

PROPERTY BECOMES ALL ABOUT INCOME

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As with the share market, investing in property has become more about income than capital growth.

While the gentle slide in housing prices of the past year appears to be petering out, rental returns are picking up.

Property's appeal as a reliable source of income with a longer-term potential for capital gain is prompting greater interest from do-it-yourself super funds.

Geared property is a way around the government's limits on salary sacrificed contributions to super.

The \$25,000 contribution cap "almost forces you to gear – before you could wait till you were 55 then whack money in", says Michael Hallinan, special counsel for Townsends Business & Corporate Lawyers.

And just as this is a stock picker's market where individual shares can go against the trend, property also has its hits and misses.

"Once you could pick any property and over the long term it would have made money. Now if you're not careful it's possible to lose money by investing poorly," says Sean Preece, chief executive of Ironstone Group, which runs the only residential property fund open to investors.

High-density units, for example, are a poor investment. “A block of 200 or 300 units is not conducive to increasing prices. There’s always a property on the market at any time and there’s no competitive [bidding] pressure,” he says.

Published median housing prices can disguise substantial movements in the market. As a rule, the top end of the market is struggling while the first-home buyer end is picking up.

Nationally, house prices fell by an annual 3.5 per cent and units 1 per cent in the September quarter, Australian Property Monitors says. The worst markets were Brisbane housing (down 6.7 per cent) and Darwin units (down 7.7 per cent).

But RP Data reports big gains in some suburbs, such as Brisbane’s Willowbank (up 41 per cent over the year), North Sydney (37 per cent) and Melbourne’s Williamstown North (35 per cent).

The only overall average price gain – a bare 0.6 per cent for the year – was recorded by Sydney units, which may be explained by the return of first-home buyers, lured back by large cuts this year in fixed rates and rising rents.

“First-home buyers are coming back in and the rate cut will have a significant impact on them. We saw that with the fall in fixed rates,” says Rob Mellor, managing director of BIS Shrapnel.

But it would take a rate cut of 1 percentage point for a meaningful impact on the market, says Ken Atchison of property analyst Atchison Consultants.

“I can’t see material price rises coming through, but rents will keep growing,” he says.

In any case, first-home buyers and investors tend to compete in the same market.

Economists expect property to be subdued for the next six months, but after that there is disagreement about the direction.

The most extreme view is that Australian property, considered among the most expensive, is grossly overvalued relative to incomes, and so unaffordable.

The International Monetary Fund says house prices are overvalued by 5 to 10 per cent. The Economist magazine goes further and says it is more like 50 per cent, and even more inflated than Hong Kong, which has experienced a runaway property boom.

There's no question affordability is low, but the disagreement comes over supply. "Rents are going up because of low vacancy rates. There's a shortage of properties," says Shane Oliver, head of investment strategy at AMP Capital Investors.

Although net immigration peaked in July 2009, it is running at about 130,000 a year, prompting forecaster BIS Shrapnel's estimate of a housing shortage of "around one year's level of underlying demand".

While rents are likely to continue rising on average 5 per cent a year, prices will remain subdued because of wariness about Europe's debt problem, the US recovery and China's slowdown. "The big theme is debt deleveraging. It'll take three rate cuts to stabilise the market," says Oliver.

Far from prompting an exodus into property, the volatile share market has merely led super funds to build their cash holdings and households to repay debt.

But the biggest argument against a crash in property prices is the absence of any forced selling. Bank mortgages in arrears have crept up only slightly from loans in the run-up to the global financial crisis when standards were slack.

Australia's low unemployment rate is the bulwark against forced selling. The dollar will "give an early read" on whether unemployment is going to be a problem, says Atchison.

"If the trade weighted index really starts to fall, it would be a sign that the terms of trade are deteriorating and that would be an indicator to unemployment and then residential property prices," he says.

Lenders say most borrowers are ahead in their repayments and the Reserve Bank of Australia's rate cut last week will also help. More pointedly, it will restore some confidence.

"The rate cut will give a huge boost to confidence in the economy. Then by the middle of next year we'll see strength in residential property," says Kevin Stanley of CB Ellis.

“At the high end, prices have stopped falling. Deals are hard to do but they’re still being done. There’s no sense of urgency.”

At the same time, more home owners are moving up from the middle to the higher bracket, leaving the mid price range of \$600,000 to \$1 million as the softest.

BIS Shrapnel is the most bullish about property in the next three years despite predicting that the fall in rates will be temporary, rising to 9 per cent in the first half of 2014.

Its authoritative LMI Housing Outlook predicts price rises between mid 2011-2014 of a low of 5.6 per cent for Melbourne, suggesting falls in real terms annually for the next three years, to as high as 20.2 per cent in Perth with Sydney not far behind at 19.4 per cent.

Rents are expected to climb by an annual average of 2 to 3 per cent for Adelaide and up to 6 and 7 per cent for Sydney (with Perth not far behind) in the next three years. That will give Sydney and Perth annual returns of more than 5 per cent in real terms. In Sydney it will be due to supply and in Perth demand.

“Sydney is massively undersupplied. Construction won’t keep pace with demand,” says Mellor.

Only Adelaide and Canberra have too much housing stock, though unlike other experts Mellor doesn’t think Melbourne is oversupplied.

But Kevin Lee, director of Smart Property Adviser, says it has “an oversupply of units coming online” that will depress prices.

Lee says supply of housing stock will continue to be a problem in Sydney where first-home buyer interest is hotting up. “Sydney is unique as the only capital with geographic constraints on all sides – mountains to the west, coast on the east and national parks to the north and south,” he says.

“While demand from first-home buyers picked up in the past few months, having slumped artificially as purchases were brought forward before the home grant boost ended, the trend will be accelerated in Sydney in the next few months.

“The below half a million dollar market is hot as first-home buyers bring forward purchases because the stamp duty exemption on buying existing homes will be killed on January 1,” says Lee. The experts agree Perth will be the best performer thanks to the mining boom.

While prices have been slipping they’re “approaching the bottom of the adjustment phase”, says chief executive of property research group Residex John Edwards, who predicts Perth will be the best performer in the next five years.

“The move to growth will come quickly and our best estimate is that this will occur in the next three to six months,” he says.

The best location for affordable investment properties in Perth is Carlisle, 6 kilometres south-east of the city, one of the rare suburbs to record a price rise in the past year, says Jason Isherwood, managing director of Capital 360. The other stand-out performer is expected to be south-east Queensland (except for newer unit developments in Brisbane) but not the Gold Coast or Noosa, and central Queensland.

Brisbane housing is among the more affordable to begin with and rising Queensland incomes from the resources boom make it even more attractive.

Edwards also suggests Hobart will do “better than all capital cities other than Sydney and Perth over the next five years”.

Property experts say Melbourne will fare worst, with falling prices and the lowest rental yield due to a supply surplus estimated by Residex to be 25,000 dwellings. Ironstone’s Residential Property Fund, which has returned an average 10.3 per cent a year since it started four years ago, is steering clear of Melbourne.

“It’s fully priced and will remain flat if not come off,” says Preece.

Perth, Sydney and Brisbane are the best prospects and “we’re getting bullish about Wollongong, Newcastle and Parramatta. These are mini metropolitan cities which are becoming self-sufficient and with their own transport,” he says.

In Sydney, the inner suburbs of Alexandria and Dulwich Hill have the most potential, while in Brisbane inner-city Paddington has a vacancy rate of only 0.8 per cent with half its

population renting, says Isherwood. But one of the fastest-growing areas in the past year was the Canberra suburb of Bruce, where prices climbed 11 per cent.

Since cash flow is king in this climate, the outer suburbs of Sydney and Brisbane come into their own.

“You can get a 7.2 to 7.8 per cent growth yield from the rental in parts of Sydney such as the St Marys, Wellington and Kingswood,” Lee says.

He argues negative gearing only supports the tenant’s lifestyle.

“My strategy is to be neutral or positively geared so the tenant is paying off the mortgage. At the end of the day you have a property. Who cares if there’s no capital growth?”

Places to live

Rankings of capital city properties by key financial metrics

Highlighted numbers indicate top ranking in that category

HOUSES						
	Suburb	Median price	12mth price growth	10yr compound price growth	Median rental rate	Indicative gross rental yield
ADELAIDE	Medindie	\$1,505,000	+10.9%	11.2%	n/a	n/a
	Mitcham	\$896,125	+47.1%	12.0%	\$400	2.3%
	Craigburn Farm	\$657,500	+2.7%	15.9%	n/a	n/a
	Tusmore	\$1,030,500	+14.3%	10.8%	\$675	3.4%
	Elizabeth North	\$190,000	-6.6%	11.6%	\$240	6.6%
BRISBANE	Chandler	\$1,285,000	+10.1%	n/a	n/a	n/a
	Willowbank	\$430,000	+41.0%	15.1%	n/a	n/a
	Darra	\$355,000	-0.7%	16.1%	\$310	4.5%
	Newstead	\$1,230,000	-5.0%	10.7%	\$875	3.7%
	Rocklea	\$280,000	-26.3%	13.0%	\$345	6.4%
CANNBERRA	Forrest	\$2,325,000	+32.5%	10.6%	n/a	n/a
	Oxley	\$632,500	+41.3%	10.1%	n/a	n/a
	Page	\$472,400	+5.0%	12.7%	\$430	4.7%
	Red Hill	\$950,000	-5.0%	5.8%	\$723	4.0%
	Monash	\$490,000	-3.9%	10.3%	\$530	5.6%
DARWIN	Bayview	\$2,750,000	n/a	30.6%	\$800	1.5%
	Darwin River	\$492,500	+41.9%	n/a	n/a	n/a
	Bayview	\$2,750,000	n/a	30.6%	\$800	1.5%
	Fannie Bay	\$866,500	-13.4%	9.2%	\$810	4.9%
	Ludmilla	\$490,000	-13.4%	9.4%	\$550	5.8%
HOBART	Battery Point	\$750,000	-11.8%	11.2%	\$520	3.6%
	Cambridge	\$428,500	+25.1%	8.8%	n/a	n/a
	South Arm	\$372,500	+9.9%	18.6%	\$310	4.3%
	Battery Point	\$750,000	-11.8%	11.2%	\$520	3.6%
	Gagebrook	\$150,000	+2.7%	13.6%	\$230	8.0%
MELBOURNE	Toorak	\$2,480,000	-10.6%	8.9%	\$1,000	2.1%
	Williamstown North	\$783,000	+35.0%	10.5%	n/a	n/a
	Dandenong South	\$573,276	n/a	16.2%	\$310	2.8%
	Toorak	\$2,480,000	-10.6%	8.9%	\$1,000	2.1%
	Millgrove	\$244,000	+6.1%	10.9%	\$260	5.5%
PERTH	Peppermint Grove	\$3,770,000	-19.4%	14.2%	\$1,800	2.5%
	Kallaroo	\$660,000	+17.9%	12.2%	\$450	3.5%
	Wattle Grove	\$490,000	-3.5%	23.5%	\$450	4.8%
	Peppermint Grove	\$3,770,000	-19.4%	14.2%	\$1,800	2.5%
	Brookdale	\$270,000	-9.5%	13.1%	\$310	6.0%
SYDNEY	Point Piper	\$8,250,000	n/a	6.0%	n/a	n/a
	North Sydney	\$1,365,500	+37.2%	7.8%	\$748	28.0%
	Wadalba	\$390,308	+0.1%	16.4%	\$400	5.3%
	Vaucluse	\$3,296,000	-12.7%	5.7%	\$2,500	3.9%
	Whalan	\$235,000	-2.9%	6.6%	\$310	6.9%
APARTMENTS						
	Suburb	Median price	12mth price growth	10yr compound price growth	Median rental rate	Indicative gross rental yield
	Semaphore South	\$652,000	n/a	19.5%	\$265	2.1%