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Wealth/Super

How to avoid losing money on property

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As the sharemarket falls, the temptation is to invest in the residential property market. Not a good idea – the outlook for the residential market is poor. Here are five tips to avoid losing a pile.

Investors stung by the highly volatile bear sharemarket are vulnerable to making a classic investment mistake of selling their shares at depressed prices and pumping the money into residential property. These investors would be much smarter to sit tight and wait for the sharemarket's inevitable turnaround.

The sale of a long-held share portfolio is likely to trigger huge capital gains tax bills, plus transaction costs.

Buying into an asset class that is facing an increasing bearish outlook just compounds the problem. And Australia's residential property is sending out plenty of highly conflicting signals about its investment potential.

On the positive side, tenancy vacancy rates are at a long-time low as demand well exceeds supply, and rents are sharply rising.

But on the negative side, official interest rates are at a 12-year high, the economy is expected to slow, lenders are being slugged by the squeeze on global credit, and a recent Reserve Bank report shows once again just how house prices have shot way ahead of household income. And crucially, auction clearance rates are falling – a key indicator of a weakening property market.

Michael McNamara, general manager of Australian Property Monitors, warns that the residential property market is in a "precautious position" and that buyers could easily lose money. There is no doubt that the market has reached a dangerous point, he says. (See also the Home Price Guide published by Australian Property Monitors.)

Apart from the high shorter-term risks in this market, McNamara believes that the strategy of buying and holding on to a property for the long-term will no longer deliver the returns of the past. "It would be false hope to expect this," he says.

Nevertheless, some sections of the market hold much more potential than others, while some are definite no-go areas.

Here are five tips for minimising your likelihood of losing money on residential property at this time:

1. Treat long-term property price forecasts with extreme

suspicion

A fundamental reason to treat these property forecasts with caution is that they sometimes contradict each other to a breathtaking extent.

“Very long-range predictions are like flipping a coin,” says McNamara. “It could go either way.

“And as predictions go further out in time, they are less likely to be accurate,” he says. McNamara does not take seriously property forecasts beyond 12 months.

Economists and property consultants BIS Shrapnel this month forecast that Australian house prices would grow by 40% over the next five years, while some analysts predict that prices will go in the opposite direction. And the International Monetary Fund has named Australian house prices as among the world's most vulnerable for a sharp fall.

2. Try to understand the true direction of the property market

Louis Christopher, head of property research for investment researcher Adviser Edge, has attempted to cut through the confusion by examining the cases for a bullish or bearish outlook. And he has come down on the side of the bears.

Christopher acknowledges that rents are accelerating because of the grave undersupply, particularly in NSW. Developers have been holding back since the beginning of 2005 because of a lack of potential profits in residential property.

But Christopher says slowing auction clearance rates are a very good indicator of a weaker market. “Eventually, sellers will have to meet the market [by lowering their prices],” he says.

“Also, higher interest rates and higher property prices do not mix. Overall, Australia’s residential property market depends on the price of credit.”

And finally, Christopher says the global economic problems and the lack of capital to lend do not augur well for Australia’s residential market.

“At the beginning of the year, I was quite bullish for residential property, but now I am increasingly bearish.”

3. Watch out for peak debt

McNamara says would-be buyers should expect much more subdued capital gains from residential property than over the past 20 years for one reason in particular – “We are at the point of peak debt.”

By peak debt, he means that lenders no longer have the capacity or appetite to provide the level of debt that has funded the growth of property prices over the past 20 years. And, he says, borrowers have almost reached the limit of their ability to take-on more debt.

“I suggest that households in Sydney, Perth and Canberra are at peak debt; and Melbourne and Brisbane are close.”

4. Know the best buys

Despite the bearish outlook for residential property, there are some good buys around – it is a matter of being highly selective.

McNamara names Sydney apartments as the best buys in Australian property. “Sydney apartments are starting to look quite cheap," he says.

"Four or five years ago, Melbourne and Brisbane apartments were almost half the price of Sydney apartments, but now their prices have moved much closer together," McNamara says. The median price of a Sydney apartment is $363,000 against a median price of $335,000 in Melbourne. And the median apartment price in Perth, at $360,000, has risen from being far behind Sydney to being almost neck-to-neck.

"Sydney apartment prices have been in the doldrums for the past five years," says McNamara. "They are at the same level as in June 2003." The same can't be said for apartment prices in most other states.

McNamara believes it would be a smart move for would-be buyers to begin researching the Sydney apartment market with the intention of seizing astute buys once interest rates begin to move downwards.

Christopher favours one or two bedroom apartments in inner-urban suburbs in Sydney – ideally in buildings with adequate security and, if you have the money, a view. Next, he favours the inner suburbs of Melbourne, but is cautious because of big price gains experienced last year and the fact that the market is slowing.

5. Know the worst buys – and keep right away

McNamara names the worst buys as houses and apartments in Perth. "Prices had gone like a rocket in Perth," he says, "but all indicators are for a 10% to 20% correction over the next 12 months."

Christopher tags as "ground zero" some of the south-western suburbs of Sydney such as Fairfield. "Prices are falling in these suburbs, where mortgage repayments are as high as 50% of income before tax." And he says mortgage belts in Melbourne and Brisbane are also under stress.

"I wouldn't be buying anything in Perth right now," Christopher adds. "And I would be reluctant to buy in the Brisbane market because of affordability [problems]."

Christopher is also cautious about the once highly favoured inner suburbs of Melbourne. "We saw some pretty big price increases last year, and the market is slowing."

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