

SMART MONEY

Bricks and mortar on the way back

Investors have been cautious, writes Robert Harley, but the essentials of a return to housing are building.

Investors have shunned housing in the past year. But it's not permanent – they'll be back – and the investment fundamentals have rarely looked better. While the collapse of equity prices has scared many investors, most housing investments have delivered. Rising rents and falling interest rates have boosted returns; values have been remarkably stable; and the risk of a fall in house prices is receding.

The one factor missing is the strong capital gains that have – often wrongly – encouraged investors into housing in the past. But many analysts believe that in the wake of the global financial crisis, the enhanced returns on a stable investment such as housing will be enough.

And the reduction in the cap on concessional contributions to superannuation in this year's budget is likely to increase the long-term attractiveness of direct property investment.

"We are starting to get to the bottom of demand from investors," says BIS Shrapnel managing director Robert Mellor, who predicts low interest rates, coupled with very low vacancy rates, rising rents and higher yields, will entice investors back into the market from late 2009.

"The fundamentals are still so good for this market; there is a massive stock deficiency. And investors, they can positive gear," he says.

IIA takes a similar view. "It is reasonable to expect an investment recovery to emerge through 2009," notes the housing group in its latest *National Outlook* report.

RP Data national research director Tim Lawless says the jump in rents of the past two years has provided the best gross rental yields investors have seen for a long time.

"Gross rental yields are likely to peak over the coming months (as rents plateau and house prices rise), suggesting that now is probably the best time for investors to roll up their sleeves and become active," he says.

The past year has been quite different. Lending for investment

housing – the only real guide to investor interest – fell 27 per cent in the March quarter, from the December quarter. At about \$3 billion a month, lending is less than half what it was a year ago.

Australian Property Monitors economist Matthew Bell says investors have been holding out for the bottom of the interest rate cycle and for the end of any first-home buyer bubble. He thinks they might hold out a little longer.

While they wait, income from housing will improve, as a shortage boosts rents and returns. But rental growth will slow.

Lawless says the growth in rents over the past two years – about 22 per cent nationally – is unlikely to be sustained.

"Rental affordability is now becoming a real issue and many renters are likely to be considering either buying or moving into a more affordable rental location," he says. "Nevertheless, there will still be upwards pressure on rental rates over the remainder of the year because vacancy rates are still at historic lows and rental demand remains high."

Australian Property Monitors says gross rental yields in most major markets rose in the year to March, except for the Gold Coast apartment market.

Median gross yields range from 4.2 per cent for Perth houses to 6.3 per cent for Darwin apartments. Many investors are finding better opportunities.

Of course, they are gross yields. The real return, after deducting government charges, management costs and insurance, and after allowance for vacancies and repairs, is much lower.

Centric Wealth Advisers' Roger Hancock points out that cash returns on listed real estate investment trusts are better.

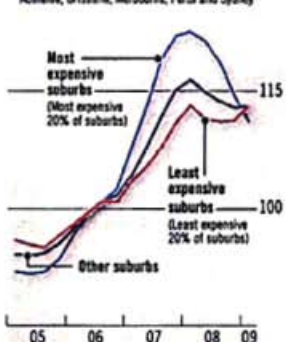
"You will get a 5 per cent yield on residential, whereas high-quality trusts are paying 10 per cent. That is double the return. And you will get much more capital growth. But it is a different mindset," he says.

For many, that mindset is tax minimisation. Which is why the changes to super will have a long-term impact on demand for investment housing.

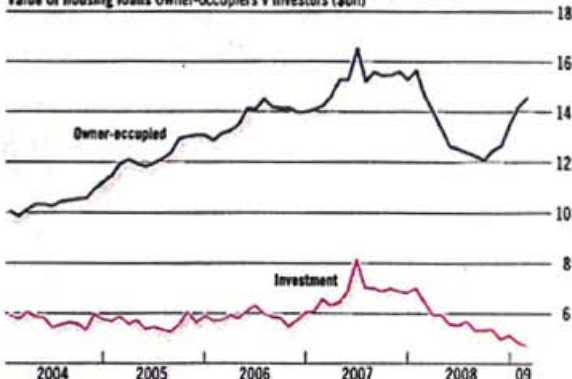
Home truths

House price index* 2006 = 100

* Weighted average of houses and units in Adelaide, Brisbane, Melbourne, Perth and Sydney



Value of housing loans Owner-occupiers v investors (\$bn)



Median property prices to April 2009

	Median house value	Houses change % YoY	Median unit value	Units change % YoY
Sydney	\$574,713	▲ 0.72	\$437,389	▲ 4.90
Melbourne	\$462,457	▲ 1.04	\$368,865	▲ 3.02
Brisbane	\$452,873	▼ -2.93	\$328,460	▼ -3.43
Adelaide	\$413,084	▼ -1.73	\$346,245	▲ 0.68
Perth	\$473,042	▼ -5.39	\$441,946	▼ -7.05
Darwin	\$494,549	▲ 13.51	\$353,201	▲ 18.44
Canberra	\$481,883	▼ -0.65	\$376,578	▲ 3.78
National	\$489,748	▼ -0.71	\$398,599	▲ 2.18

Gross rental yields to March 2009

	Houses		Units	
	Yield %	% YoY	Yield %	% YoY
Sydney	4.49	8.1	5.47	8.3
Melbourne	4.27	10.0	4.95	5.7
Brisbane	4.57	1.1	5.09	8.4
Adelaide	4.42	1.9	5.07	1.7
Perth	4.29	14.3	5.02	9.8
Hobart	5.14	3.4	4.98	2.9
Darwin	5.33	10.1	6.37	8.6
Canberra	4.94	3.9	6.02	3.4
Newcastle	4.96	4.9	4.66	3.6
Gold Coast	4.54	5.5	4.96	-0.4
Sunshine Coast	4.27	5.0	4.76	8.8

SOURCE: RP DATA, AUSTRALIAN PROPERTY MONITORS

There will still be upward pressure on rental rates because vacancy rates are at historic lows and rental demand is high.

Matthew Bell, APM

Under the old rules, a couple over the age of 50 could have contributed \$200,000 a year to their super at a concessional rate. By 2012-13, their concessional threshold will be just \$50,000.

"Which means they will be paying a hell of a lot more tax," Hancock says. "What that will do, almost assuredly, is push those people on higher taxable income to more deductible investments. People will start looking back to cash deductions and cash savings. So negative gearing, and gearing, and those sorts of things will come back into focus."

The change sends a more subtle message. "This is the first sign that the goalposts of superannuation are going to be shifted," says Melbourne property investment adviser Monique Wakelin.

"For investors to be reliant wholly on superannuation-based investments to fund a designer lifestyle and income when they retire is now falling into the 'too many eggs in one basket' story," she says.

"A lot of investors are looking for investments over which they have more control... I am hearing the rumbling already."