

NZ Residential Rental Market

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Property Fundamentals

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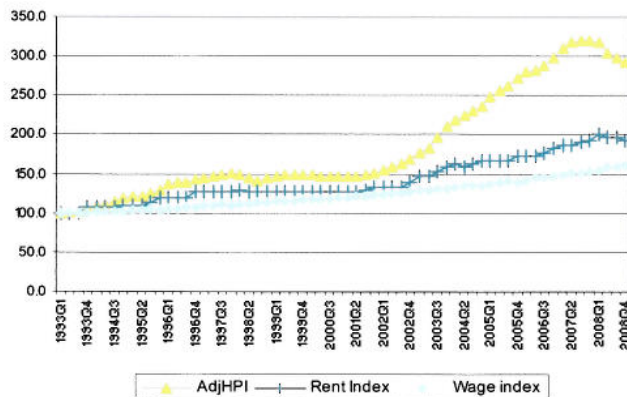
DATA SOURCE The private sector rental data is supplied by the Department of Building and Housing (Bond Centre). Information on wage rates, demographics and the structure of the rental housing stock is drawn from Statistics NZ data. House price information has been extracted from Real Estate Institute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

Theory and Practice

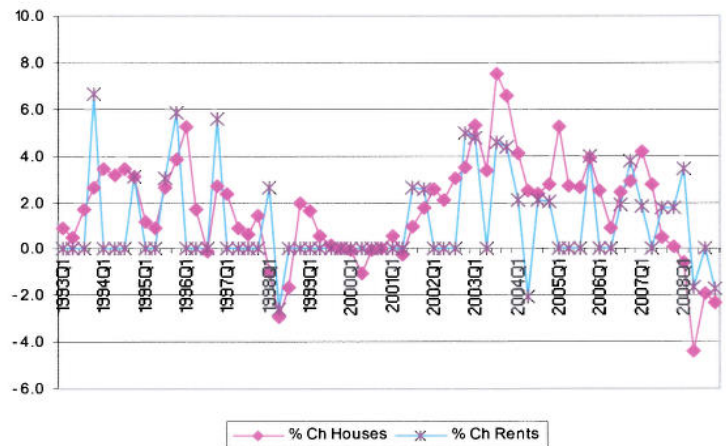
In the aftermath of the recent property boom attention has become refocused on property fundamentals. The fundamental value of an asset is normally thought of as the discounted value of its future earnings capacity. This leads to the old adages, “cash flow is king” and “near cash flow is worth more than future cash flow”. In the case of a residential rental property near cash flow is a function of the net rental income stream. Net income before debt servicing is typically is about 75 percent of effective gross income (total potential gross rent less an allowance for vacancies and bad debts).

During property “bubbles” investment decisions appear to be largely based on potential capital gain (future cash flow) and an element of speculation enters the market with house prices continuing to increase irrespective of changes in rents. As the relationship between income and value continues to widen property yields may drop below the mortgage interest rate. Behavioural research on property bubbles suggests a herd instinct applies and many buyers go along with the crowd. The chart below tracks changes to house prices, rents and wages over the period 1993 to 2008. The changes are indexed to a common base of 100 at the start and show house prices peaked at 320 in the last quarter of 2007, rents at 200 in the first quarter of 2008 and wages at 161 in the last quarter of 2008. By the end of 2008 the house price index was down 9 percent from its peak and rents down 3 percent from their peak.

Changes in rents are more closely correlated to changes in wages than they are to changes in house prices so another property fundamental landlords have to be aware of is rental affordability considerations.



The second chart maps quarterly percentage changes in rents and house prices over the period 1993 to 2008 and shows rents generally leading house prices. Massey property lecturer Song Shi has used monthly data and found a similar effects in his detailed study of the main cities in New Zealand. These findings can be interpreted as follows: First, assuming there is a fundamental relationship between house prices and rents then the first chart shows this relationship is still out of balance, suggesting either further falls in house prices or rent increases. Given rents are closely aligned to wages and unemployment is rising then past experience in recessionary times indicates the probability rents will stay flat. The counteracting force in the current recession is high levels of net migration and low rates of new house construction may underpin rental demand.



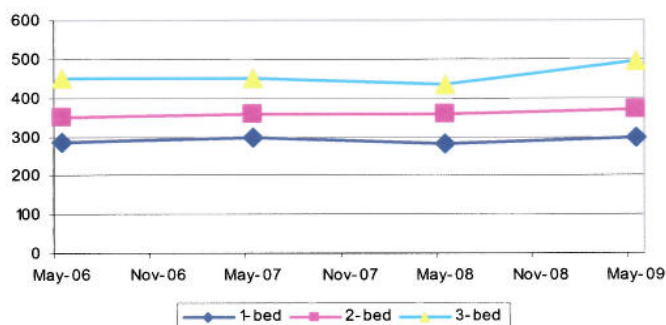
The favourable taxation treatment enjoyed by residential property investors (Loss Attributing Qualifying Companies, depreciation etc) has caused some analysts to argue there is a new set of property fundamentals. However, concessions given by Government carry some risk and can be removed. For example, the subsidies removed from agriculture during the “Rogernomics” period in the 1980s resulted in substantial reductions in the value of farm land. Currently one of the options being considered by the government committee looking at taxation reform is some form of property tax.

Finally there is interest rate risk. Certainly, low interest rates helped to fuel the recent housing boom, particularly in the USA, but interest rates are volatile. The price New Zealand taxpayers will have to pay for increased government borrowing is likely to be higher mortgage interest rates. Another property fundamental is that housing is a long term asset and investors need to take a long view on interest rates. Interest rates in New Zealand are typically higher than in many other larger and less risky economies.

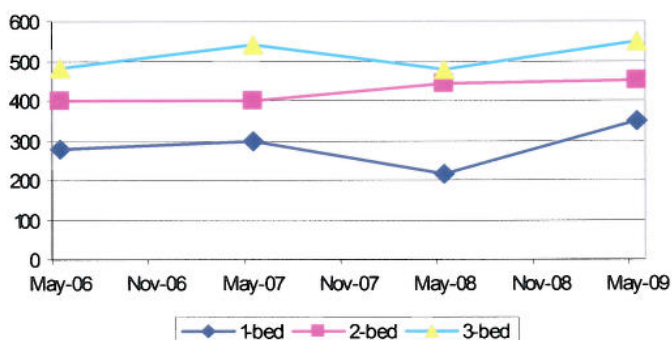
Apartment Rents

Snap shots of the median rents for apartments (1, 2 and 3 bedroom) located in Auckland and Wellington cities are shown in the two charts below. Rents in the Wellington apartment market have generally stayed ahead of those in Auckland, but both markets have been relatively flat over the last four years. During this same period the national median rent increased by 15%.

Auckland City Apartments



Wellington City Apartments



Rental Levels Remain Flat

The table at the top right hand column on this page shows rental levels in the main cities over the survey period. Over the last quarter the national median weekly rent decreased by \$1 bringing it back to \$299 per week. In May 2008 the national median rent was \$295 per week. The current difficult economic times along with rising unemployment makes some landlords reluctant to increase rents because anecdotal evidence suggests vacancy rates in parts of the country are increasing. An empty rental unit does not cover the mortgage payments! Also some tenants are down-sizing their accommodation requirements while others may be part of the "rebound" generation and returning home to live with Mum and Dad.

There are no real surprises in the rental data. Past results show the Upper Hutt medians tend to be rather volatile, possibly due to relatively small private sector sample sizes. The Wellington data for May 2008 appeared to be skewed by the large number of individual "room" category accommodation contained in the data.

Median

Rents	May-08	Feb-09	May-09
Whangarei	280	270	270
North Shore	400	390	395
Waitakere	330	330	330
Auckland	360	360	360
Manukau	340	360	350
Papakura	320	305	320
Hamilton	290	300	290
Tauranga	310	300	300
Rotorua	225	230	225
Gisborne	240	250	240
Hastings	250	250	250
Napier	285	272	290
New Plymouth	280	280	280
Wanganui	195	180	200
Palmerston North	250	250	250
Kapiti	280	300	285
Porirua	310	310	310
Upper Hutt	270	250	295
Lower Hutt	300	300	310
Wellington	270	385	395
Nelson	280	297	295
Christchurch	290	299	280
Dunedin	242	260	240
Invercargill	200	200	200
All NZ	295	300	299

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