



# NZ Residential Rental Market

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### Where to with rents?

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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.

#### The Landlords View

A spokesperson for the Auckland Property Investors Association was reported on national radio (August 21) as saying he expected residential rents to rise by 20% over the next two years. This level of rental increases appears to be unprecedented in a low inflation environment where for the last decade rental increases have been averaging just over 5% per year. Is 20% over 2 years just wishful thinking? Perhaps it is an example of anchoring type behaviour on the part of the property investors? Maybe a 20% increase is a realistic expectation based on current market supply and demand? One argument for rental increases being advanced by some landlords says that under a scenario where increases in house prices are slowing (and may become static) then increasing rents is the only way to maintain profitability. Of course only time will tell the actual outcome. Predicting future rents is difficult!

#### Anchoring Behaviour

First of all what is anchoring type behaviour? Well an increasing body of research in negotiations in general and property in particular suggests if buyers don't have good information on the price of a good then their expectations can be influenced by the vendor suggesting prices that people then anchor onto. Also a number of overseas behavioural studies have shown that if inexperienced valuers are not familiar with a location or property type then it is possible to lead them to an inaccurate conclusion by supplying slanted information about prices.

#### Market Transparency

However, anchoring type behaviour is less likely to be effective in relatively transparent markets such as found with residential rents. Transparency in New Zealand achieved by an open system whereby Tenancy Services regularly publishes market rent information (down to a suburb level) on their website ([www.dbh.govt.nz](http://www.dbh.govt.nz)). Furthermore there is a large volume of rental information available because private sector renters are highly mobile. About 1/3 of households rent and tenants usually move in less than one year. Certainly residential rental properties

are somewhat heterogeneous, but usually not sufficiently so to make establishing rents very difficult. Finally, anchoring behaviour is unlikely to be effective because overpricing leads to higher vacancy rates. The supply side of the market is dominated by several hundred thousand Mum and Pop landlords who generally act independently of each other and are unwilling to accept high vacancy rates.

#### Rental Drivers

On the demand side one of the key variables is the rate of new household formation and this is a function of the rate of population growth and the state of the economy. When the economy is doing well young people are more likely to move out and set up flats. Conversely in hard time young people "double up" and move home again. Population growth occurs with natural increases in the population (births less deaths) and net migration. Natural increase runs about one percent (40,000) and is reasonably predictable but net migration is a much more volatile statistic. On an annual basis net migration is currently around 5000 after being negative in the late 1990s and strongly positive (over 40,000 in 2003). The demand for rental properties is also driven by affordability considerations that show even if the total population remained static increasing numbers of households will be renters. The demand side is also influenced by a long term trend showing the average occupancy rate per dwelling unit falling due to smaller family sizes.

The supply side of the rental housing market is dominated by private sector rentals. The typical rental house is a 3 bedroom bungalow situated in a suburban environment. Rental houses typically are 40-50 years old and are originally part of the owner occupier housing stock. The economics of converting second hand owner occupier housing to rentals is usually much better than building new rental housing. However there are some exceptions when land costs can be reduced by building a second unit on an existing site.

#### Rental Returns

Over the last five years the total annual returns on rental housing investments has been very good, mainly due to capital appreciation in the value of housing. Since 1993 residential rents have averaged around 5% compound rate of increase and house prices about 8% compound. Over time this period

the yields on rental property have been driven down to a point where net yields are currently often less than half the mortgage interest rate. This means significant numbers of highly leveraged properties are showing negative cash flows. Certainly there may be some tax advantages with running a property at a loss that can be offset against other income. However a fundamental rule with rental property is that cash flow is King and near cash flow counts more than future cash flow. The consequences of ignoring this rule becomes apparent when house prices flatten, or decrease as seen in the late 1990s. At this point recent buyers of rental properties have to take a longer term view in the hope that property values will eventually start going up again.

### On Balance

In an effort to maintain total returns on investment landlords will naturally look at the option of increasing the rents. However, unless there is a big surge in net migration then over the next two years the demand for rental accommodation is unlikely to get out of step with supply. Historically rental increases have tended to be more in line with wage increases than increases in house prices. Thus a 20% increase in rents over two years does seem to be an unlikely scenario.

### Rental Levels

A snap shot of rents in the main Territorial Local Authorities (TLAs) is shown in the table at the top right. The weekly national level of median rent remained at \$280 per week during the quarter June 2007 to August 2007. Over this period the largest increase was in Lower Hutt (7.69%) followed by Gisborne (6.98) and then Whangarei(4%). Readers should note that the median rental statistic can be strongly influenced by an usual mix of rental tenancies in one month. This is illustrated by the August 2007 rents for Wellington City which contain an unusually large number of tenancies for rooms, meaning multiple tenancies are possible for one property. This has pulled the Wellington median down. Comparing rents for August 2007 with August 2008 shows the national median moving up 7.67% with the largest increases in Gisborne (17.95%), Lower Hutt (16.67%) and Dunedin (15.79%). The national statistic is dominated by rents in the Auckland region with all cities except Manukau showing increases below the average.

### Apartments

The table below takes snapshots of median apartment rents in Auckland and Wellington in August 2006 and August 2007.

	Aug-06	Aug-07
<i>Auckland</i>		
1 bed	285	300
2 bed	367	369
3 bed	420	460
<i>Wellington</i>		
1 bed	295	235
2 bed	350	370
3 bed	480	517

Median Rents	Aug-06	May-07	Aug-07
Whangarei	240	250	260
North Shore	350	370	370
Waitakere	300	320	320
Auckland	330	340	350
Manukau	300	330	330
Papakura	290	300	300
Hamilton	252	280	280
Tauranga	265	290	290
Rotorua	200	210	210
Gisborne	195	215	230
Hastings	225	242	240
Napier	250	260	260
New Plymouth	240	250	250
Wanganui	170	190	190
Palmerston North	220	230	230
Kapiti	240	265	275
Porirua	270	290	280
Upper Hutt	222	242	220
Lower Hutt	240	260	280
Wellington	320	350	300
Nelson	247	272	260
Christchurch	260	275	270
Dunedin	190	230	220
Invercargill	160	180	180
All NZ	260	280	280

#### 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 Donna Dowse, Phone (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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