Tips for success in a volatile property market

Smaller, older-style apartment blocks are more likely to retain value and appeal, say investment specialists.
Rodger Cummins

by **Duncan Hughes**

Getting the most from a property portfolio in volatile markets could mean culling under-performers and reinvesting in quality dwellings that provide income and prospects for capital growth, say property specialists.

"Managing risk does not mean investors should quit investing," says Phillip Almeida, director of acquisitions for Performance Property Advisory, a company that brokers real estate for time-poor professionals.

But it requires avoiding markets where there is little opportunity for returns – areas with poor infrastructure, a long way from central business districts and which are over-supplied with apartments.

High peaks and deep troughs tell the story of the Australian property market during the past five years, with Melbourne and Sydney posting strong gains and Perth struggling with over-supply and falling demand.

10 tips for buying an investment property

1. Capital growth

Look for areas that haven't performed for the past five to seven years but have had consistent rental growth of more than 20%.

2. Owner occupiers

Areas where owner occupiers dominate tend to be occupied all year. Always stick to major population centres.

3. Strong land value

This should represent 70% of the value of the property for free-standing houses. The closer to the CBD, the higher the land value.

4. Location, location, location

Properties close to the CBD are in shorter supply than middle and outer-ring locations and are usually in strong demand. The right location ensures stable cash flow and opportunity for capital growth

5. Quality residential stock

Ideally the property should be a free-standing house (single- or double-storey terrace) with two to four bedrooms or an older style apartment in a blocks of no more than 12 dwellings. Ensure units have low body corporate fees, an appropriate maintenance plan and ample funds in the sinking fund.

6. Scarce supply

Best opportunity is from period and older-style properties that cannot be replicated. They should preferably be in a street where dwellings have consistent style.

7. Broad appeal

Avoid properties on main roads or near service stations, industrial area and commission housing.

8. Add value

When renovating you need to optimise, not overcapitalise.

9. Infrastructure

Buy in areas or cities where major infrastructure projects, either under construction or in the planning stage, will drive population growth and jobs.

10. Resale

Seven out of 10 dwellings are held by owner-occupiers. They are likely to be the main source of demand when property is sold.

SOURCE: PERFORMANCE PROPERTY ADVISORY

Annual growth in the nation's capital cities has fallen to its lowest pace in nearly three years, says CoreLogic RP Data.

OVER-SUPPLY OF DWELLINGS

Properties in popular Melbourne suburbs valued between $2 million and $4 million have recently been passed in at auction, reversing a trend in recent years of quick sales and big returns, adds Christopher Koren, director of buyers' agent Morrell and Koren.

Analysts such as LF Economics and Roger Montgomery, chief investment officer of The Montgomery Fund, a $1 billion funds management group, claim there is a massive over-supply of dwellings.

Montgomery reckons – in the absence of big interest rate hikes and defaults – it will result in a few years of sluggish prices rather than a sharp correction.

LF Economics warn of a possible "bloodbath", with Melbourne likely to be the epicentre.

"Melbourne's inner-city high-rise apartments are top of the list for over-supply of dwellings," says Almeida. "They typically attract transient, student and short-term single and young couple tenants."

PRICE DROPS

Prices for high rise apartments in some of Melbourne's most prestigious addresses, such as Little Collins Street, have plunged by more than 40 per cent in the past five years, despite double-digit property gains in other suburbs.

A two-bedroom, two-garage apartment in Little Collins Street that was bought for $2.2 million in 2010 recently sold for $1.6 million. The values of other apartments in the same block are down between 4 per cent and 23 per cent.

Nearby blocks are also performing dismally.

"There are probably 50 buildings nearby that are exactly the same," says Koren.

He warns off-the-plan apartments in the central business district are routinely dropping in value by 20-40 between commencement and completion.

WHERE TO BUY

"Buy with eyes wide open," Koren says. "These are a lifestyle investment. Don't expect to make the returns that a large house in a leafy suburb might offer."

A "red alert" – an underperformance warning – has been issued by SQM Research, which monitors prices and performance, for inner Brisbane apartments. Further, it says, swathes of Perth, Darwin and Cairns are laggards.

For example, it takes about three times as long to sell a property in Perth as in Melbourne or Sydney, says CoreLogic RP Data.

"Other no-go zones are areas of over-supply such as greenfield development projects and areas zoned for high-density living, with a full pipeline of planning approvals near central business districts," says Almeida.

Buyers' agents recommend areas where the majority of buyers are home-buyers. They should be close to public transport, job centres, schools, restaurants, amenities and village-like shopping centres.

WHAT TO LOOK FOR

Investment quality properties are those with some scarcity value, typically built between the mid-1800s to the 1960s and include designs from the Victorian, Edwardian, Spanish Mission, Art Deco and early post-world war II eras.

According to Almeida, best buys are located in blue-chip suburbs, or those undergoing gentrification, within two to 15 kilometres of the central business district of a city with good infrastructure, particularly quality schools, and strong population growth.

They also should be structurally sound, with only cosmetic renovations needed, and have a "clear property title", which means no easements, no contamination and a good heritage overlay.

"Stick to the shrewd investors' formula," says Koren. "Buy rock-solid, bullet-proof real estate that is within 10 kilometres of the central business district and not threatened by other developments."

Daren McDonald, a partner with ShineWing Australia, which advises property developers, advises buyers concerned about possible redevelopment to employ a town planner to check land titles or contact the local council.

KEEP AHEAD OF ZONING

McDonald says most councils can provide details of the zoning overlay. This will keep you abreast of pending changes, planning permit applications and whether an area is defined as heritage, farming or development.

Many councils have an on-line register of development applications that can be accessed online.

David Sinn, partner and head of real estate with Herbert Smith Freehills, urges buyers to seek professional help in understanding a contract's small print because "what appears to be simple might hide a complication".

For example, there might be a covenant restricting development height or size.

Many Generation Y investors would never have experienced a major market correction, much less double-digit interest rates.

"Volatile markets could tempt some to sell," says Almeida. "Now is the time to get out for those with inferior stock. Flattening market conditions are generally an ideal time for investors to pick up bargains."

WHAT TO IMPROVE

Those with quality properties might consider refurbishing, which should normally be handled by a property manager. It may involve cosmetic updates to a kitchen or bathroom and painting.

"A good refurbishment increases the value of a property and increases rents, which can help to reduce debt," Almeida says.

A high loan-to-value ratio – which is a measure of the amount borrowed compared to the value of the property – could leave an investor exposed if the value of the property slumped or the buyer loses their job.

Financial advisers can provide information on freeing-up cash flow by reducing debt.

An alternative strategy might be to consider higher yielding asset class than residential property, such as commercial and residential.

"Like residential, it should always be blue chip – that is high quality, highly desirable stock with capability of attracting stable tenants such as government organisations and major corporations," says Almeida.