



**Massey
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NZ Residential Rental Market

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Do Rents Lead House Prices?

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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.

Income and Value

Changes in the level of house prices are frequently reported in the media because they are of interest to the general population, property professionals and policy makers. With few exceptions, people are either renters or owner occupiers. Since 2000 the Economist magazine has reported on an unprecedented increase in house prices in a number of western countries, including New Zealand. A number of commentators have suggested house prices are now out of line with "fundamentals" based on the historical relationship between income generating capacity and value. For example, Robert Shiller in his book "Irrational Exuberance" (2005) takes the view that a number of the psychological factors (such as herd like behaviour and over confidence) that led to dot com share market bust are present in property markets.

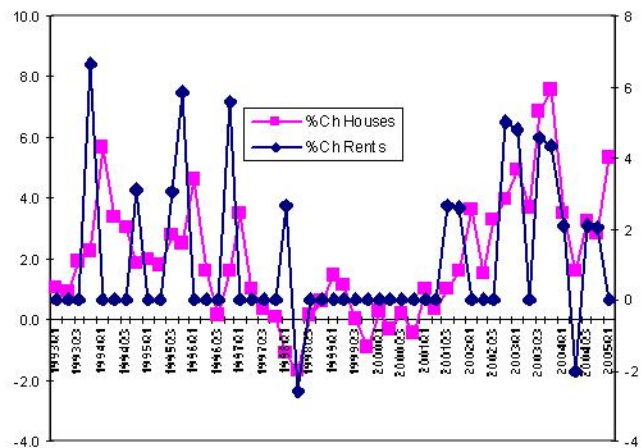
This objective of this edition is to determine if changes to private sector residential rents can be used to forecast changes to New Zealand house prices. The hypothesis being that there is a strong linkage between income and value in both the share markets and commercial property markets and the same effect is likely to be true for housing. This means that house prices are more likely to adjust to rents rather than rents adjusting to house prices. This is because the value of a house now is the discounted value of its future income. Ultimately future capital appreciation expectations rely on rents continuing to increase.

Yields and Interest Rates

The consequence of house prices increasing at a faster rate than rents has been a decline in net yields. Yields are simply the relationship between income and value. Yields are quite strongly correlated with mortgage interest rates. At the same time lower interest rates were helping to push up house prices they were lowering yields. From 1993-2004 floating mortgage interest rates were on average 3.2 percent higher than average yields. Although appreciation in house prices (8.2 percent on average) was more than double the gap between yields and floating mortgage interest rates highly leveraged investors were being placed in a risky position. As the rate of increase in house prices slows down and eventually flattens buyers are likely to demand higher yields. Higher yields are possible if rents increase but currently this does not appear to be a very likely scenario. It is more likely the prices for some classes of investor housing will at least stabilise and possibly decline. It can be argued that lower yields are justified so long as mortgage interest remain low but this argument overlooks the fact that interest rates are more volatile than yields since property is a long term investment.

Rents and House Prices

The chart below shows the quarterly percentage change in house prices for New Zealand (left hand scale) against the percentage change in rents from 1993-2005 (right hand scale). Over this period rents led house prices down in the late 1990's and up in 2001. Data on rental vacancy rates is not available but there may be a tendency for landlords to accept higher vacancies rather than reduce rents.

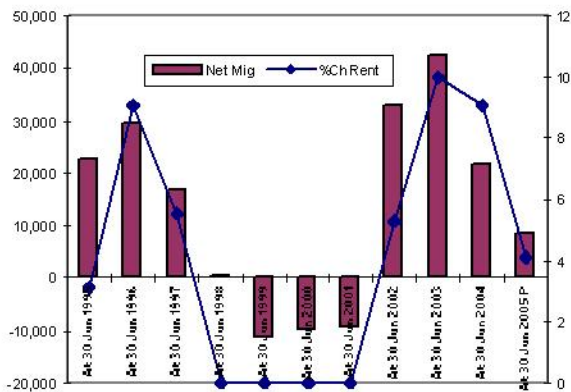


The table below shows the correlation coefficients between 6 monthly house price and rental data for all New Zealand as well as Auckland, Wellington and Christchurch cities. The adjusted coefficients are where the rental data is lagged 6 months. The correlation coefficients increase significantly when the rental data is lagged by one period confirming that rental levels lead house prices.

Correlations of Rents and House Prices		
	Unadjusted	Adjusted (6)
All New Zealand	.15	.80
Auckland	.30	.75
Wellington	-.18	.38
Christchurch	.27	.65

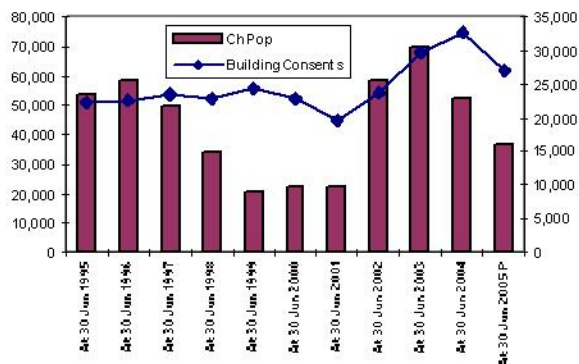
Rents and Net Migration

One of the key demand drivers in the New Zealand rental market is net migration. The annual rate of natural increase in the population averaged 29,000 persons over the period June 1995 to June 2005 with a standard deviation of only 1440 persons. Conversely over the same period net migration averaged 13,100 persons, with a standard deviation of 18,700. Net migration has a history of providing "shocks" to residential rents because in the short run it is hard to match a relatively inelastic supply of housing with sudden changes in demand. The chart below tracks the annual percentage change in rents on the right hand axis and net migration statistics from 1995-2005 on the left hand scale. Negative net migration from 1999-2001 is clearly related to a static level of national rents. Strongly positive net migration levels in 2002 and 2003 resulted in annual rent increases peaking at 10 percent in 2003.



The Supply Side

The chart below illustrates the difficulty that developers have in matching supply with demand. The right hand scale maps building consents and the left hand scale the annual increase in population. Over the last decade the average ratio of population increase to new building consents was 1.9 with a high of 2.56 in 1996 and a low of 1.35 in 2005. In other words in mid 2005 we were planning to build 100 new dwelling units for each increase in population of 135 persons. Certainly not all building consents translate into actual building completions, but most do and the 2005 ratio suggests oversupply.



Rental Trends

Over the last quarter the national level of median rents remained unchanged at \$260 per week, up 4 percent on the same period in 2005. The table in the right hand column shows rental levels for the main TLAs.

Median Rents

	Jan 05	July 05	Jan 06
Whangarei	200	220	212
North Shore	330	340	340
Waitakere	300	290	300
Auckland	320	320	320
Manukau	290	300	310
Papakura	270	275	280
Hamilton	240	250	250
Tauranga	255	260	270
Rotorua	180	185	190
Gisborne	180	190	190
Hastings	220	220	220
Napier	222	240	240
New Plymouth	220	220	220
Wanganui	152	156	165
Palmerston North	200	200	210
Kapiti	200	220	230
Porirua	240	225	230
Upper Hutt	172	227	190
Lower Hutt	225	235	240
Wellington	300	300	300
Nelson	240	240	250
Christchurch	250	250	260
Dunedin	225	212	240
Invercargill	160	160	160
All NZ	250	250	260

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 secretary of the Foundation is Alison Smith, Phone (09) 486-5224.

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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