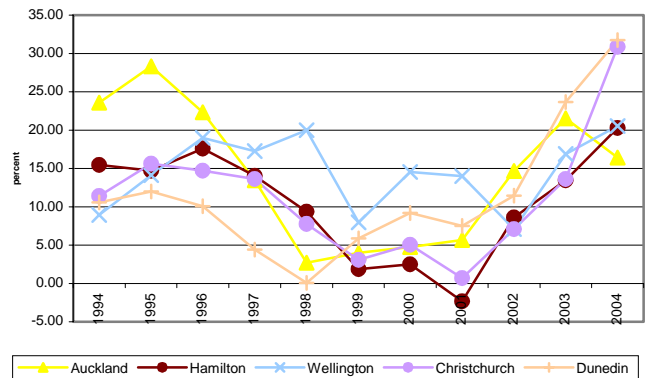
Yields



Changes in House Prices



Total Returns



Risk and Return

With investments it is normal to expect a trade off between risk and return. Investors who expect higher returns generally have to accept more risk than investors who are prepared to accept a lower rate of return. One measure of risk with property investments is the volatility of returns, often expressed as the standard deviation of returns. The table below shows the average total returns for the main urban areas from June 1994 to June 2004, the standard deviation of these returns and the risk ratio (standard deviation divided into the average return).

	Average	Std Deviation	Risk Ratio
North Shore	13.20	8.35	0.63
Waitakere	13.98	10.17	0.73
Auckland	14.31	9.01	0.63
Manukau	12.96	7.78	0.60
Papakura	11.81	10.46	0.89
Hamilton	10.49	7.20	0.69
Tauranga	13.03	8.66	0.66
Napier	12.71	8.03	0.63
Palmerston North	9.81	4.59	0.47
Porirua	13.38	5.14	0.38
Upper Hutt	12.13	4.47	0.37
Lower Hutt	13.18	4.38	0.33
Wellington	14.57	4.78	0.33
Nelson	12.42	9.62	0.77
Christchurch	11.24	8.21	0.73
Dunedin	11.50	8.91	0.77
Invercargill	11.91	11.08	0.93
All NZ	12.97	6.53	0.50

One of the interesting points that shows up on the above table is the volatility of the Auckland market as compared with the Wellington market. Thus investors in Wellington appear to be achieving similar average returns compared to those in Auckland but with considerably less risk. This may be a function of the stability of the large public service sector in the Wellington work force and the fact that fluctuations in net migration have a larger effect on Auckland. From an investment perspective risks can be reduced by adopting a portfolio approach and diversifying investments between cities. For example it turns out that the Auckland and Wellington markets are not very highly correlated with each other as illustrated in the total returns graph on page 1. For an Auckland investor splitting the investment between the two localities will considerably reduce the Auckland risk without having to trade off returns. The main reason why more investors do not diversify probably relates to small investors preferring to take a hands on approach to managing their locally based rental properties.

Current Rental Levels by TLA

Over the last quarter the national level of median rent for private sector rental accommodation remained unchanged at \$250 per week. A snap shot of rents in the main TLAs over the period April 2004 to April 2005 is shown in the table at the top right. Over this period small rental increases were recorded in a number of the North Island provincial cities including Hamilton, Hastings, New Plymouth, Wanganui and Palmerston North. Rents in the main centres and South Island remained relatively static.

	April 04	Jan 05	April 05
Whangarei	190	200	210
North Shore	340	330	340
Waitakere	298	300	295
Auckland	325	320	325
Manukau	300	290	295
Papakura	260	270	275
Hamilton	230	240	250
Tauranga	240	255	250
Rotorua	175	180	190
Gisborne	170	180	175
Hastings	190	220	210
Napier	210	222	220
New Plymouth	180	220	220
Wanganui	140	152	160
Palmerston North	180	200	200
Kapiti	220	200	220
Porirua	220	240	240
Upper Hutt	170	172	200
Lower Hutt	225	225	230
Wellington	290	300	300
Nelson	250	240	240
Christchurch	240	250	250
Dunedin	210	225	220
Invercargill	170	160	160
All NZ	240	250	250

Massey University Property Foundation

The foundation is established to sponsor research and education in property related matters in New Zealand. The Chairman of Trustees is Mr Bill Cleghorn. 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. The acting secretary of the Foundation is Donna Dowse, Phone (06) 3505799 ext. 2321.

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)

Inquiries concerning this publication and other research papers prepared by MUREAU may be addressed to:

MUREAU
 Department of Finance, Banking and Property
 Massey University, Private Bag 11.222
 Palmerston North
 Telephone: +64 6 350-5799 ext: 2321
 Facsimile: +64 4 350-5651

<http://property-group.massey.ac.nz/mureau/mureau.htm>