Rents to rise close to the city

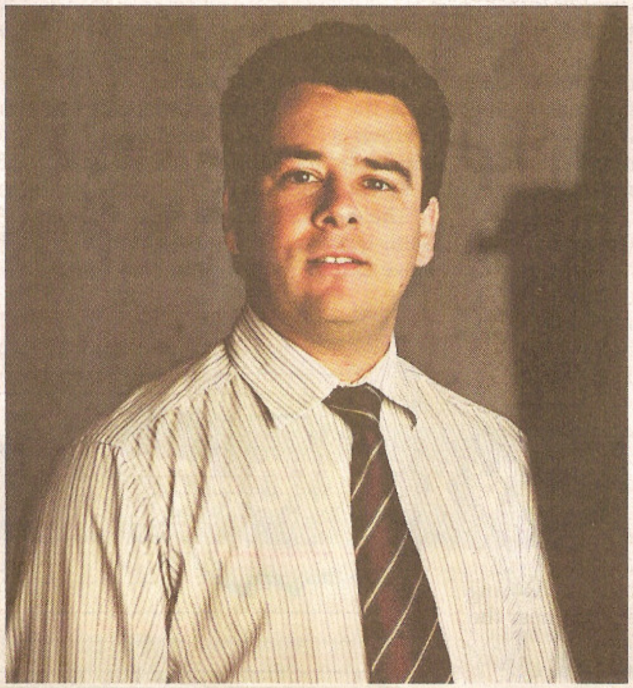
Generation Y can't afford to buy houses in good locations, so demand for units is growing.

Hot spots
Stephen Nicholls

Apartments close to the city and harbour are the best property investment in Sydney, say experts, as rental yields and prices increase due to rising demand from renters and first-home buyers.

"Even if we have another two rate rises I believe residential property prices will still rise," says Louis Christopher from property researcher Adviser Edge.

"Interstate migration to Queensland has slowed and that means demand for accommodation in Sydney has been rising quicker than anticipated.



Stay close to town ... Michael McNamara (left); Louis Christopher.

that developers have not been able to build profitably (until now), has meant there is a large gap between what is demanded and what is been supplied and we don't believe this gap will be resolved in the immediate future."

Michael McNamara, general manager of Australian Property Monitors, says Generation Y are priced out of the market for well-located houses and this is pushing up rents in the inner-city locations.

"Displaced would-be home owners and university students pushed up gross rental returns for apartments in Ultimo, Pyrmont and Chippendale to above 6 per cent over the last year. We recommend areas with strong local economies that attract young renters with lifestyle, education and employment."

Both property experts warn against trying to capitalise in poor-performing suburbs, with McNamara suggesting: "Astute investors know that if an area is super cheap, there is probably a good reason."

Below are the pair's varying views on where property investors should focus – one suggests keeping a sharp eye on transport and employment centres, while the other says only the region's credentials are important.

MICHAEL McNAMARA

General manager, Australian Property Monitors

Picking good property investments requires the blend of art and science. The art being the human overlay that only an astute investor or adviser can provide.

Local knowledge trumps analysis often. Otherwise investors would all be rushing to dip into that property honey pot that is North Dubbo houses, with their attractive 7.8 per cent annual rental returns. Too far to check on the tenants? Perhaps then you will consider the more modest annual rental returns of Sydney's outer suburbs. How about Lethbridge Park or Tregear houses at 6 per cent? Both have median prices at exactly $200,000 – well within budget. And both suburbs are equidistant with Palm Beach from the Sydney CBD. Just look at what the property prices have done there.

Nor is there any clear conclusion to be found by focusing on long-term capital growth. A mixed bag of suburbs have achieved 10 per cent year-on-year growth for the last decade. In the 10 per cent club are suburbs as disparate as Sadleir and Clontarf, as Ambarvale and Bondi. As they say in the classics, this condition is necessary but not sufficient.

'We don't recommend suburbs that are not close to town, or suburbs where there isn't access to a train or ferry.'

MICHAEL McNAMARA, AUSTRALIAN PROPERTY MONITORS

Perhaps, property investment decisions were once as simple as yield versus capital growth, units versus houses or country versus city. If only things were still that simple. The current landscape of Sydney property is more likely to be shaped by localised debt servicing ratios, public transport access, demographic change and proximity to major employment centres.

This city's clogged roads, high petrol prices and lack of public transport will starve markets on our outskirts of the oxygen needed to grow. We don't recommend suburbs that are not close to town, or suburbs where there isn't access to a train or ferry.

On the outskirts of Sydney, weak property markets have exposed the mortgage stress that lurks beneath. These have manifest in too many repossessions and bankruptcies. We are not recommending purchases beyond 20km of the city either.

In an uncertain economic backdrop, we like to play it safe with suburbs with solid credentials. We choose North Sydney, Alexandria, Ultimo and Parramatta for their combination of the right investment fundamentals and qualitative common sense.

LOUIS CHRISTOPHER

Head of property research, Adviser Edge

Sydney is showing healthy signs of a recovery after a time of stagnant growth after the last boom abruptly ended with two successive rate rises in 2003.

Sydney's median house price, as reported by Australian Bureau of Statistics and confirmed by Australian Property Monitors, rose during the December quarter by 2.4 per cent, taking the 12-month change to December 2007 to 8 per cent.

However, it is interesting to note that in several inner-suburban regions of Sydney, residential property prices have increased beyond 10 per cent over the year and we believe this rate of growth will accelerate this year as share market investors look for other investments and seek a hedge against rising inflation.

The inner urban areas such as the inner east, lower north and lower northern beaches will do better than 12 per cent and on this front we like apartments where the gap between unit and housing prices is substantial.

We strongly believe that the rises will be broad-based and history has shown that suburbs in these regions hold their relative value to each other over the long term (greater than 10 years).

Investors should, however, look at the lower end of the market (below $500,000) where demand for rental accommodation is at its highest and stamp duty rates are at their lowest. This is also a price point where a new breed of investor, the residential property trust fund manager, is increasingly buying into.

'In Sydney the underlying demand picture is supportive to investors.'

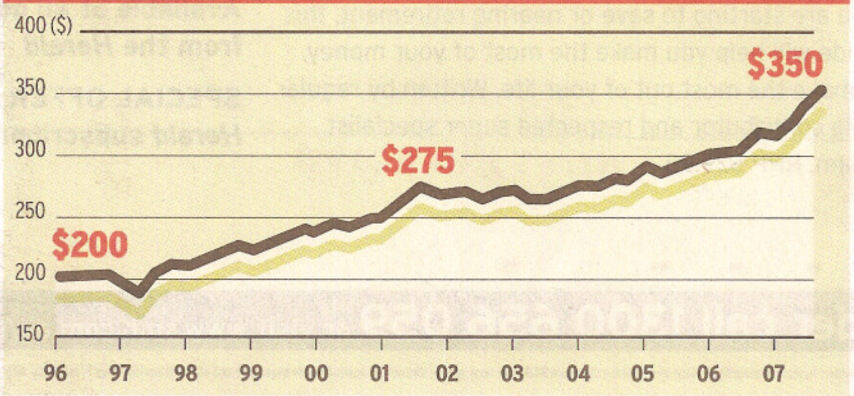
LOUIS CHRISTOPHER, ADVISER EDGE

With regard to buying new or old, we like apartments that are between five to 10 years old. In our opinion this is the ideal "sweet spot" where one can still claim building depreciation and yet the risks of buying brand new have been mitigated.

Like new cars, brand new apartments have often suffered the fate of rapid depreciation within the first three years of their existence. Especially where they were overpriced to the rest of the market to begin with.

For Sydney overall, the underlying demand picture is supportive to investors. It hasn't been this supportive in a very long time.

ALL ABOARD THE RENT-RISE EXPRESS*



*MEDIAN RENT FOR A TWO-BEDROOM UNIT

SOURCE: NSW DEPARTMENT OF HOUSING