RESEARCH

JULY 2015

RESIDENTIAL PROPERTY MARKET

INVESTMENT RETURNS IN AUCKLAND'S RESIDENTIAL PROPERTY MARKET

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The ongoing saga that is the Auckland residential property market is continuously in our eyes and ears through the attention from media. Knight Frank has taken a particular interest in the actual net returns achieved from residential investment property purchases to ascertain the presence of speculation, and if so, how prevalent.

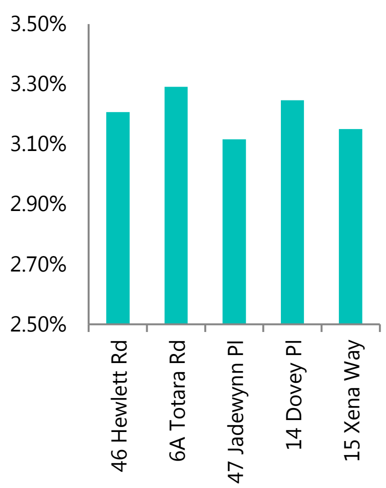
There are two typical investment property options that Knight Frank has focussed on: one being the standalone dwelling sold with a lease in place to Housing NZ with a guaranteed rental return and the other being the typical block of residential units, or 'sausage block flats' as many Kiwis would know. Knight Frank have analysed net yields or returns after accounting for non-recoverable outgoings such as rates, insurance, repairs and maintenance and management.

Housing NZ Leased Properties

Throughout Auckland there are a large number of residential properties with leases in place to Housing NZ, guaranteeing rental return and also with annual market adjusted rental reviews. These properties are worth analysing in that the likely purchaser is primarily an investor only, ruling out any influence of owner occupiers in potentially skewing yields.

Knight Frank have researched a number of recent transactions of this asset type and we detail a selection of analysed sales below. As evident, net yields are trending between 3.1% and 3.3% which falls below the current 'risk free rate' of many of the major banking institutions by some 100 to 125 basis points. This indicates that some level of speculation around capital gain is prevalent for investors within this asset class.

FIGURE 1
Housing NZ Leased Standalone Dwellings (Net Yield %)



Residential Investment Blocks

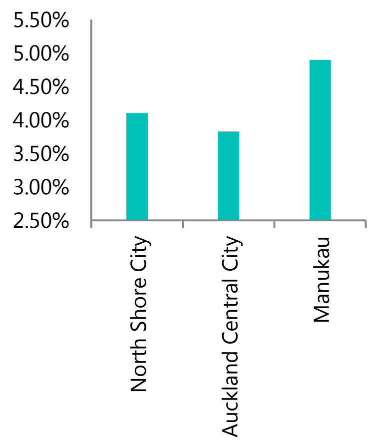
Residential investment flats are just one of the sectors in the property market sought after by investors. A block of traditional investment flats typically consist of a minimum of three, one or two bedroom units of 1960's to 1970's era and offer a basic fitout with either an open allocated car park, single carport or single car garage. On the whole, the quality of fitout for a block of flats are generally average and dated.

Like the abovementioned examples of Housing NZ leased properties, owner occupiers are generally excluded as a prudent purchaser and should in theory not impact on the indicative yields achieved. However, adding to this is the fact that the capital outlay can be quite significant for a block of flats, in turn limiting the pool of potential purchasers.

Over the past 18 months Knight Frank has tracked and analysed a number of residential block investment sales and derived a net return for each property. The Net Yield was used over Gross Yield as it is a true measure of the property's earning potential taking non-recoverable outgoings such as rates, insurance, repairs and maintenance and management.

Our analysed yields are below and identify a slightly higher range than the abovementioned HNZ properties by some 70 to 150 basis points, trending between 3.80% to 4.90% and area specific with lower yields in quality localities and vice versa.

FIGURE 2
Residential Investment Flats (Net Yield %)



In addition to yield analysis, the tenure of the underlying land can take on various forms within these types of properties, varying from Fee Simple, Cross Lease and Unit Title. When analysing these sales, it is important to recognise the tenure component as one would expect a lower return for units on individual titles as opposed to units on one parent title, given the opportunity for the owner to sell all or part of a complex in the future if desired. Our analysis has indicated that units that sold with individual titles are achieving lower yields typically around 50 basis points.

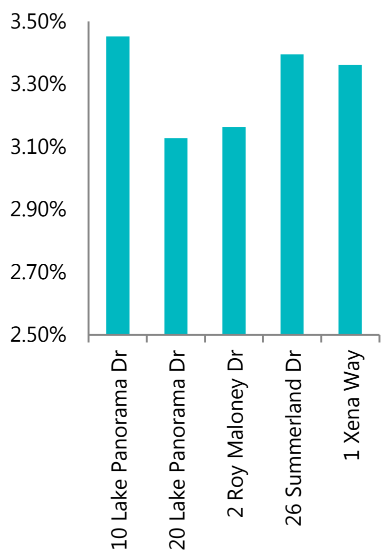
As the chart suggests, the localities can have a strong impact as to the yields achieved. Unlike the abovementioned Housing NZ tenanted properties, Knight Frank's analysis of Investment Blocks cover a vast array of suburbs across the greater Auckland Region. As anticipated, the more sought after central localities of Auckland, characterised by good schools and generally high property values attracted the lower yields, whereas the outer suburbs of Auckland encompassing generally lower socio-economic characteristics derived higher yields, perhaps reflecting higher tenant risk and value growth preservation.

Are Standalone Vacant Dwellings Achieving a Premium?

Now that we have been able to ascertain typical yields for investment property across the Auckland Region, Knight Frank asked the question 'Are vacant properties also available to owner occupiers achieving yields lower than that of a typical investment property?'

To answer this question, Knight Frank have analysed a large number of recent sales with similar attributes to the Housing NZ leased properties. A small selection of these sales and their respective results are below and indicate varying net yields of between 3.00% and 3.50%. Surprisingly, the yields are very similar to comparable standalone investment properties such as those subject to Housing NZ leases.

FIGURE 3
Standalone Dwellings (Net Yield %)



In addition, we highlight an example of an investment block of flats within Mt Eden, one of Auckland's prime central suburbs. A block of seven two-bedroom units on a Fee Simple title sold December 2014 for $4,100,000. It had an average rental income of $360 per unit, deriving a net yield of 2.70%. There was no exclusive outdoor living and each unit had one off street car park away from their respective unit. The property is located in close proximity to Mt Eden Domain and is zoned for six schools including Epsom Girls Grammar and Auckland Grammar.

When comparing the above example with a standalone dwelling on a Fee Simple title, a property in Mt Eden sold for $1,410,000 in March 2015, comprising a three bedroom 1880's villa in average condition with a single detached garage on a 589 sqm site. The property is typical of a Mt Eden character dwelling. It rented for $800 per week in May 2015, resulting in a net yield of 2.55%.

One would anticipate that when analysing sales of vacant properties also available to owner occupiers, downward pressure would be placed on yields given the greater buyer pool and lower emphasis on the requirement for rental return. The near parity in yields, together with clear differences between other more traditional 'risk free' rates, suggests that Investors are potentially 'winning the race' in terms of purchase price achieved. It appears to be evident that owner occupiers are not prepared to outlay similar levels to secure a home, or are having to compete fiercely with Investors who are perhaps less concerned on rental return, in lieu of expected capital gain.

Auckland's Market and Where Are We Heading?

The Auckland property market continues to plough full steam ahead with values increasing at an average of 18% per annum. Research carried out by Knight Frank in certain Auckland suburbs is actually identifying a greater rate of increase. Within the three months from February 2015, some suburbs have experienced an approximate increase of 3.5% per month. Demand for property far out strips supply, which is being fuelled by low interest rates, strong migration and changes to the Kiwi Saver scheme to name but a few. There is also a lot of speculation awash within the Auckland residential property market and we constantly hear the words "bubble" and "correction" being quoted by the media and commentators. The government has introduced policy to try to take the heat out of the market and make property more affordable, but with inflation nearing zero and dairy prices on the rapid decline it appears when the OCR came up for review the Reserve Bank Governor Graeme Wheeler's hands were tied and he dropped the OCR from 3.5 to 3.25 on the 11th June 2015.

Almost immediately after the drop in OCR many of the major banking institutions cut their retail rates. With the low cost of debt forecast to carry on, anecdotal feedback from Mortgage Brokers are predicting another 25 basis point cut by Q1 2016 and sub 5.00% interest rates for a fixed 5 year term. This is a very strong contrast to the GFC period when the OCR was 8.00 and above for over a year.

The Auckland property market shows little sign of slowing down and predictions of further cuts in the OCR only aid in adding fuel to the fire. As much as the Government is trying to "cool" the property market, it appears this is proving challenging and is caught in a perfect storm of economic factors all driving values up. First home buyers are having to compete with investors that have high equity ratios from existing property portfolios and access to low interest rates. This results in a very real potential of creating a 'two tier society' of home owners and non-home owners.

That being said, Auckland is New Zealand's largest city and the gateway to our international trading partners. There is strong positive migration, job opportunities and an excess demand for housing from both domestic and foreign buyers. Like many major cities within other first world countries, Auckland is following the trend in terms of a buoyant housing market fuelled by centralisation of industry or jobs and low interest rates, equating to strong demand.

Auckland is unique in terms of its housing infrastructural makeup. Standalone dwellings on reasonable sized sites make up the greater proportion of residential stock which is a by-product of a young city internationally. The likes of London or even Sydney have adapted to more close quarter living by way of intensive housing development such as apartments or terraced housing, serviced by quality public transport infrastructure. Knight Frank sees the trend shifting in Auckland with more and more apartment or terraced housing type developments being released or undergoing the consent process. As more Aucklander's adjust to this shift in living lifestyle, together with improved public transport and infrastructure, we see the demand-supply imbalance being corrected. However, it will take time for our love affair with the "kiwi dream" to abate in preference for the more intensified living.

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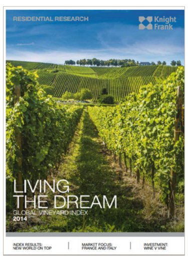

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