

# Forget the lemons invest in a peach

There's action in real estate despite talk of rate rises, writes **David Potts**.

**W**ith all the real estate flyers that have been landing in our letterbox of late, promising willing buyers for our dump, I've been thinking of extending. The letterbox, that is.

The funny thing is, they're piling up even faster since the Reserve Bank governor, Glenn Stevens, said interest rates would rise by at least 2 percentage points "at some point".

Obviously he can't have deterred all those willing buyers.

That's because as rates rise, so do rents.

Higher mortgage repayments discourage first-home buyers, who have no choice but to stay with their parents or rent.

"If interest rates rise, this will increase rents," says the head of property markets at Westpac, Frank Allen.

"The 2 per cent test is normal – it's not really a stress," Allen says, although he added it could be more of a worry in two or three years when rates may be a lot higher.

Meanwhile, property prices are starting to rise, rental yields have levelled out at their best in a decade and, along with an acknowledged shortage of housing, there's record immigration.

Economists agree that as the first-home buyer boost is phased out, new opportunities will arise for investors.

So where should you look?

Steady on, there's no rush. The market might have bottomed but nobody's predicting prices will soar in the next six months. The biggest mistake is looking in your own, er, backyard.

Sure, it's convenient to have an investment around the corner: it will be easy to check on, arrange repairs for and even allow you to dispense with an agent.

But it's not good economics.

You're more likely to be too emotionally involved with a property in your own neighbourhood and could be missing better opportunities. Besides that, you need to

be diversifying.

Arguably, the further from home you go the better, since you'll be saving in land tax by investing in another state.

There'll be a lot more to choose from this spring, particularly in November, which is the season of greatest supply.

Your first port of call is probably Sydney, where prices have been weakest for longest.

"The average price is under what it was in 2004, yet rents have been pushed up to yield 5 per cent or 6 per cent for a two-bedroom unit," Allen says.

It could pay to check recent developments as developers have been doing it tough and, in some cases, are forced sellers.

One property group, Ironfish ([ironfish.com.au](http://ironfish.com.au)), specialises in off-the-plan projects by buying "pre-public" – that is, before they're advertised.

But do new properties or established ones give a better return?

New properties have building depreciation allowances and are easier to rent. On the other hand, properties in established areas are scarcer, closer to the city and have more potential for value-adding renovations.

So, as always in property, the answer depends on the location.

The same goes for whether you buy a unit, townhouse, semi or a house. And how many bedrooms it has.

"What you buy depends on what the demographics demand," says Margaret Lomas, a property expert and financial adviser. "When you know who lives there, or rather who's going to be living there, then you know the right kind of dwelling. If it's families, you want a house. If it's itinerant workers or yuppies, a unit is more suitable."

As a general rule, units should be close to public transport, amenities and cafes, while houses should be situated near schools and parks, says the research director at Ironfish, Grant Ryan.

By the same token, you don't want to

invest in a unit miles away from the city centre, or a house on a large block close to the city.

Neither will give a high return compared with other properties.

Remember, buildings depreciate, so property is ultimately all about land value.

That's why a house should appreciate more than a unit in a high-rise block.

Lomas also suggests choosing an area with a diverse population, one that has people from different cultures and age groups.

"If it's concentrated with the same kind of person, growth is limited," she says.

Ryan says you should look for population growth and increasing affluence and not pick a place just because you like it.

"It's not what you like that makes money," he says. "It needs some value or potential added value such as new infrastructure."

Or, as Lomas points out: "Nice things are too costly to replace and fix."

And always see property as a long-term

investment – that is, 10 years at least – by which time it should have doubled in value.

"You need to ask: Can you hold on long enough without having to sell?" Ryan says.

That means it must be easy to rent and give a high return for the outlay.

So a \$1 million home returning \$700 a week will be harder to hang on to than two units costing \$500,000 each, both of which earn \$500 a week.

"You can't get the perfect property," Lomas says. "But you can ensure it's not a lemon."

"Not buying the worst is more important than buying the best."

Oh, and when it comes to handing over the cheque, avoid auctions.

"You get very emotional and competitive at auctions," Lomas says.

"Have a handful of places you're looking at because among them there'll be one vendor more inclined to sell and you can make an offer before auction, or after it's passed in."

## The lure of commercial

**PROPERTY** investing isn't only about houses or units.

Twelve months of double-digit price falls have put commercial property back on the map, so to speak.

"I'd be investing in commercial before residential," says the head of property markets at Westpac, Frank Allen, pointing to 10 per cent yields.

In fact, like housing, a shortage of office space is looming thanks to developers being unable to secure bank finance.

Although vacancy rates have risen, corporate collapses have been fewer than feared, removing the spectre of unlet space.

And because bosses are cutting working hours rather than jobs, there's been less downsizing of office space than had been feared.

The prospects for shopping centres have also been improving thanks to government handouts and very low interest rates.

But industrial space, where there is a glut, will require much stronger economic growth than anybody has been prepared to predict for the next year or so.

The budget-conscious way to invest

in offices or shops is through listed property trusts (also known as real estate investment trusts, or A-REITs).

Their prices have dropped almost four times as much as the values of their underlying properties, which fell 10 per cent to 20 per cent in 2008-09.

Many are trading at only half the value of the properties they own. Despite lower distributions, their yields are near 10 per cent a year.

A-REIT unit prices have jumped about 50 per cent in six months.

But they have their problems still.

They overextended themselves by going offshore, which was the undoing of Centro, and there's the lingering problem of having blurred the distinction between developing properties and managing them.

It would take just one forced asset sale for independent valuers, who rely on the last traded market price, to mark down entire portfolios.

Certainly the values of their offshore properties are still vulnerable, judging by falling prices in the US and Europe.

Analysts favour Westfield, GPT, Mirvac, Stockland, Colonial First State Retail Fund, Commonwealth Property Office and Dexus.