

Study Report

SR390 [2018]



Building to rent

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Preface

This is part of a series of reports prepared as part of the BRANZ research programme entitled 'Exceeding the minimum'. This programme of work aims to help both consumers and the building industry to understand that standards are a minimum only and that there are benefits to exceeding them (BRANZ, 2016).

It is the first piece of work looking to answer the research question: Why don't landlords choose features that exceed the minimum and what are the enablers for changing this? The aim is to identify the barriers to an improved rental stock and potential solutions to overcome these barriers.

Building to rent

BRANZ Study Report SR390

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Abstract

Housing affordability issues are adding additional pressure to the rental housing market in New Zealand. The strain this is putting on the housing sector means that previously untenable housing may be becoming part of the stock. This is particularly concerning for desperate or vulnerable tenants who may be finding themselves with no option but to occupy sub-par housing.

Any improvements that landlords make to their rental housing is unlikely to be recouped through increased rents. Features such as those that would improve energy efficiency are difficult for tenants to judge before occupying the rental property. Tenants are unlikely to consider costs other than rent payments when choosing where they want to rent. This leads to a lack of incentives for landlords to invest in their properties.

Keywords

Exceeding the minimum, landlords, tenants, rental housing, quality

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Executive summary

Housing affordability is a well identified issue in New Zealand. Using the relatively simple to understand measure of housing affordability called the median multiple, housing in 41 of the 67 territorial authorities would be classed as severely unaffordable. This adds pressure to the rental stock within these territorial authorities. This research looks at how we can improve the rental stock given the affordability pressures. This strain on the housing sector means that desperate or vulnerable tenants may be finding themselves with no option other than to rent sub-par housing.

Much of the rental stock is in a condition only requiring minor repairs to bring it up to the same standard as its owner-occupied counterpart. Our analysis suggests that, for over half the stock, less than \$5,000 would need to be spent to bring it up to the same standard as a typical owner-occupied home. Given the rate of inflation in house prices over recent years, this suggests that it should be well within landlords' means to improve these houses.

However, landlords face the issue of recouping their investment. About half of the tenants we surveyed as part of this work said that they could not afford to pay any more in rent than they are currently paying. In addition, many tenants did not consider other costs (such as electricity, transport and so on) in choosing their current residence. This led to a lack of incentives for landlords to invest in their properties.

Our projections suggest that the rental stock is likely to grow in number over the next 20 years. We estimate that, by 2038, there are likely to be an additional 225,000 rental units over the 2013 Census. Many of these additional units are likely to be occupied by those over 65 years of age. We estimate that the number of people 65 years or over in rental accommodation is likely to more than double between 2013 and 2038.

Matching what the rental stock is delivering with needs is going to be a difficult task. This is also an opportunity for landlords and government to look into solutions for the rental industry. Looking at replicating energy performance certificates, promoting real estate investment trusts or investing in different models to deliver rental housing could lead to better housing outcomes and an improved rental stock.

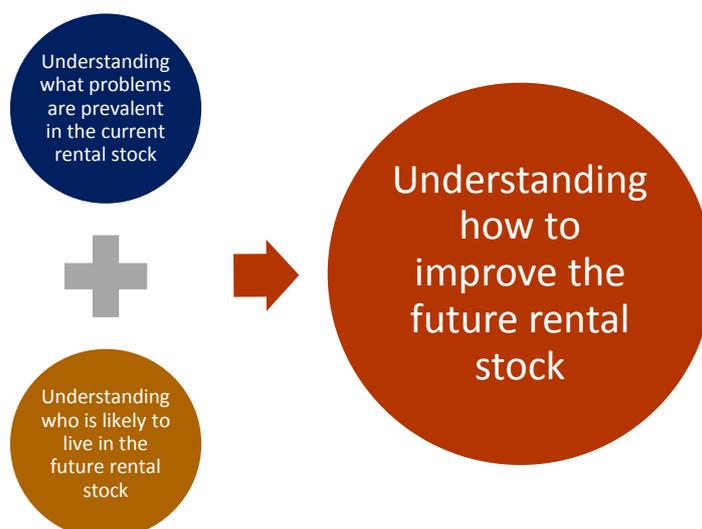
1. Introduction

Homeownership has become a challenge as rising prices and on-going lending restrictions have put mortgages out of reach of many low to middle-income New Zealanders. In 2013, the Reserve Bank of New Zealand brought in restrictions on lending via a loan-to-value ratio (LVR). This limits the proportion of loans banks can make to borrowers with less than a 20% deposit. This, combined with increasing house (and construction) prices, has put purchasing housing out of reach of some households. The affordability of purchasing housing differs by region (see section 3.3). For New Zealand overall in May 2017, the ratio of average house value to median household income is 8.1. A ratio of 3 or less is seen to be 'affordable'.¹

In response to the difficulties many New Zealanders face in buying their own home, this work looks at the rental market in New Zealand and how we can improve it. It also offers some innovative solutions for potential landlords.

This report focuses on the private rental market. For this study, we define the private rented sector (PRS) as a self-contained housing unit, with the main purpose being a place of habitation, where rental payments are made. This is based on the Statistics New Zealand definition of a private dwelling as "accommodating a person or a group of people and generally unavailable for public use. The main purpose of a private dwelling is as a place of habitation for residents who usually live independently within the community." (Statistics NZ, n.d.). It does not consider what the correct minimum standard is for rental housing. Therefore, there is no discussion of the appropriateness of existing legislation, the Healthy Housing Bill or the rental warrant of fitness in setting a minimum standard.

After the literature review, this report is split into three sections. The first provides some explanation on the problems that are prevalent in the current rental stock. The second provides projections for the future of the rental stock. Both sections in conjunction offer some understanding of how to improve the future rental stock in New Zealand. This is the focus of the third section, which also offers an analysis of some possible solutions to improve the rental stock.



¹ The World Bank recommends a measure of housing affordability called the median multiple, which rates housing to be affordable with a ratio of 3 and less.

2. Literature review

The New Zealand rental market is dominated by the private sector. Research undertaken by Beacon Pathway defines the New Zealand rental market as having 85% of the rental housing stock in private ownership (Cowan, Burrough & Easton, 2014). Further, most people with one or more rental houses in the market are deemed to largely be passive investors in property. They state that “anyone who owns a house can be a landlord and the role is sometimes, but not always, backed up by property management” (Cowan et al., 2014, p. 4).

In addition, the standard of rental housing is typically below that of owner-occupied housing. In New Zealand, many houses are constructed to the minimum standard at the time, rather than international best practice (Howden-Chapman et al., 2012). This leads to many of the common issues with rental housing in New Zealand that many studies have identified. Whilst many studies are specific in nature, the results/observations can be applied more generally.

A common issue identified in literature is the lack of insulation, which leads to dampness and mould problems (Keall, Baker, Howden-Chapman, Cunningham & Ormandy, 2010). The Beacon Pathway report on the performance of rental housing stated that rental housing was less likely to have ceiling insulation, underfloor insulation and wall insulation than owner-occupied houses (Cowan et al., 2014). It was felt that the focus on insulation and heating in New Zealand has lagged behind European countries and that the perceived compliance costs of increasing insulation standards in New Zealand caused major construction companies to lobby against changes (Howden-Chapman et al., 2012).

The New Zealand General Social Survey in 2014 found that renters were more likely to report that their home felt cold than owner-occupiers. Cowan et al. (2014) found that New Zealand homes are generally cold and have temperatures that regularly fall below the World Health Organisation’s recommendation of a minimum indoor temperature of 18°C.

Lack of heating and ventilation and the associated risks of a damp, high-humidity house was another common issue (Bullen et al., 2008; Cowan et al., 2014; Keall et al., 2010). High humidity can be an issue for housing as it makes the house harder to heat and can encourage the spread of harmful microorganisms, which have implications for the health of occupants (Bullen et al., 2008). Temperature, humidity and ventilation, overcrowding, affordability, fuel poverty and hazards in the home contribute significantly to health outcomes. In addition, about a quarter of households in New Zealand are in fuel poverty (Cowan et al., 2014). Fuel poverty is likely to affect renters to a larger degree than owner-occupiers as they generally have to spend a higher proportion of their income on heating but are often unable to improve the energy efficiency of their homes (Bullen et al., 2008).

Rental houses are generally smaller than owner-occupied houses. Cowan et al. (2014) found that 46% of rental houses were less than 100 m², whereas just 17% of owner-occupied houses were less than 100 m². Rental houses also had fewer bedrooms. On average, rental houses had 2.9 bedrooms compared to 3.3 for owner-occupied houses. Renters were more likely to report feeling that their house was small in the New Zealand General Social Survey 2014. This can lead to overcrowding, which increases the risk of transmission of infectious diseases (Bullen et al., 2008).

Other common issues that come up in literature include the following:

- Structural defects, lead, asbestos, volatile organic compounds, lack of safe drinking water, ineffective waste disposal, inadequate facilities for food storage and preparation, household pests, noise and radon (Keall et al., 2010).
- Exterior envelope, interior and wet area components, Lack of working smoke alarms, hot water cylinder turned up dangerously high and low windows or ranch sliders without visibility strips (Cowan et al., 2014).
- Child-friendly areas not being available (Tucker & Ryland, 2014).
- Exposed wiring (Bullen et al., 2008).

Maintenance is often lacking in the rental market. Many landlords are in the rental market for capital gain, and little consideration is given to maintaining the property or even upgrading (Cowan et al., 2014). They may not even be aware that there is a need to maintain the asset. The Beacon Pathway report states that “the underlying cause of poor quality housing is the lack of maintenance and improvements ... ideally, regular maintenance should be carried out to avoid having to spend large amounts of money to bring the house back up to an excellent standard” (Cowan et al., 2014, p. 12).

A cost-benefit analysis by Sapere Research Group for the Ministry of Business, Innovation and Employment (MBIE) estimated the average cost of repairs and upgrades. They found that the cost to bring rental housing to a minimum standard developed by MBIE was \$1,811 per dwelling for those houses that did require action. Many rental houses, around 42%, would not require spending of more than \$1,000 to comply with the minimum standard (Blick & Davies, 2014).

Incentives to improve rental housing are not always clear. Issues may arise as landlords face the costs of improvements but the immediate benefits (such as lower energy bills and/or increased comfort) fall to the tenants. Tenants are also unlikely to improve their homes as they have uncertain occupancy periods and are unable to alter the fabric of the building without the consent of the landlord (Howden-Chapman et al., 2012). Cowan et al. (2014) found that 19% of rental households intended to move in the next 12 months compared to 6% of owner-occupied houses. This has consequences on the willingness of owners to face the costs of improving the house.

Bullen et al. (2008) suggest that there is an emerging consensus that the burden of responsibility for making houses healthy and safe needs to shift to landlords (state or private) and homebuilders. In a survey of Tokelau housing in New Zealand, those surveyed agreed that the government had some responsibility to ensure that the market provided suitable housing for the needs of extended families (Howden-Chapman et al., 2000).

2.1 Overseas solutions

Many of the issues with rental housing in New Zealand are also faced in overseas markets. In the United Kingdom, there is a need to construct more housing to overcome the imbalances between demand and supply, and therefore a build-to-let programme is under way. Another solution to undersupply used widely overseas is real estate investment trusts. To overcome the imperfect information with energy efficiency improvements in housing, the European Union has implemented energy performance certificates.

2.1.1 Build-to-rent (build-to-let) in the United Kingdom

Build-to-rent (or build-to-let) is a term used to describe the purchase of a property off the plans and then rented out after completion. It is in contrast to buy-to-rent (or buy-to-let), which describes the purchase of existing property for the purpose of renting it out. The Montague report was commissioned by the UK Government to “consider the potential for attracting large-scale institutional investment into new homes for private rent” (Montague, 2012, p. 5).

In 2013, 19% of all dwellings in the United Kingdom were owned by buy-to-let landlords. This was up from 11% a decade earlier (Fuerst, McAllister, Nanda & Wyatt, 2016). Policy initiatives were put in place to encourage institutional investment in the private rented sector. However, the bulk of landlords are private individuals, many of whom own just a single unit (Scanlon, Whitehead & Williams, 2015).

The Montague report provides insights for how New Zealand can deal with the issue of lack of rental supply, particularly in Auckland. It identified that:

... imbalances between supply and demand for housing make it critical to develop new models – models in which housebuilding does not rely solely on demand from owner-occupiers, and which offer a greater variety of options for the increasing number of households who are renting their home. (Montague, 2012, p. 5)

Montague (2012) also suggests that new investment in high-quality rentals was seen by some local authorities as encouraging improvement in the existing stock and its management. They also want to encourage expansion in quality rental housing as it is recognised that fewer people could buy in the current market.

A year on from the Montague report, Savills World Research compiled a report looking at the private rented sector in the United Kingdom. It found that organisations from both the public and private sectors were creating innovative build-to-rent models that were attractive to investors. The developments at Elephant and Castle were seen to show the Mayor of London’s recognition of the role build-to-rent had to play in meeting housing targets in the capital (Daly, Emmett & Hudson, 2013).

2.1.2 Real estate investment trusts

Real estate investment trusts (REITs) are a structure for investment in real estate that was first established in the USA in the 1960s. REITs can increase housing supply by providing capital for development and long-term ownership of real estate assets (HM Treasury, 2010). In the USA, residential REITs typically own and operate large apartment complexes, and in the UK to date, residential REITs have provided capital to housing associations that provide affordable rental dwellings. REITs are typically tax transparent, that is, untaxed profits are redistributed to individual investors who are in turn responsible for tax. This tax transparent status is contingent on the REIT deriving most of its income from real estate, redistributing most of its profits and dispersed ownership of multiple properties (Jones, 2007).

While REITs were initially popular in USA for commercial and retail property, residential REITs developed significant scale through the 1990s and 2000s. This was led by existing institutional investors in apartments converting to the REIT structure (Jones, 2007). REIT-owned apartment residents report higher satisfaction with maintenance and higher rents than non-REIT owned apartments (Russell, 2009). Institutional investment in residential real estate has been limited in Australia and the UK, and

consequently, REITs are primarily focused on commercial and office real estate, with minor involvement in residential property. REITs require considerable scale to be cost effective – both large individual developments and a large portfolio overall.

2.1.3 Energy performance certificates in the European Union

Energy performance certificates (EPCs) are now common across the European Union and are backed by nationally mandated minimum performance levels. The certificates are similar to common rating schemes on many consumer products such as clothes dryers and washing machines (Fuerst, McAllister, Nanda, & Wyatt, 2015). EPCs aim to address the issue of imperfect information in the housing market and increase investment in energy efficiency. Increasing investment in the energy efficiency of buildings is seen as one of the cheapest forms of greenhouse gas mitigation (Amecke, 2012). Implementation of EPCs in New Zealand is a possible solution to encourage landlords to improve the energy efficiency of their properties.

EPCs take account of the quality of insulation, heating installation, (natural) ventilation and indoor air climate, solar systems and built-in lighting (Brounen & Kok, 2011). The certificate ranges from A to G, where A signifies the most energy-efficient dwellings and G a highly inefficient dwelling, and is valid for 10 years (Fuerst et al., 2015).

Energy labels help solve an information asymmetry problem where tenants may be unaware of how energy efficient a rental property would be. The energy efficiency of a building can only be experienced by the buyer/tenant after occupancy (Amecke, 2012). Energy labels help to make the energy consumption in the real estate sector more transparent by giving information about the performance of the building. They are required of all buildings when construction is completed, sold or rented (Brounen & Kok, 2011; Fuerst et al., 2015).

However, there remains a split incentive problem in the rental housing sector. The investment by building owners in energy efficiency for buildings leads to a benefit for tenants from the resulting lower energy bill. Compensation through realisation of an increase in the value of the asset as a result of improvements in energy efficiency would encourage building owners to make investments (Chegut, Eichholtz & Holtermans, 2016).

A study of the Dutch market (Brounen & Kok, 2011) found that A-labelled homes sold at a price premium of 10.2% compared to homes with a D label. In addition, G-labelled dwellings sold at a 5% discount. When the authors compared the capitalised energy savings of A-labelled dwellings with G-labelled dwellings, they found that it yielded a present value of about €16,000 or 7.2% of the average transaction price. Therefore, they found that the 15% price premium for A-labelled dwellings compared to G-labelled dwellings seemed to reflect more than just future energy savings alone. It is worth noting that EPC labelling was voluntary at the time of this study.

A more recent Dutch study of affordable dwellings (Chegut et al., 2016) found a slightly smaller premium. The authors found that an A-labelled dwelling sold for 6.3% more than a C-labelled dwelling, and a B-labelled dwelling sold for 2% more. Also, houses with an A or B label were found to sell 1.3% higher than non-labelled housing. Their overall finding was that their rough estimates suggested that energy efficient retrofits may be partly or fully compensated by an increase in transaction price.

Similar studies were run in Wales and England. In the Welsh study (Fuerst et al., 2016), the authors found that there were significant premiums for A and B-labelled

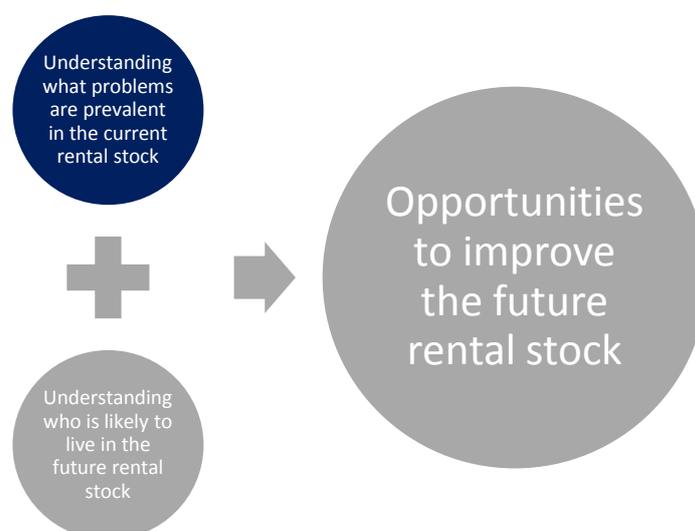
dwellings of 11.3% and C-labelled dwellings of 2.1% compared to D-labelled dwellings. The authors also found that there were significant discounts of -2.1% for E-labelled dwellings, -4.7% for F-labelled dwellings and -7.2% for G-labelled dwellings. There was also evidence that less-dense housing typologies sold for higher prices. Detached housing was found to sell for about 28% more per square metre than terraced dwellings.

In the English study (Fuerst et al., 2015), the authors found significant premiums for A and B-labelled dwellings compared to D-labelled dwellings of 5% and 1.8% respectively. There were also statistically significant discounts for E-labelled dwellings of -0.7% and F-labelled dwellings of -0.9%. The authors also found that a 1% increase in the energy efficiency score produced a 0.1% increase in predicted dwelling price.

3. Understanding our current stock

This section looks at a range of information that identifies issues with the current rental stock. It starts by looking at Census data to understand what the rental market looks like and who is in the private rental market. We then look at media articles relating to rental housing over a 4-year period. We then use the BRANZ house condition survey (HCS) to determine the condition of rental housing in New Zealand. The final subsection analyses the results of the New Zealand Housing Preferences Survey.

In conjunction, the pieces of information help provide an understanding of what problems are prevalent in the current rental stock.



3.1 What the market currently looks like

Most of New Zealand's rental stock is owned by private individuals or businesses. As of the 2013 Census, 78% of rental dwellings were in the private rental sector (PRS). However, the single largest owner of rental housing was the Housing New Zealand Corporation, which owned 12% of rental housing (Table 1).

Table 1. Sector of landlord.

| Sector of landlord | Percentage |
|-----------------------------------|------------|
| Private person, trust or business | 78% |
| Local authority or city council | 2% |
| Housing New Zealand Corporation | 12% |
| Other public entity | 7% |

Source: Statistics NZ using Census 2013 data

Table 2 shows where the PRS was located at the 2013 Census. In terms of the total number of dwellings, a third of the PRS stock was in the Auckland region. Both the Wellington and Canterbury regions had about 54,000 PRS dwellings each (12% of the rental stock each). We can also look at each region to see what proportion of the private dwelling stock was in the PRS. The proportion was highest in the Auckland region, with 35.3% of private dwellings operating in the PRS.

Table 2. Location of PRS.

| Region | Number of dwellings in PRS | Percentage of total occupied dwellings |
|-------------------|----------------------------|--|
| Northland | 15,041 | 28.1% |
| Auckland | 154,347 | 35.3% |
| Waikato | 44,589 | 31.7% |
| Bay of Plenty | 29,280 | 30.9% |
| Gisborne | 5,118 | 34.8% |
| Hawke's Bay | 16,122 | 29.8% |
| Taranaki | 10,392 | 25.7% |
| Manawatu-Wanganui | 24,624 | 30.1% |
| Wellington | 53,934 | 32.3% |
| Tasman | 3,678 | 21.1% |
| Nelson | 5,106 | 28.9% |
| Marlborough | 4,188 | 25.0% |
| West Coast | 3,066 | 25.2% |
| Canterbury | 54,081 | 27.8% |
| Otago | 20,877 | 28.0% |
| Southland | 8,622 | 24.3% |
| Total | 453,069 | 31.2% |

Source: Statistics NZ using Census 2013 data.

Most of the PRS stock at the last Census were detached single-storey houses (53%). About 63% of the stock were detached dwellings, whereas attached dwellings made up 34% of the PRS stock. Very few of these attached dwellings appear to be in mid-rise or high-rise apartment buildings. Some of the 12% of dwellings defined as 'attached two-or-more-storeys' are likely to be low-rise apartments. However, this category is likely to be made up mostly of attached townhouses/terraced houses. Other private dwellings include baches, cribs, motor camps, improvised dwellings/shelters, other holiday homes, dwellings adjoined to or part of a business or shop and private dwellings that could not be further classified (Table 3).

Table 3. PRS dwelling type.

| Dwelling type | Percentage |
|---|------------|
| Separate single-storey house | 53% |
| Separate multi-storey house | 10% |
| Separate house (no storey information) | 0% |
| Attached single-storey building | 19% |
| Attached 2–3-storey building | 12% |
| Attached 4-storey+ building | 3% |
| Attached building (no storey information) | 0% |
| Other private dwelling | 3% |

Source: Statistics NZ using Census 2013 data

Dwellings in the PRS are generally smaller than owner-occupied dwellings (Table 4). About 12.6% of dwellings in the PRS had 1 bedroom. Very few houses in the PRS had 4 or more bedrooms. Just 17.6% of dwellings in the PRS had 4 or more bedrooms compared to 31.5% of all private dwellings. On average, houses in the PRS had 2.7 bedrooms. In comparison, all private dwellings had an average of 3.1 bedrooms.

Table 4. Number of bedrooms.

| Number of bedrooms | PRS percentage | Private stock percentage |
|--------------------|----------------|--------------------------|
| 1 | 12.6% | 5.5% |
| 2 | 29.0% | 18.9% |
| 3 | 40.7% | 44.6% |
| 4 | 13.4% | 23.6% |
| 5 | 3.1% | 5.8% |
| 6+ | 1.1% | 1.6% |

Source: Statistics NZ using Census 2013 data.

3.2 Who is in the PRS?

The rental market is not solely the domain of those households that cannot afford to enter the owner-occupied market. There are a multitude of reasons why a household may choose to occupy rental housing such as their lifestyle, career stage, mobility or family circumstances. Over 34% of households in rental accommodation in the last Census earned more than the median household income in New Zealand (Table 5).

Table 5. Household income for renters.

| Household income | Percentage |
|-------------------|------------|
| Loss/zero | 2% |
| \$1–20,000 | 16% |
| \$20,001–40,000 | 23% |
| \$40,001–70,000 | 26% |
| \$70,001–100,000 | 17% |
| \$100,001–150,000 | 11% |
| \$150,000+ | 6% |

Source: Statistics NZ using Census 2013 data.

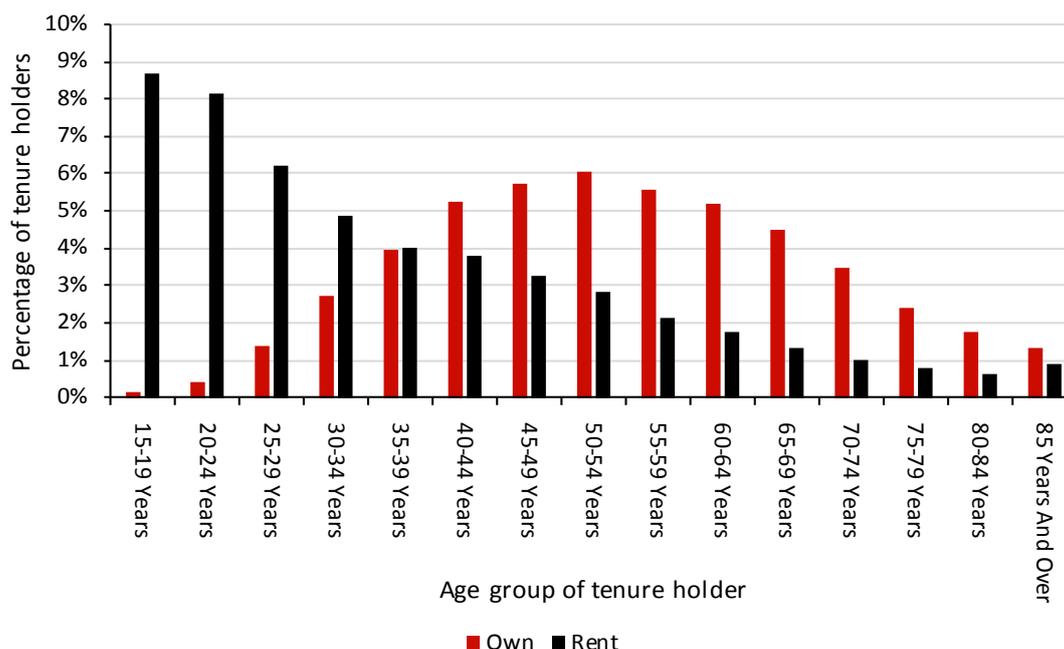
The last Census indicates that most households in the PRS remain single-family households (Table 6). However, almost a quarter of the PRS were occupied by one-person households. A one-person household is likely to have different housing requirements than a one-family or multi-family household.

Table 6. Household composition for the PRS.

| Household composition | Percentage |
|------------------------------|------------|
| One-family household | 63.2% |
| Two-family household | 3.7% |
| Three-family+ household | 0.3% |
| Other multi-person household | 9.3% |
| One-person household | 23.5% |

Source: Statistics NZ using Census 2013 data.

Looking at data from the 2013 Census, we can analyse the proportion of tenure holders that live in a house that they own or a house that they rent. Those households where tenure holders were aged 35 and under typically lived in rental housing. Of those aged 35 and under that lived in private dwellings, 80% rented their home. This is even higher if we restrict it to those tenure holders aged under 25, 92% of whom rented their home (Figure 1).



Source: Statistics NZ using Census 2013 data.

Figure 1. Ownership and rental proportions by age group.

3.3 Rental affordability

Household incomes are not rising at the same rate as house values. The national median household income has risen by 4.2% per annum over the last 5 years. In some regions, such as Northland, Waikato, Gisborne and Canterbury, household income has risen by slightly more than the average. However, house values are increasing far more rapidly than household incomes for much of the country.

The World Bank recommends a measure of housing affordability called the median multiple. This measure is the ratio of median house prices to median gross annual household income. Table 7 shows the affordability rating by median multiple as defined by the World Bank.

Table 7. Affordability rating.

| Rating | Median multiple |
|-------------------------|-----------------|
| Affordable | ≤3.0 |
| Moderately unaffordable | 3.1–4.0 |
| Seriously unaffordable | 4.1–5.0 |
| Severely unaffordable | ≥5.1 |

Data on median house prices was sourced from the Quotable Value residential house values dataset (QV, 2017b). Median household incomes were sourced from Statistics New Zealand’s household income by region, household type, and source of household income dataset based on Household Economic Survey information (Statistics NZ, 2017). May 2017 data on the average household value was used. Median household income was updated to 2017. For New Zealand overall, the median multiple was 8.1.

In New Zealand, the most unaffordable areas are Auckland and Queenstown (Figure 2). Auckland has a median multiple of 10.8, well above the 5.1 defined as severely unaffordable by the World Bank. Queenstown is even more unaffordable, with a

median multiple of 11.1. This data illustrates the problems currently facing these markets. Housing (un)affordability issues are not restricted to those areas with particularly high values. Using Lower Hutt as an example, house values now exceed \$500,000. The median multiple for Lower Hutt is currently 6.2, which would also be classed as severely unaffordable.

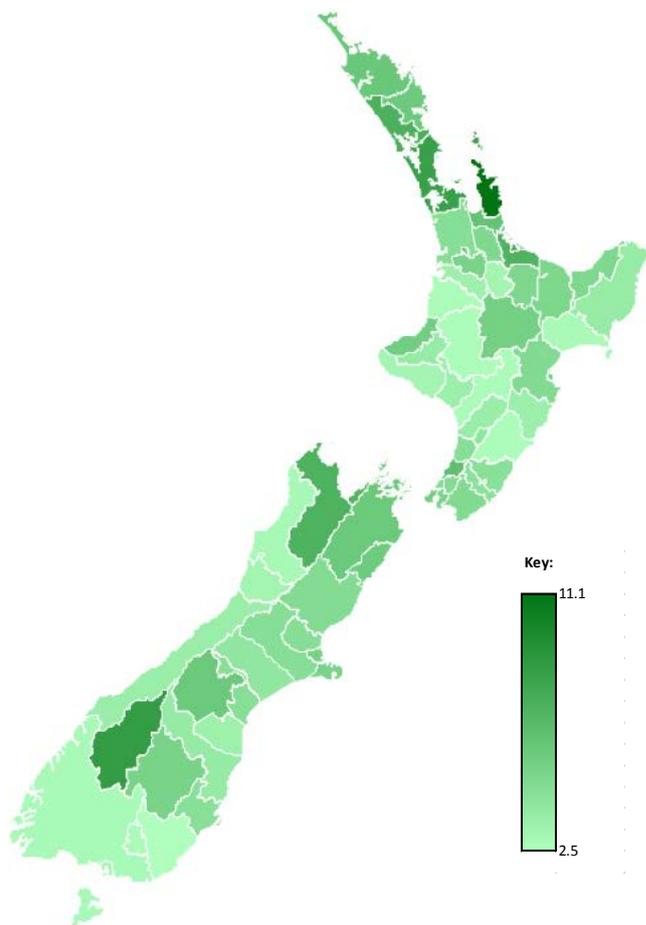


Figure 2. Housing affordability 2017 – median multiple.

Given that house values are rising at a faster rate than household incomes, the above picture is only likely to get worse, particularly for the already unaffordable areas. This places increased strain on mortgage holders, who are not only having to put down sizeable deposits to secure a housing loan but then pay off large loans.

This also has implications for the quality of the housing stock. As the amount that a household needs to service their mortgage increases, the amount of their salary/wages left over to undertake maintenance decreases. Flowing on from this, we are likely to see homes of lower quality due to use of cheaper materials. These will require more maintenance and be less fit for purpose despite increasing values.

Weekly rents have not been rising to the same extent as house prices. Over the last 5 years, median weekly rent has risen by 4.2% per annum.² In comparison, the average house value has risen by 9.7% over the last 12 months. In the Wellington area, the average house value has increased by 20.4% over the last 12 months.

² Analysis using MBIE rental bond data.

Rental affordability can be measured comparing rents to income or house values. For the purposes of this report, we compare the mean rents to the median household income for each territorial authority. Results are then presented in Figure 3, showing the percentage of the median household's income required to make average rent payments.

The least affordable territorial authority to rent in as of May 2017 was the Thames-Coromandel District. Just under 35% of the median household's income would be required to make average rent payments. It is worth noting that rental accommodation is generally the domain of those households earning less than the median household income. Therefore, these affordability figures do not tell the whole story.

A common affordability benchmark suggests that households should spend no more than 30% of their income on housing costs (Robinson, Scobie & Hallinan, 2006). However, there are several territorial authorities where the median household would have to pay more than 30% of their income in rent payments. These are Kaipara District, Thames-Coromandel District, Western Bay of Plenty District, Tauranga City, Kapiti Coast District, Tasman District, Nelson City and Queenstown-Lakes District.

For this analysis, we have used gross income, whereas these ratios typically (but not consistently) use disposable income (i.e. income less income tax). If disposable income were to be used, rental affordability would be worse than presented in Figure 3.

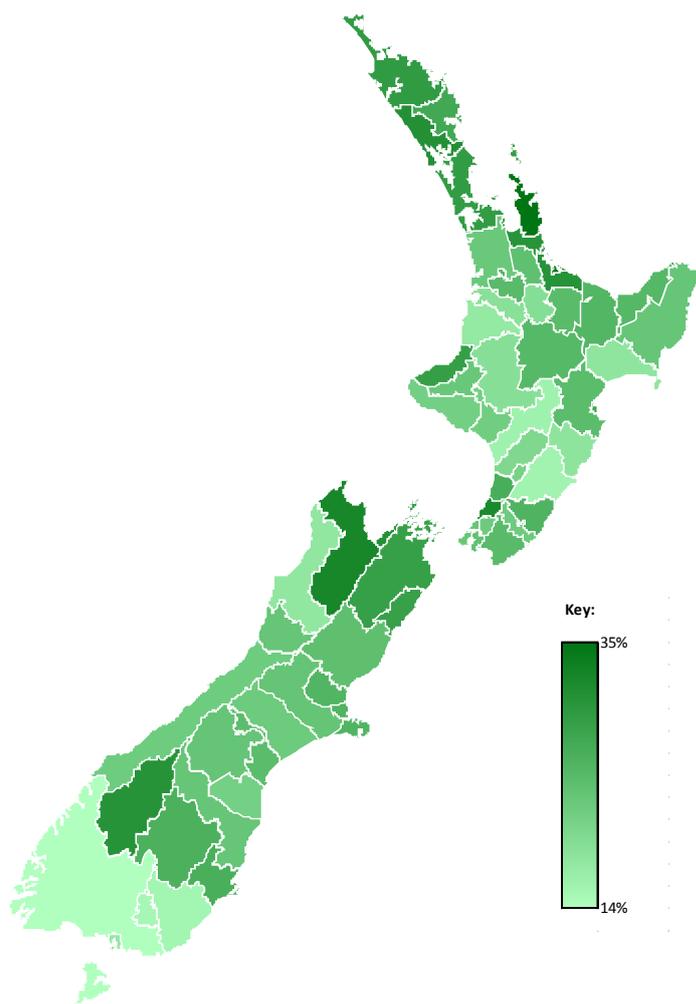


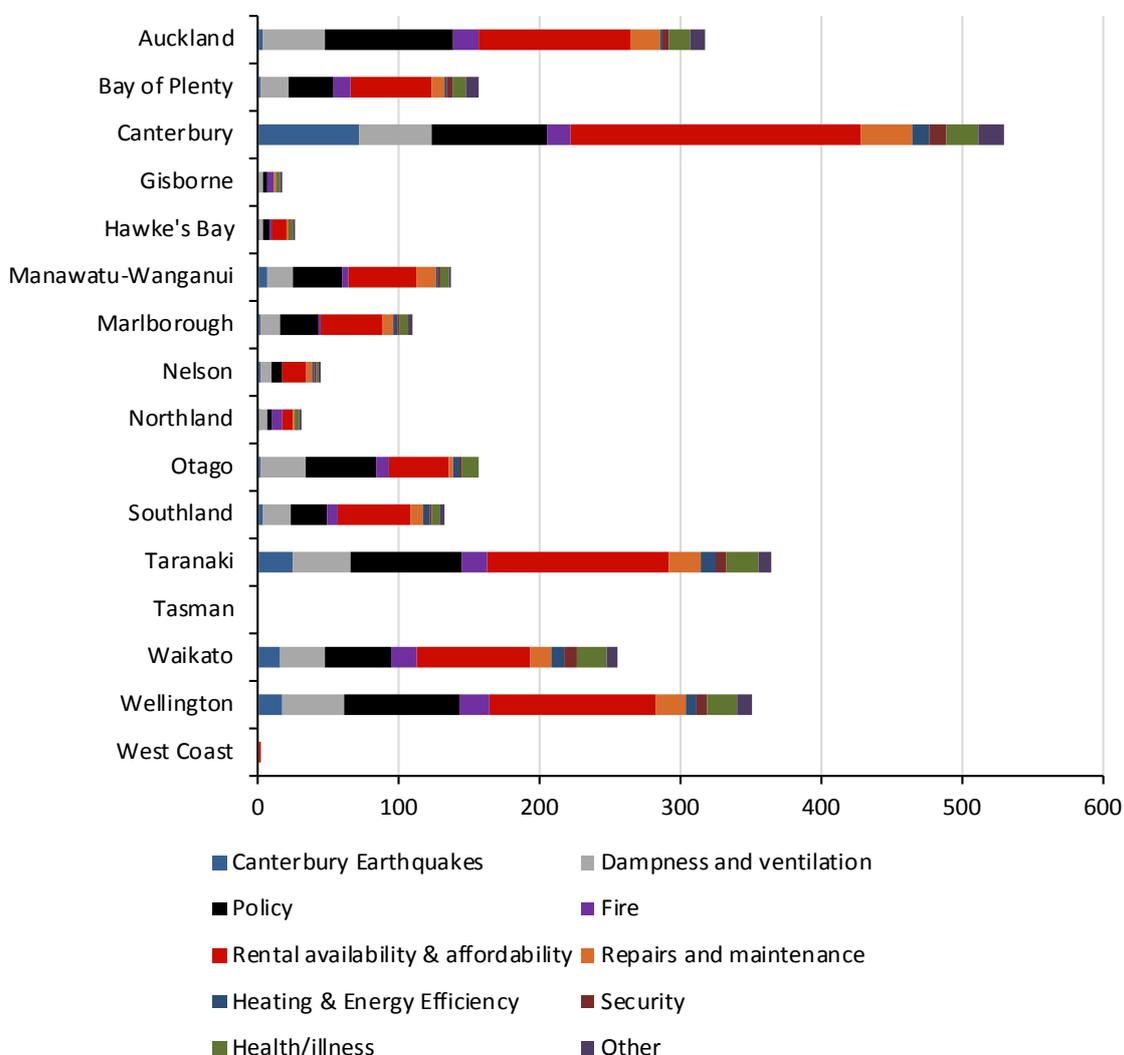
Figure 3. Rental affordability 2017

3.4 Media analysis

An analysis of media articles over a 4-year period was undertaken to ascertain how the media were speaking about our rental stock and what common problems they had identified. BRANZ recruited Wellington media monitoring and measurement company Mediamine³ to undertake the analysis. Media items relating to the accessibility, affordability and quality of rental accommodation in New Zealand between June 2012 and June 2016 were examined using quantitative and qualitative methods. A random sample of 2,750 media items were selected for the following analysis. While media articles are not a precise indicator of the biggest issues affecting the rental stock, it is a good indicator of what is bothering the average New Zealander.

3.4.1 Media categories

Media items were grouped into topic categories (Figure 4). The items could be assigned to up to two topic categories. The most frequently used topic category was 'rental availability and affordability', followed by 'policy' and 'dampness and ventilation'.



Source: Mediamine.

Figure 4. Topic categories by region.

³See <http://www.mediamine.co.nz/>

Most media items were from the Canterbury region. This was largely due to the selection of the time period to be analysed, as much of the media attention was on the Christchurch post-earthquake recovery. This highlighted the struggle after the earthquake for renters to find accommodation. Other regions, such as Auckland, Taranaki, Waikato and Wellington, also had many media items focusing on the availability and affordability of rentals.

There were also many articles focused on policy. Most of these articles were around new and proposed policy, with the Healthy Homes Guarantee Bill making it to its second reading and talk of a compulsory rental warrant of fitness.

Items around 'fire', 'heating and energy efficiency', 'health/illness' and 'security' were not as frequent.

3.4.2 Key themes

Eleven key themes were identified from the media items analysed. These key themes were grouped as follows:

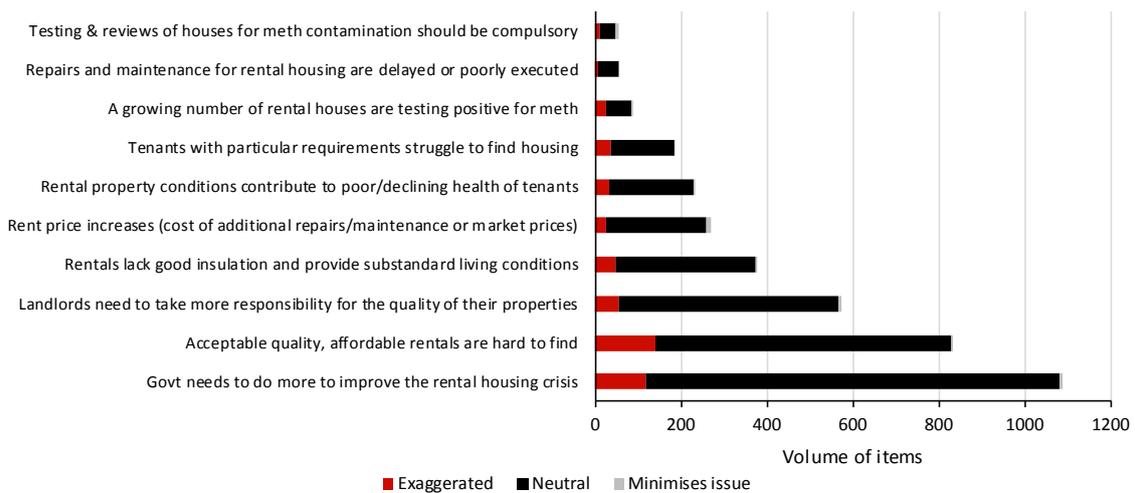
- The government needs to do more to improve the rental housing crisis.
- Acceptable quality and affordable rentals are hard to find.
- Landlords need to take more responsibility for the quality of their properties.
- Rental housing lacks good insulation and provides substandard living conditions.
- Rent prices are increasing because of additional repairs and maintenance costs or to align with market prices.
- Rental property conditions contribute to poor/declining health of tenants.
- Tenants with particular requirements struggle to find housing.
- A growing number of rental houses are testing positive for methamphetamine.
- Repairs and maintenance for rental housing are delayed or poorly executed.
- Testing and reviews of houses for meth contamination should be compulsory.

Most media items related to the affordability of rental housing. The two most common themes were the government needing to do more to improve the rental housing crisis and acceptable quality and affordable rentals being hard to find. Media items relating to the government tended to be driven by articles on the rental warrant of fitness or Healthy Housing Bill.

Figure 5 shows that, in general, the tone of the headline for these articles was deemed to be neutral. A headline was considered exaggerated when it contained emotive language or sensationalised the topic. A headline was considered to minimise the issue when the facts were downplayed.

Very few headlines minimised the issue. The most common themes for headlines to minimise the issue were around methamphetamine in rental housing. However, the headlines for these themes were also the most likely to exaggerate the issue, indicating that methamphetamine in rental housing is a divisive topic.

Looking at the tone of the actual article, the majority had a positive tone. This means that the key theme was supported or endorsed. For the theme 'government needs to do more to improve the rental housing crisis', this would mean that these articles were deemed by Mediamine to be supported or endorsed by tenants.

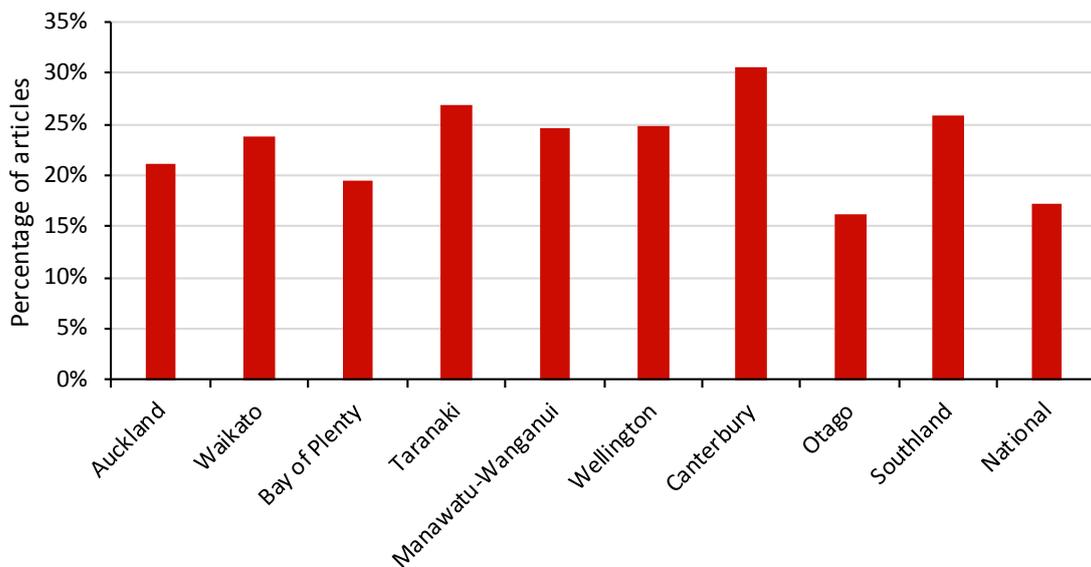


Source: Mediamine.

Figure 5. Key theme by tone of headline.

Looking particularly at the key theme ‘acceptable quality, affordable rentals are hard to find’, we can see the proportion of media items in each region that were attributed to the theme (Figure 6). Regions were restricted to those that had more than 100 media articles in total analysed.

The Canterbury region had the highest proportion of media items attributed to the theme. About 30% of media items came under the key theme ‘acceptable quality, affordable rentals are hard to find’, which is indicative of the housing issues in Christchurch post-earthquake. It is worth noting that most media articles under the key theme ‘repairs and maintenance for rental housing are delayed or poorly executed’ were from the Canterbury region (excluding national media outlets).



Source: Mediamine.

Figure 6. Acceptable quality, affordable rentals are hard to find.

3.4.3 What does this tell us about the quality of the stock?

The media analysis highlights the housing issue for some New Zealanders. Securing mortgage finance is difficult for many looking to buy their first home, and finding acceptable and affordable rentals is an issue too. This causes strain on the housing sector, young people take longer to leave their parents' home and those with specific housing needs are unable to find an appropriate rental.

The strain on the housing sector means that previously untenable housing may be becoming part of the stock. Desperate or particularly vulnerable tenants may be finding themselves with no option other than to rent sub-par housing, influencing the overall standard of our rental stock.

Media articles also focused on the government's need to improve the rental "housing crisis". This illustrates that there may be a general feeling that regulation on the rental sector is too light, and tenants would like to have more protection. Tenants do not appear to be happy with the quality of the rental stock.

In general, the portrayal of the rental stock in the media suggests that the quality is poor. It highlights a stock of rental houses that are undermaintained and in need of repair and the need for tighter regulations and higher standards.

3.5 House condition survey

The BRANZ house condition survey (White, Jones, Cowan & Chun, 2017) is a 5-yearly survey that considers the condition of the New Zealand housing stock. The latest survey, which took place in 2015/16, was the first to have a representative sample of rental housing. This survey allowed analysis of the difference between the owner-occupied and rental stock and identified where there was room for improvement in the rental stock.

White et al. (2017) first looked at where there were significant differences between the condition of components in the owner-occupied and rental stock. This was in order to determine whether some components of the rental stock were in worse condition due to the way renters lived in their home. All the components in the rental stock in need of repair were then looked at. This allowed pricing the cost of repair and comparing this to the cost of repairing the owner-occupied stock.

3.5.1 Which components in rental houses are in worse condition than for owner-occupied houses?

The first step was to find out which differences in condition rating (Table 8) could be significant.

Table 8. Condition rating.

| Condition rating | Description | Grouping |
|------------------|---|-----------------|
| Serious (1) | Health and safety implications; needs immediate attention | Requires repair |
| Poor (2) | Needs attention within the next 3 months | Requires repair |
| Moderate (3) | Will need attention within the next 2 years | Requires repair |
| Good (4) | Very few defects; near new condition | OK |
| Excellent (5) | No defects; as new condition | OK |

Those components deemed to need attention within the next 2 years were grouped as 'requires repair' for the t-tests to determine significance (see Appendix A). To test the statistics for significance, IBM's SPSS Statistics was used.

The analysis was not to find out which components of rental houses needed repair, but instead to determine which components were more likely to need repair in rental houses than owner-occupied houses. This analysis identified 14 components that were more likely to require repair in rental houses in comparison with owner-occupied housing. These were kitchen linings, kitchen joinery, cookers, main bathroom linings, main bathroom fittings, laundry linings, other rooms trims, internal doors, waterpipes, wastepipes, paths, exterior doors, windows and chimneys.

It is unclear from the data whether the degradation in these components is due to the rental stock generally being older or the way that renters tend to occupy housing. However, the components listed are significantly more likely to require repair in rental housing. Some of these components such as linings, windows and doors could be due to the way that renters live in housing. They may be less likely to properly ventilate the house or unable to heat the house to the same level as owner-occupiers. Others may be due to lack of maintenance from the landlord or lack of upkeep from the tenant.

Cost of repair

The next step was to estimate the cost to repair the components identified previously. QV costbuilder (QV, 2017a) was used to estimate costs of fixing the defects that most commonly occurred for each component. QV costbuilder is "a subscription based online platform that provides access to building cost data for those in the building trade industry and property professionals" and provides a comprehensive reference to New Zealand building costs and other related information (QV, 2017a).

Where cost data was not available through QV costbuilder, merchant websites were used and GST removed from the prices. Once a subtotal for each component was derived, an additional 50%⁴ was added to account for contingencies, site conditions, GST and working on an existing building. This percentage can vary significantly based on the site conditions and the particular component in need of repair.

The assumed average cost to repair each of the components is shown in Table 9. These costs assume a house size of 150 m² (based on the average house size in New Zealand) and could be considered to bring the components up to near new condition. Additional costs would be required to bring these components up to as new condition. For example, to bring the cooker up to as new condition, a new cooker would be required to be purchased. However, these costs should cover the remedy of most defects and provide a more liveable home for the tenant.

Average repair costs are low, as very few houses required a complete replacement of components. Lining defects, for example, largely required a repaint or in some cases a replacement of a section of the wall lining. However, many components simply required cleaning or minor alterations to make good.

In some cases, assumptions had to be made about the severity or spread of defects. Efforts have been made to assume a reasonable proportion of the component needs repair. However, without reinspecting each individual house and providing individual costs, these averages are our best estimate.

⁴ BRANZ estimate.

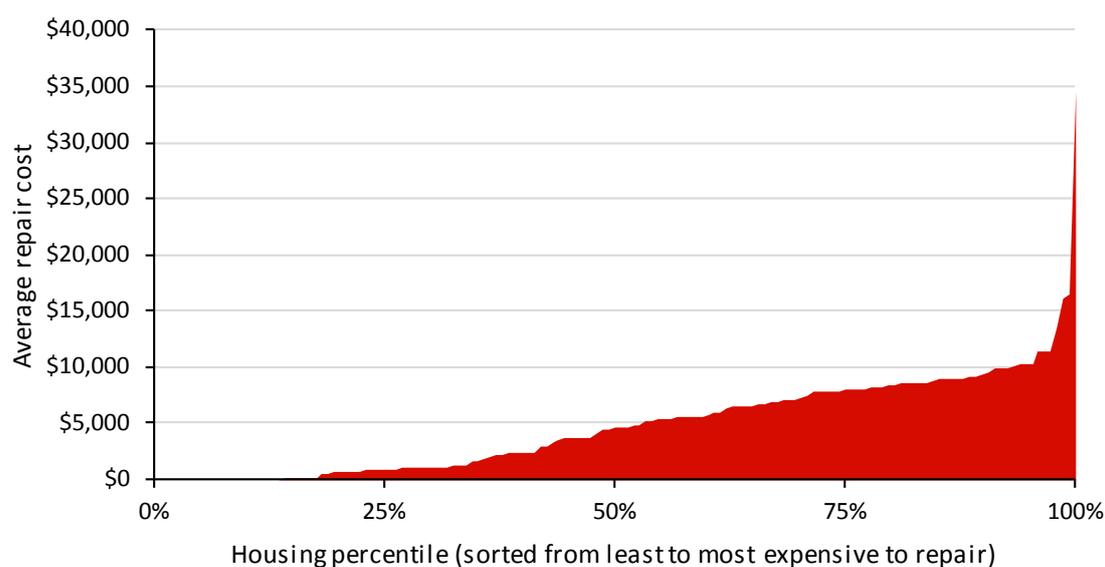
Table 9. Average repair cost by component.

| Component | Average repair cost |
|------------------------|---------------------|
| Kitchen lining | \$630 |
| Kitchen joinery | \$2,215 |
| Cooker | \$60 |
| Main bathroom lining | \$950 |
| Main bathroom fittings | \$510 |
| Laundry linings | \$690 |
| Other rooms trims | \$2,070 |
| Internal doors | \$530 |
| Waterpipes | \$230 |
| Wastepipes | \$530 |
| Paths | \$165 |
| Exterior doors | \$325 |
| Windows | \$885 |
| Chimney | \$545 |

Some costs will vary with the size of the house. Items such as linings, joinery and pipes are assumed to be related to the size of the house. Other items such as the cooker, exterior doors and chimney are assumed to be independent of house size.

Most landlords would not face significant costs to repair these components of their house. Over 50% of houses would require less than \$5,000 to be spent to remedy these issues. This suggests that, for much of the rental stock, mitigating for the effect of tenants may not be cost effective. In addition, 14% of rental houses required no repairs on these components.

However, there were some houses where the landlord would have to spend more than \$5,000. At the 75th percentile, repairs are estimated to cost \$7,500, and at the 95th percentile, houses would cost over \$10,000 to repair.

**Figure 7. Average cost of repair per house.**

Learnings from components in need of repair

Many of those components in need of repair can be traced back to our rental stock generally consisting of older houses. Kitchen-related repairs are likely to be prevalent due to landlords being unwilling to undertake expensive kitchen renovations as frequently as owner-occupiers may.

Other items such as waterpipes and wastepipes would likely be in similar condition in owner-occupied housing if the same materials were installed at the same time. Pipes are generally something that occupants do not think about until something goes wrong. Therefore, problems generally occur through deterioration or an external event such as an earthquake.

3.5.2 Overall rental stock

The rental stock needs additional work to be undertaken to bring the standard of the stock up to good condition. The previous subsection looked at the cost of repairing those components where the component was in significantly worse condition in rental housing compared to owner-occupied housing. However, other components are likely to also need some work. This subsection looks at the total cost of bringing the rental stock up to good condition.

Cost of total repair

As with the previous subsection, QV costbuilder was used to estimate the cost of repairs to fix all the components in need of repair. The methodology for the cost of total repair was the same as was used for the cost of repair of those components in significantly worse condition in rental housing.

The analysis was performed for both the rental stock (Figure 8) and owner-occupied stock (Figure 9) to compare the overall condition of both sets of houses. This helps provide an overall estimate of the cost to fix the rental stock and a comparison with the owner-occupied stock.

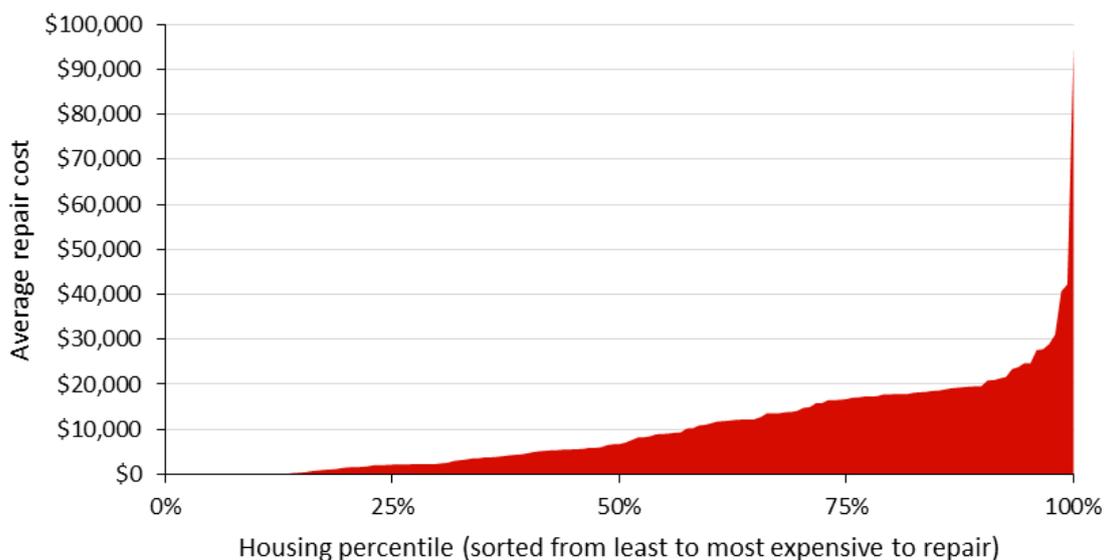


Figure 8. Average cost of total repair for rental housing.

Over 50% of houses in the rental stock require less than \$10,000 of repairs. At the upper quartile (75%), \$17,000 of repairs are required. This shows that, for the clear

majority of rental houses in the housing stock, little money is required to repair houses, particularly when compared to the value of housing. In May 2017, the average value of a house in New Zealand was \$634,000, which was an increase of 9.7% over May 2016.

Assuming that the upper quartile house in the rental stock is valued at the average for New Zealand, the repair required equates to 2.7% of the value of the house. Given that the value of the average house increased by \$56,000 over the previous year, one could argue that some of that capital gain should be spent on maintaining/repairing the rental stock.

In comparison, the average cost of total repair for owner-occupied housing was slightly lower almost right across the board. The median house would require just \$6,000 of repairs, and the upper quartile house would require \$15,000 of repairs. Just under 20% of owner-occupied houses surveyed required no repairs.

Given that the owner-occupied stock is likely to be made up of newer houses and owner-occupiers are in a better position to monitor the condition of their home, this is not surprising. However, it does highlight the discrepancies between the owner-occupied and rental stock.

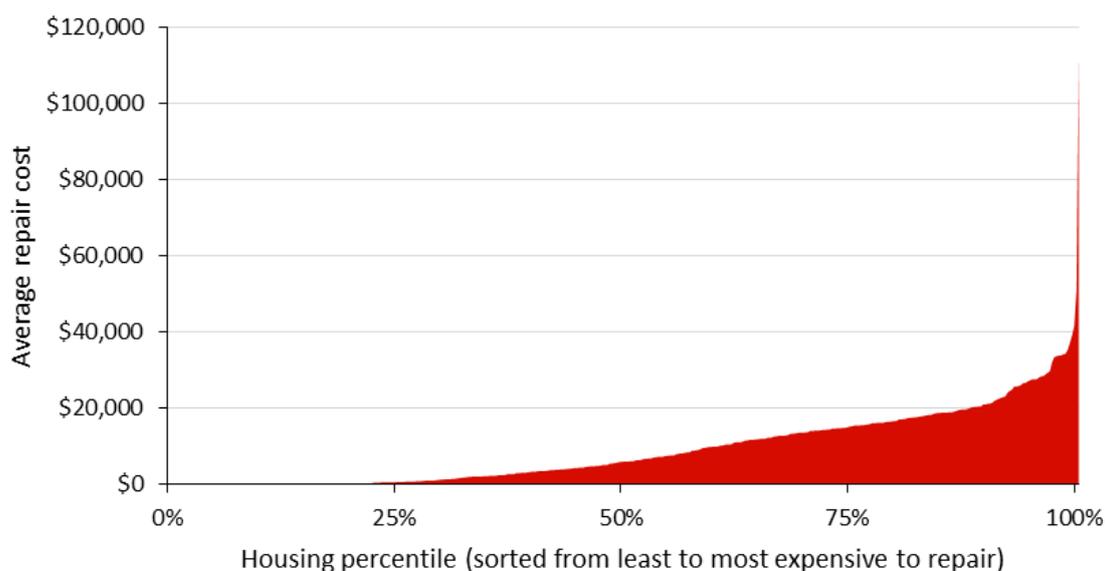


Figure 9. Average cost of total repair for owner-occupied housing.

3.6 The New Zealand Housing Preferences Survey

As part of other work, BRANZ has undertaken a survey of occupants of dwellings to measure perceptions of medium-density housing across New Zealand (Bryson, 2017). This survey included a set of questions for occupants of rental housing about how they chose their residence, maintenance of the residence and how well their residence meets their needs.

Of the 1,601 respondents to the New Zealand Housing Preferences Survey, 339 reported renting their current residence and make up the sample for the following results.

3.6.1 Weekly rent

The first question asked respondents what they are currently paying in weekly rent (Table 10). Data from the latest Census does not break down weekly rent in quite the same way, as the top weekly rent category is \$350 and over. However, it does look like the sample had a slight bias towards lower rents than the nationwide average.

Those rental houses where respondents were paying \$400 per week or above were largely located in the Auckland or Wellington regions. Houses in the more rural regions largely occupied the lower weekly rent categories.

Table 10. Weekly rent.

| Rent amount | Percentage of respondents |
|-------------|---------------------------|
| Under \$200 | 25.4% |
| \$200–299 | 22.4% |
| \$300–399 | 23% |
| \$400–499 | 14.5% |
| ≥\$500 | 14.7% |

3.6.2 Important factors in choosing to rent current residence

The next question asked respondents about which factors were important to them in choosing to rent their current residence (Figure 10). Most respondents stated that the rental price was an important factor (79%), followed by the number of bedrooms (59%). Proximity to schools or work, the level of insulation and good public transport links were not reported as being important factors by most respondents.

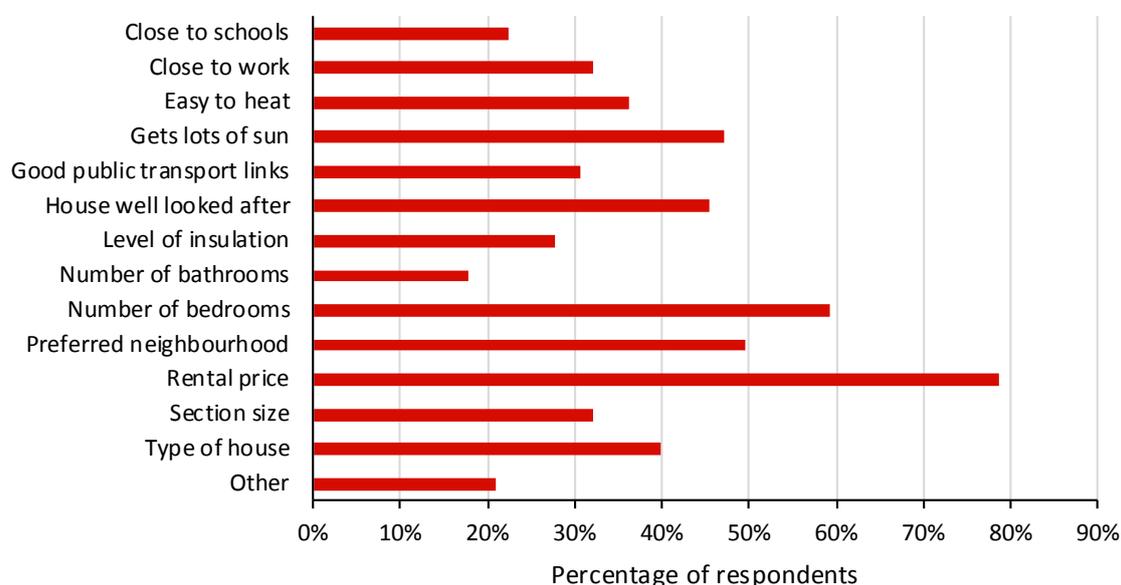


Figure 10. Important factors in choosing to rent current residence.

For those respondents who stated that rental price was an important factor in choosing their current residence, just 57% also considered other costs such as energy costs, medical costs and travel costs (Table 11). This is slightly higher than for those who did not state that rental price was an important factor, where 46% of respondents considered other costs.

Table 11. Were all costs considered?

| | | Did you consider other costs when choosing your current rental? | |
|--|-----|---|-----|
| | | Yes | No |
| Was rental price an important factor in choosing your current residence? | Yes | 57% | 43% |
| | No | 46% | 54% |

This illustrates the difficulties faced by landlords. For many, the rental price is an important consideration in choosing their residence. However, this is only one aspect of the cost of housing, and many respondents were not considering other costs such as energy costs, medical costs and travel costs. Therefore, landlords may see a lack of value in investing in property with good public transport networks or improving the property to provide greater benefits to the occupant.

It is unclear why the residents are not taking other costs into account. Perhaps the most likely reason is that many of the other costs are difficult to measure, particularly where good information is lacking. Costs such as energy costs or medical costs can be unknown until after one has resided in the property for a long period of time. It is also plausible that residents do not think of these other costs as being part of their budget when looking for a rental property, or they are simply not considered.

3.6.3 Does the rental stock meet residents' needs?

Respondents were asked to rate how well their current residence suits their needs on a 5-point scale from very poor to very good (Figure 11). Most respondents rated their residence as at least good (68.2%), and just 9.1% of respondents felt that it was poor or worse. Those respondents who rated their residence as poor or very poor were most likely to have stated that price was an important factor in choosing their current residence. This indicates that there is likely a budgetary constraint restricting them from being able to afford a rental property that better suits their needs. About 65% of respondents who were paying under \$300 per week in rent rated their current residence as poor or very poor at suiting their needs. This percentage was generally lower at higher levels of rent, although those who rated their residence suiting their needs highest were in the \$300–399 weekly rent category.

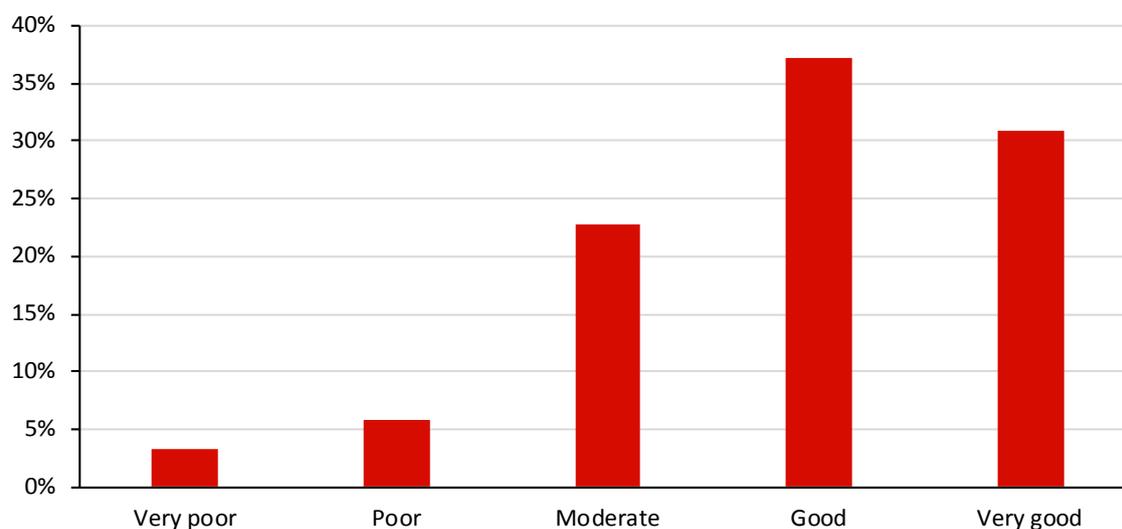


Figure 11. How well current residence suits needs.

3.6.4 Ability to heat current residence

Almost half of respondents (48%) rated their ability to heat the living room and bedrooms in their current residence as easy to heat or very easy to heat (Figure 12). However, 8% of respondents stated that their residence was very difficult to heat, and 13% stated that their residence was somewhat difficult to heat.

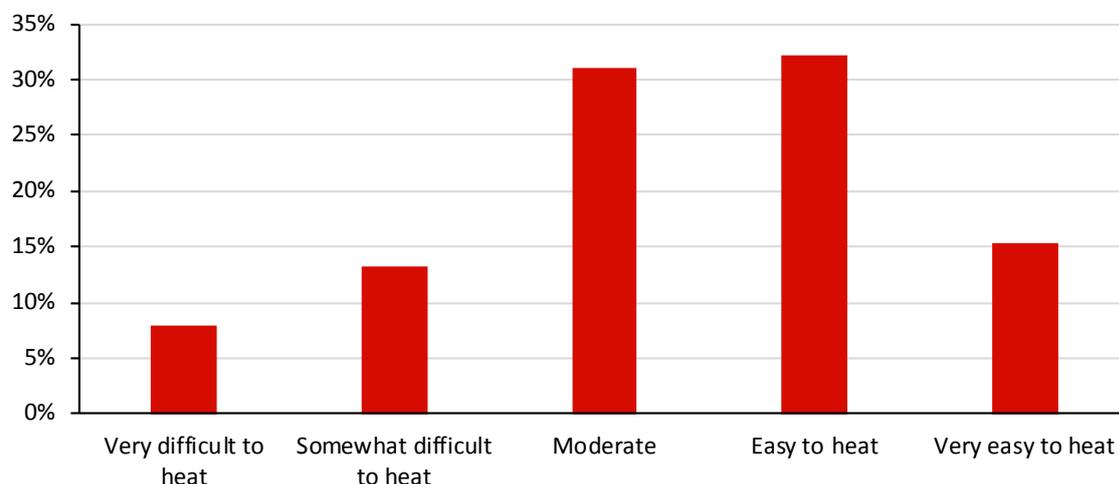


Figure 12. Ability to heat living room and bedrooms in current residence.

There was generally little difference in the proportion of respondents stating that their living room and bedrooms were difficult to heat by weekly rent. About 24% of respondents paying between \$200 and \$300 per week or \$500 and above reported their residence as being very difficult or somewhat difficult to heat. Just 17% of respondents paying between \$400 and \$500 per week reported the same.

Difficulties in heating the home seem to be more of an issue in those regions with larger cities. The Waikato, Bay of Plenty and Wellington regions all have higher than average proportions of respondents reporting difficulties in heating their home.

3.6.5 Repairs and maintenance

Most respondents reported they contact their landlord straight away for repairs. Over 70% of respondents stated that they contact their landlord for minor repairs or maintenance straight away, compared to 94% that would contact their landlord for major repairs or maintenance straight away (Figure 13).

Of those reporting that they would not contact their landlord straight away for minor repairs, the majority stated that it was too much hassle. Just 8% of respondents stated that they would not contact their landlord straight away for minor repairs because they were concerned that it would lead to paying more rent. A further 1% of respondents would not because they would be concerned about being evicted.

Of those respondents who reported that they would not contact their landlord straight away for major repairs or maintenance, the majority would not do so because it was too much hassle (3.3%). Just 1.8% would not do so because they were concerned about it leading to having to pay more rent, and 1.2% because they were concerned about it leading to them being evicted.

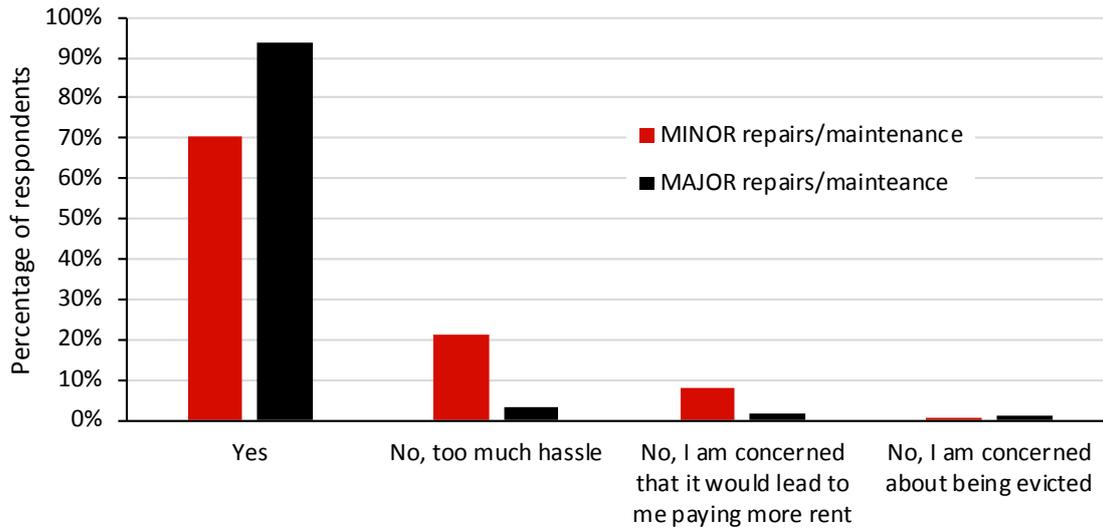


Figure 13. Do residents contact their landlord for repairs/maintenance?

The area most frequently identified as needing repair/maintenance was roof cladding (Figure 14). Almost 12% of respondents stated their roof cladding needed repair/maintenance. The next most frequently reported area was fixtures and fittings (door handles, taps) at 5%. Most respondents reported at least one area in need of repair/maintenance in their current residence (71%). Of those respondents who reported that their current residence needed repair/maintenance, 43% reported just a single problem area. Of more concern were the 15% of respondents who reported that five or more areas needed repair/maintenance.

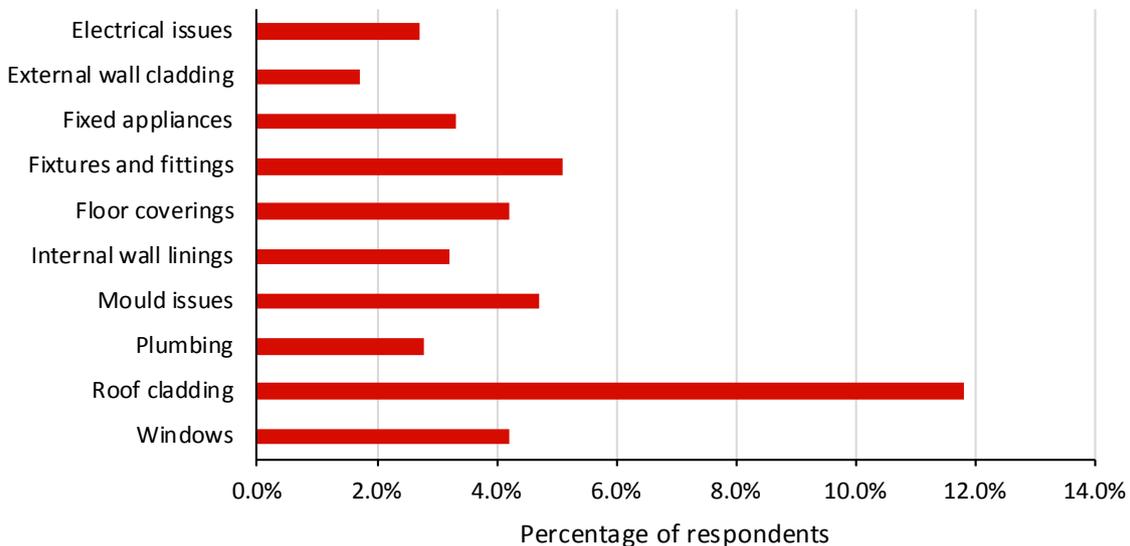


Figure 14. Areas in need of repair/maintenance.

3.6.6 Ability to pay more rent

A final question around whether respondents would be able to pay more in rent for a better-quality property was included in the survey. Almost half of respondents reported that they would be unable to pay any more rent (49%). A further 33% reported that they would be able to pay more but would not be willing to pay any more than they currently do. The final 18% would be willing and able to pay more in rent for a better-quality rental.

Those respondents who identified that they would be unable to pay any more rent for a better-quality rental were generally in the lower weekly rent categories. Just under 60% of respondents who were paying less than \$200 per week in rent stated that they would be unable to pay any more rent. Those paying \$500 or more per week were most likely to report that they would be able to pay more in rent but were not willing to do so (53% of respondents).

Respondents from the Waikato (24%) and Wellington (21%) regions were most likely to report being willing and able to pay more in rent for a better-quality rental property. They were also less likely than average to report being unable to pay any more rent. The Auckland (35%), Taranaki (40%) and Manawatu-Wanganui (43%) regions were most likely to report being able but unwilling to pay more in rent. Finally, the Bay of Plenty (58%), Hawke's Bay (55%), Canterbury (53%) and Otago (60%) regions were most likely to report being unable to pay any more in rent for a better-quality rental.

4. The changing rental need

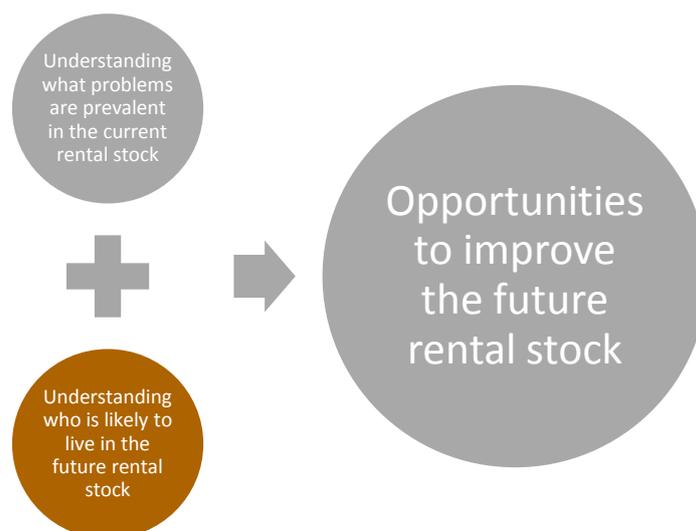
An increasing proportion of households in New Zealand are having to rent rather than own their own home. Census data shows that the proportion of total households in New Zealand that are occupied by the owner has been decreasing since 1991. As of the 2013 Census, just 65% of households lived in a house that they own, down about 9 percentage points from the 1991 Census. Statistics NZ's demography dwelling and household estimates suggest that, since the last Census, the homeownership rate has continued to decline (Table 12).

Table 12. Homeownership rate.

| Census year | 1991 | 1995 | 2001 | 2006 | 2013 |
|--------------------|------|------|------|------|------|
| Homeownership rate | 74% | 71% | 68% | 67% | 65% |

Source: Statistics NZ using Census data.

Given that the homeownership rate shows no signs of reversing in the short term, it is important to understand the changing needs of renters. This section provides projections of the rental population through to 2038 and looks to provide some figures around the likely rental stock population.



4.1 Projections of rental population

To assist in understanding changes in rental accommodation, we have projected the likely number of people residing in rental accommodation in the future and the homeownership rate. These projections rely on Statistics NZ data – mainly projections around population and household formation. The data provided in this section adds to previous work undertaken by Mitchell (2015). Mitchell's report provides a regional breakdown. However, this work uses updated Statistics NZ data.

The first step was to understand future demographic changes. We used the Statistics NZ subnational population projects, by age and sex, 2013(base)–2038 to understand how the age profile in New Zealand was changing. We then estimated how the percentage of each age group that would own their home may change over time. These estimates formed the basis of the projections of homeownership and number of people in rental accommodation.

Figure 15 shows estimates of the homeownership rate by age group for 2018, 2028 and 2038. These estimates assume that homeownership for most of the population is delayed slightly, shown by a rightwards shift of the homeownership curve. However, this trend starts to reverse as younger people start to inherit family homes and house prices adjust to income levels.

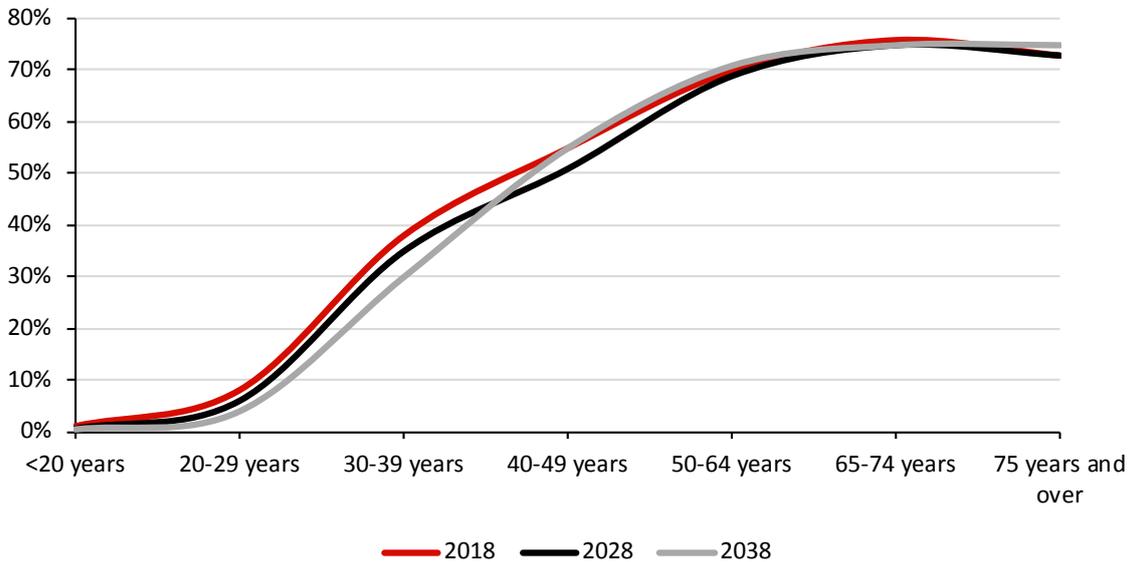


Figure 15. Homeownership by age group assumption.

Using the assumptions in Figure 15 we can forecast the projected homeownership rate. Figure 16 shows low, medium and high projections for the homeownership rate, based on the different Statistics NZ population and household formation projections. The medium line uses the medium population and household formation projections. From these projections, we can determine the likely persons per household.

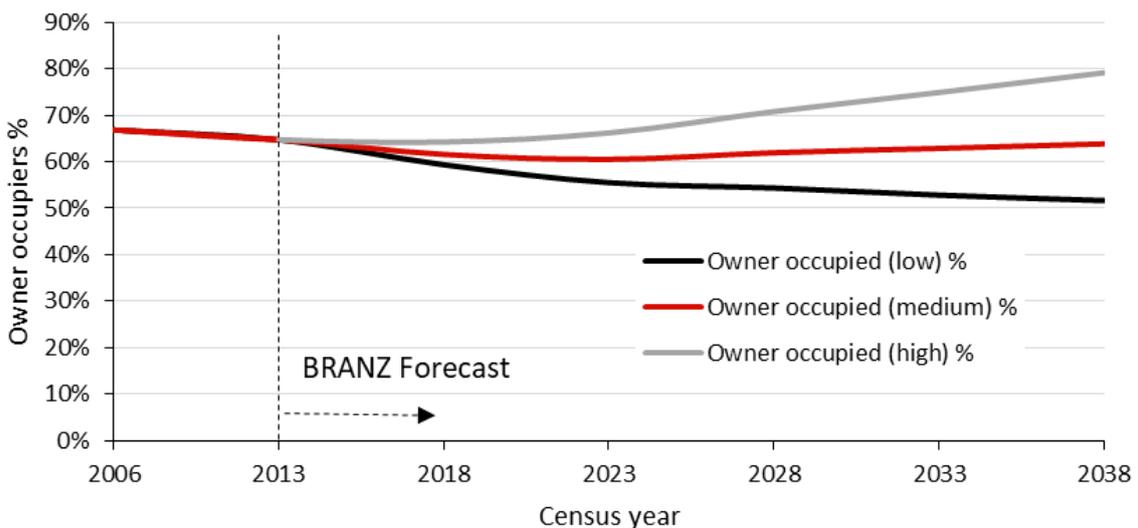


Figure 16. Homeownership projections.

The high projection assumes a smaller household size. This uses Statistics NZ low population projections and high household projections and acts as a proxy for more affordable housing. Demand for housing is lower as the population is smaller and the supply of housing is greater than for other projections. The low projection is the opposite.



The assumptions consider housing affordability through changes in the supply and demand for housing. The medium forecast assumes that housing affordability worsens through to 2023, before returning to 2013 levels by 2038. In contrast, housing is assumed to be 24% less affordable in 2038 for the high forecast and 24% more affordable for the low forecast.

Looking specifically at the medium projection of homeownership and the medium household projection from Statistics NZ, we can project the number of houses in the rental stock in the future (Figure 17). The projections show that there are likely to be an additional 138,000 dwelling units over the number in the 2013 Census by 2018.

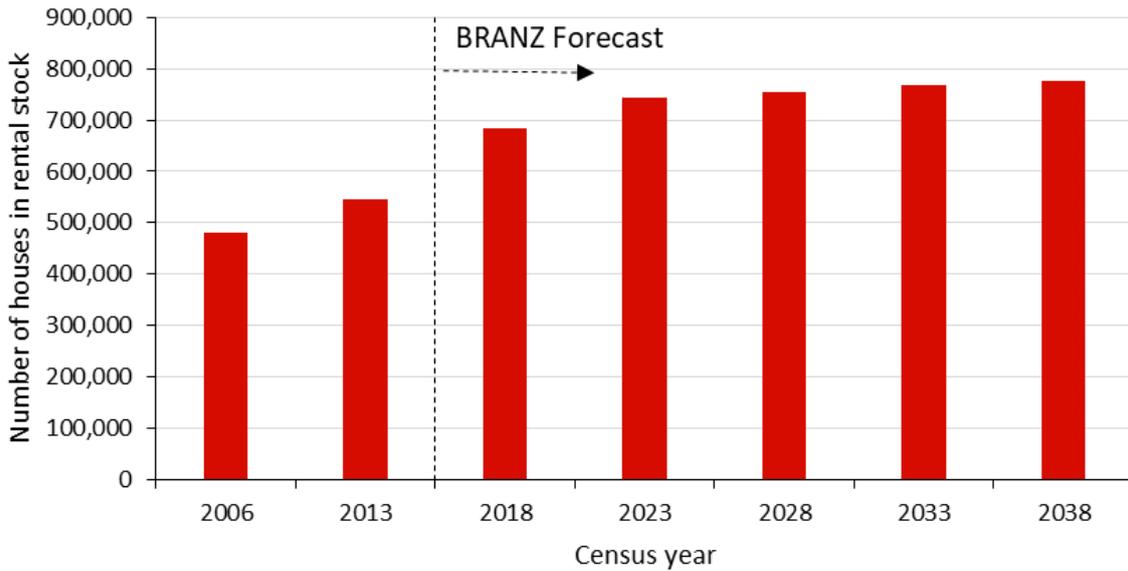


Figure 17. Estimated rental stock (medium case).

The ageing population is a key consideration for our future rental housing need. Some of these older people will be likely to be living in rental accommodation (see Figure 15), and their needs are different from a young couple, for example. Our projections show that the number of people 65 years or over in rental accommodation is likely to more than double between 2013 and 2038 (Figure 18).

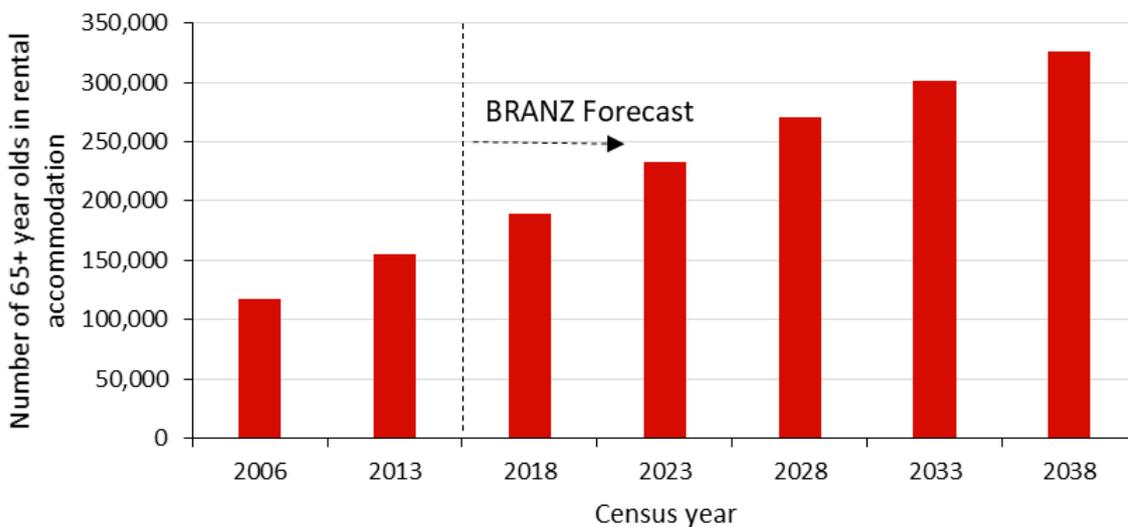


Figure 18. Estimated number of older people in rental accommodation (medium case).

In 2013, Statistics NZ ran their fourth national survey on disability (Statistics NZ, 2014). It provides information on the prevalence of impairments by type of impairment. The survey found that 23% of the population in private households have at least one type of impairment. The most common impairment was found to be mobility, with 12% of the population in private dwellings reporting it as an issue.

Of particular interest is those people with impairments who are less than 65 years old. Many of the aged housing features targeted towards those over the age of 65 would also meet the needs of the considerable number of people with impairments under the age of 65. In addition, the survey on disabilities found that 59% of respondents aged 65 years or older had an impairment.

Impairments such as sight, mobility and agility may require some form of modification to housing to make it more liveable for the occupant. As with aged housing, these modifications can be expensive to retrofit into existing housing. However, these impairments do make up a relatively small percentage of the population (Figure 19).

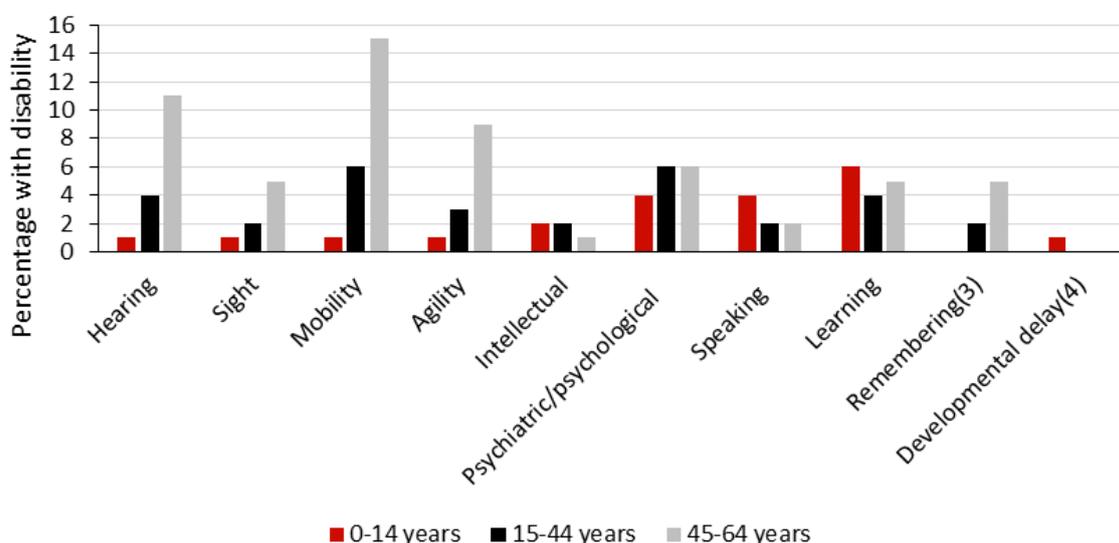


Figure 19. Disabilities by age and type.

Little information could be found about tenure status and disabilities. Therefore, we have assumed that there is little difference in the tenure status between those with and without the selected impairments (sight, mobility, and agility). We have also assumed that there is no change in the proportion of people in each age group with an impairment. A final assumption is that the net migration boost between the 2013 and 2018 Censuses is unlikely to include many people with the selected impairments.

Figure 20 shows that there is an increasing number of people likely to require housing modifications (and many of them are likely to be renters). Our estimates suggest that just over 250,000 people could have required housing modifications due to their impairment at the last Census.

This analysis suggests that, by 2038, 53,000 additional people will have impairments that may require housing modifications. Of that 53,000, 23,000 could end up in rental accommodation. To estimate how many additional houses this equates to, we assume that there is one person with an impairment per household and then apply our persons per household rate. Applying this rate, we estimate that an additional 20,000 houses may require some form of housing modification. Of this, 11,000 are likely to be rental houses.

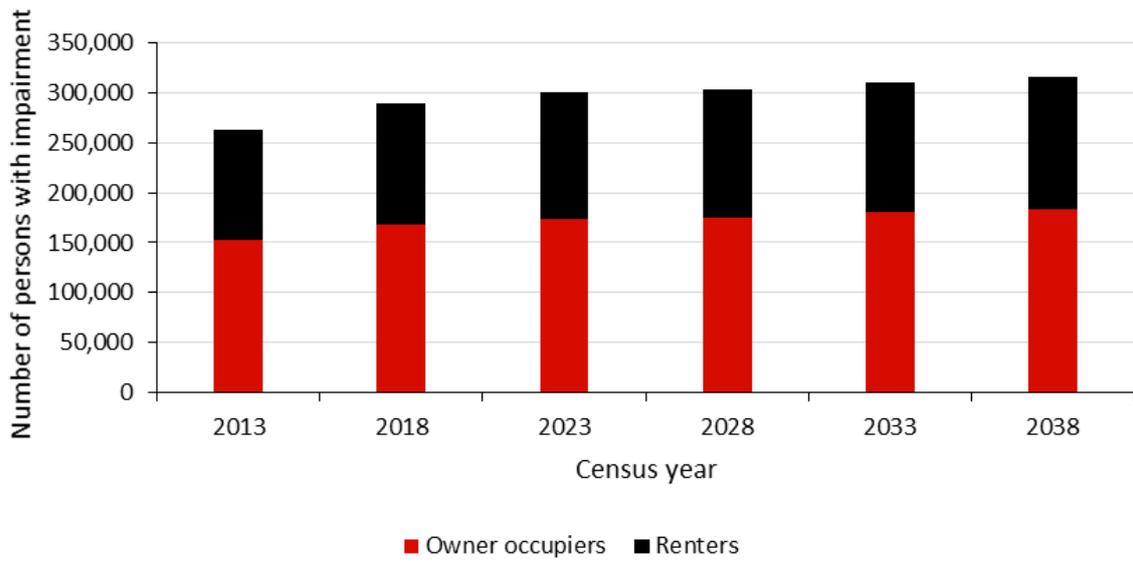
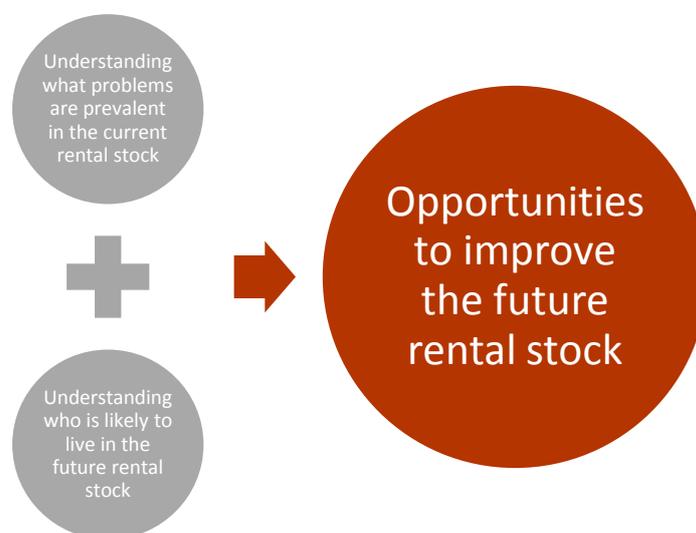


Figure 20. Estimate of number of people (<65 years old) with some form of impairment likely to require housing modifications.

5. Opportunities to improve

Opportunities to improve the rental stock in the future can be identified through understanding what the current and future rental stock looks like. This section looks to combine the understanding gathered through the previous two sections and provide opportunities to improve the rental stock.

This section first offers alternative rental models, which may in certain circumstances provide greater financial benefit than the existing model. We then move on to a way to assist tenants in pricing in costs other than rental price to make decisions on where to rent. The section then finishes with some opportunities based on the changing rental need and findings from other pieces of BRANZ work that have applications within the rental stock.



5.1 Build-to-rent model

This section considers the viability of an alternative rental model loosely based on overseas build-to-rent models. It would provide for improved housing quality, greater security and length of tenure and the freedom for tenants to customise their housing, compared to the status quo.

A new 'shell and fit-out' model is developed, which resembles a commercial lease. The tenant commits to a basic shell structure in a multi-year lease and is responsible for completing the interior fit-out in a way that suits them. This new model is benchmarked against the existing rental market, both for existing dwellings and new builds, using the net present value for both the tenant and landlord.

Net present value is "the sum of the discounted future cash flows, both costs and benefits/revenues"⁵ – that is, costs and benefits adjusted for the time value of money.

The shell and fit-out model involves a long-term lease of 5–15 years and the landlord providing and maintaining a new basic structure that meets the requirement of the Building Act.

⁵ EN 16627:2015 *Sustainability of construction works – Assessment of economic performance of buildings – Calculation methods*

The landlord provides a one-off payment towards the cost of the fit-out, which is capitalised over the length of the tenancy. This is a common feature of commercial leases, as the landlord can borrow against the property at a lower interest rate than the tenant can borrow at on an unsecured basis. The tenant is then responsible for arranging and maintaining the interior fit-out, including painting, flooring, fixtures and fittings. The landlord receives slightly less rent than if they were providing the interior fit-out. However, they will also face lower costs as they are not responsible for interior maintenance. This would likely lead to greater predictability of their revenue.

5.1.1 Financial analysis

The net present value (NPV) of three models was compared:

- Existing stock – landlord purchases an existing 40th percentile priced dwelling, and it is rented out for mean rent.
- New build – landlord purchases a section and builds a completely new dwelling, and it is rented out for mean rent.
- Shell and fit-out – landlord purchases a section, builds a new dwelling shell and provides lump sum payment to tenant for complete fit-out. Rent is set at below market rent.

Across all three models, the same parameters were assumed:

- Mortgage interest rates – 6% p.a.
- Mortgage term – 25 years.
- Rent price growth – 4.2% p.a.
- Capital gains – 3% p.a.
- Rates – \$2,000 and 5.5% inflation p.a.
- Insurance – \$950 and 3.4% inflation p.a.
- Property management fees – 8% of rent and repairs.
- Tax rates – 30% p.a.

All parameters were based on historical trends or current market rates. The existing stock model is financed with a 40% deposit, consistent with loan-to-value ratio (LVR) restrictions from the Reserve Bank. The new-build model and shell and fit-out model are financed with a 20% deposit, reflecting their exemption from LVR restrictions and common lending practices.

Repairs and maintenance expenditure was estimated based on a rule of thumb of 1% of the value of the building element per year, tempered in the first 10 years to 0.1% to reflect the low maintenance requirements for recently constructed buildings. The BRANZ house condition survey indicates that 13% of houses less than 10 years old were maintained in 2015, compared to 31% of houses greater than 10 years old. Furthermore, houses older than 10 years are likely to incur more expensive maintenance as elements approach replacement rather than repair.

Tenancies are assumed to last for 2 years, with a 2-week vacancy in between for both the existing stock and new-build models. For the shell and fit-out model, tenancy is assumed to last for 10 years, with a 6-week vacancy period. At the start of each 10-year tenancy, the landlord provides a lump sum payment to the incoming tenant to replace the fit-out, as the landlord is able to borrow against the property at a considerably lower cost than the tenant. The lump sum is amortised over the period of the lease, consistent with a commercial property shell and fit-out lease.

5.1.2 Findings

The new-build model and shell and fit-out model offer a considerably higher NPV than the existing stock model. Figure 21 shows that the new-build model and shell and fit-out model offer a similar NPV, which is significantly higher than that of the existing stock model, regardless of investment horizon. That is, whether the investor chooses to sell the property at 10, 20 or 30 years, the NPV is higher for our alternative models than for the existing stock model. Counterintuitively, rentals of newly built stock are relatively uncommon in practice. This may be due to the cash flow constraints faced by small-scale property investors, as building new can require a significant upfront investment and only start generating returns up to a year later.

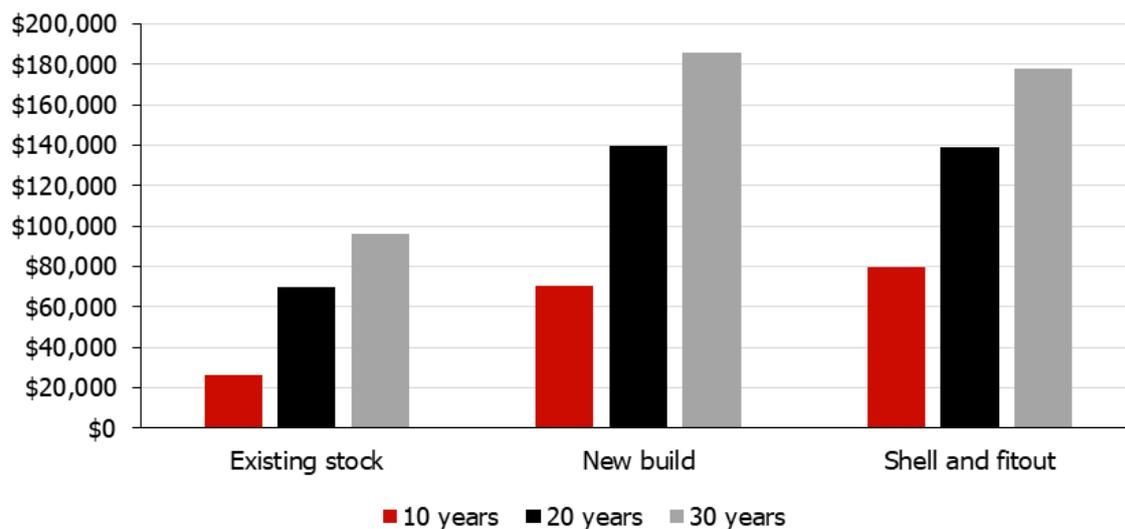


Figure 21. Investor NPV comparison of rental models – varying investment horizon.

The new-build and shell and fit-out models generate a higher NPV as they generate a positive cash flow several years earlier than the existing stock model. This is primarily due to reduced expenditure on repairs and maintenance within the first 10 years.

Focusing on a 20-year investment horizon, Figure 22 shows that the new-build and shell and fit-out models offer the least negative (i.e. best) NPV from the tenant's perspective.

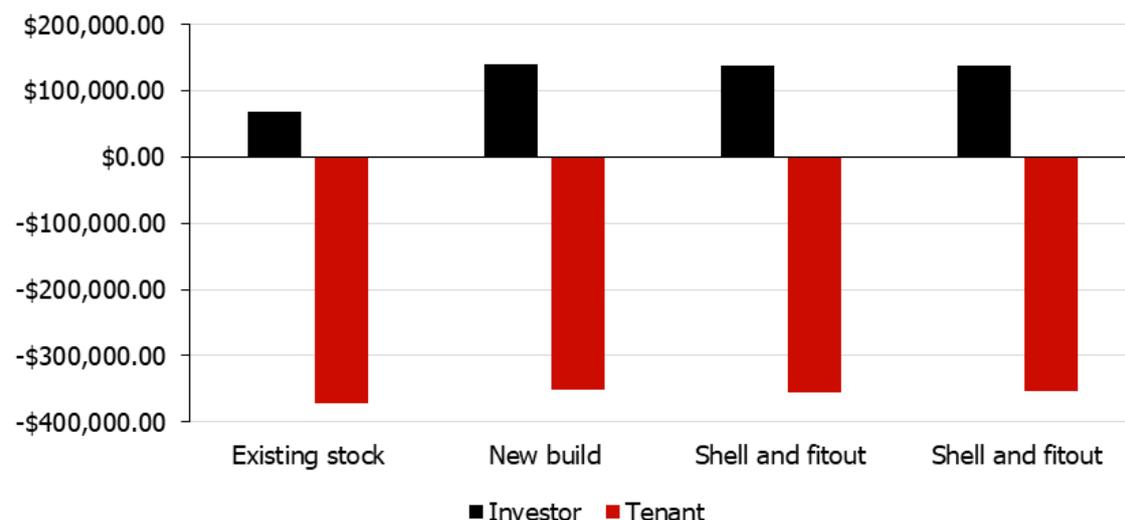


Figure 22. NPV comparison of rental models – 20-year investment horizon

This does not include the numerous intangible benefits for the tenants of a new dwelling, such as enhanced warmth and comfort that comes with a new dwelling or fit-out. The shell and fit-out model provides further intangible benefits, such as enhanced security of tenure and freedom to customise the dwelling as needs change.

Renting out new dwellings instead of the older existing stock offers greater long-term value to investors and provides a better quality PRS. Adoption of a shell and fit-out model would be a significant change from current practice in the PRS. However, the shell and fit-out model provides significant benefits to the tenants, particularly those who anticipate renting for the long term.

Implementing such a model would require market acceptance from both tenants and landlords, which has not been tested. Amendments to the Residential Tenancies Act would also be required, as landlords currently have inalienable obligations to provide and maintain certain interior facilities. Maintenance of interior facilities would logically lie with the tenant under a shell and fit-out model.

5.1.3 REIT

To encourage uptake of build-to-rent models, individuals could consider combining into a REIT. A successful REIT could achieve sufficient scale to sustain a development pipeline and a cost-effective management structure, supporting returns that are competitive with small-scale property investment. As long-term investors, REITs would be well placed to offer the long-term tenancies required for the shell and fit-out build-to-rent model. A sufficiently large and liquid REIT would enable individual investors to enter and exit the trust without disrupting long-term tenancies. However, for REITs to be viable in New Zealand, they would require equivalent or preferable tax treatment to small-scale property investors.

5.2 Energy performance certificates

An issue highlighted by the Housing Preferences Survey was that most respondents did not consider other costs when choosing their rental house. Some renters will not look past the rent payments. However, others would likely benefit from an increased understanding of the performance of the home and be willing to pay more rent in return for reduced energy costs.

Those houses that perform better than the average rental house require some way to show interested renters the performance of their house. It is unlikely to make financial sense to invest in features that improve the performance of the house where renters are unable to compare the performance to other rental properties.

Therefore, to improve the performance of the rental stock, having an independently assessed certification of the energy performance of the house, similar to Energy Star rating labels for appliances, could prove useful. There are learnings from the EPC system implemented in the European Union (see section 2.1.3).

5.3 Matching changing needs

The profile of renting households is projected to change over the next 20 years as the number of renting households increases, so houses built for the rental market should consider this profile. An increase in the number of multi-family households is projected in the PRS, which may require a greater number of bedrooms and configurations with multiple common areas such as kitchens. The current PRS has a smaller proportion of

large houses (4 or more bedrooms) than owner-occupied stock. The number of bedrooms is the second most important criteria in choosing a rental property, so matching bedrooms to household need is important for attracting tenants.

Lifetime design features are inexpensive to incorporate when the building is being designed and constructed and will meet the needs of two growing groups of renters. The number of renting households that include an individual over the age of 65 is projected to increase. With an elevated rate of impairments, this group will increasingly require houses with lifetime design elements. Similarly, the number of renting households with an individual under the age of 65 who is impaired will also grow and will require houses with lifetime design elements. Mobility and agility impairments are most common. Provision for these impairments is straightforward when considered in specifying the width of spaces and doorways, handrails and door, cupboard and tap handles.

5.4 Learnings from previous BRANZ work

Page (2016) identified some specific considerations that landlords should take into account, particularly if they are able to provide evidence of improved energy efficiency:

- Additional ceiling insulation and under-slab insulation is likely cost effective for the average occupancy in cooler climates (Wellington and the lower South Island).
- Flow restrictors on taps and showers save significant volumes of water and further reduce electricity use for water heating.
- Where flooding occurs regularly (at 10-year or less intervals), the best financial option is often to raise a house.
- Preparing a new house for future lifetime design features typically costs about \$3,000 extra and allows for easy adaption should occupiers' requirements change.
- Using low-maintenance or resilient materials does not cost much more than low-cost materials over the lifetime of a house.

Further BRANZ work on lifetime housing (Page & Curtis, 2011) suggested that 80% of new houses require, at most, minor changes to layout and doors and strengthening of bathroom fittings prior to construction. In 2011, this added about \$500 to the total cost of a new house. However, those houses that required significant changes averaged about \$8,000 additional cost per house. In addition to those internal changes, many new houses required wider parking areas and pathways to the front door. This typically added another \$1,200 to the total cost of a new house.

The report found that, when making changes to an existing house, the costs were significantly higher. The costs were typically over \$15,000 per house for any internal work that needed to be undertaken. The external work was about \$7,000 if ramps and paths were required. Given the expense in altering an existing house for lifetime housing, if higher rents can be charged for those requiring lifetime housing, the additional cost could be recovered through rent payments.

In early 2011, BRANZ conducted a study looking into the cost efficiencies of standardised new housing. It found that medium-sized builders (8–30 houses per year) were constructing the cheapest houses on average between mid-2009 to early 2010. They were found to be approximately 8% cheaper than one-off designs. This was likely due to a combination of factors such as repetition, bulk purchase of materials, selective design aspects to minimise difficulties and good organisation (Page & Fung, 2011). This highlights further opportunity for large-scale investors to consider entering the residential market offering new homes for rent.

6. Conclusions

This project looks to provide an overview of the rental stock as it currently stands, estimate the rental housing need in the future and identify opportunities for the rental industry as we go forward.

The research suggests that there is not a sufficient market for high-performing rental houses in New Zealand. Many tenants are basing their decisions on where to live on rental price, number of bedrooms and neighbourhood. Travel costs, medical costs, cost to heat and other energy costs are often not considered. Further research is needed into why this is the case, how we can encourage tenants to consider these other costs and the impact this will have on the rental stock.

Further research is also needed into why the rental stock is generally in a worse condition than the owner-occupied stock. Until we can better understand the impact that the way tenants occupy buildings has on the different components, it is difficult to identify components where it is worth landlords spending additional money.

From an 'exceeding the minimum' perspective, improvements in the current state of the rental sector look like they will need to be driven by government. There appears to be a lack of incentives for the market to lead change, particularly when there is a housing shortage and landlords are able to keep their properties tenanted.

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Appendix A: Results of t-tests

Table 13 shows results of the t-test for each component analysed in the BRANZ 2015 House Condition Survey. Some secondary components were not analysed (spare bathroom, deck, hot water system). Components where the difference in condition was found to be significant at the 95% confidence interval are highlighted in green.

Table 13. Results of t-test by component.

| Component | Significance |
|------------------------|-------------------------|
| Kitchen linings | $t(249)=3.26, p=0.001$ |
| Kitchen joinery | $t(242)=3.56, p<0.001$ |
| Cooker | $t(237)=3.78, p<0.001$ |
| Main bathroom linings | $t(249)=2.95, p=0.003$ |
| Main bathroom fittings | $t(254)=2.62, p=0.009$ |
| Laundry linings | $t(555)=3.27, p=0.001$ |
| Laundry fittings | $t(247)=1.58, p=0.115$ |
| Hot water system | $t(509)=-0.17, p=0.869$ |
| Other rooms trim | $t(240)=2.75, p=0.006$ |
| Staircase | $t(135)=1.66, p=0.1$ |
| Internal doors | $t(553)=3.80, p<0.001$ |
| Skylight | $t(75)=-0.20, p=0.841$ |
| Roof space | $t(467)=1.08, p=0.282$ |
| Roof framing | $t(481)=0.84, p=0.404$ |
| Header tank | $t(119)=-1.07, p=0.289$ |
| Foundations | $t(320)=1.26, p=0.207$ |
| Waterpipes | $t(178)=2.99, p=0.003$ |
| Wastepipes | $t(183)=2.40, p=0.018$ |
| Joists/bearers | $t(328)=0.47, p=0.641$ |
| Fasteners | $t(327)=1.75, p=0.081$ |
| Timber floor | $t(334)=0.34, p=0.735$ |
| Subfloor vents | $t(266)=0.19, p=0.849$ |
| Basement | $t(50)=-0.01, p=0.989$ |
| Paths | $t(521)=3.11, p=0.002$ |
| Steps and ramps | $t(362)=1.06, p=0.289$ |
| Main decks | $t(382)=1.69, p=0.092$ |
| Wall cladding | $t(554)=0.38, p=0.708$ |
| Exterior doors | $t(243)=3.45, p=0.001$ |
| Windows | $t(553)=4.50, p<0.001$ |
| Gutters and chimneys | $t(556)=1.03, p=0.306$ |
| Chimney | $t(304)=2.52, p=0.120$ |
| Carport | $t(82)=1.19, p=0.238$ |
| Canopies | $t(50)=-0.52, p=0.608$ |
| Verandas | $t(102)=1.47, p=0.151$ |
| Lean-tos | $t(29)=-0.49, p=0.625$ |
| Sleepout/garage 1 | $t(18)=0.24, p=0.811$ |
| Water storage tank | $t(12)=-0.85, p=0.410$ |