

# the matusik snapshot

A regular focus on the residential property scene

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## Think long term

*We anticipate a move back to the safety of bricks and mortar.*

A wise man once said that “all investment markets gravitate towards their long-term average overtime.” This is a somewhat apt quote given the financial turmoil of recent weeks. The headlines last week were again all doom and gloom but this time – if that is possible – with a more depressing sense of forebode. But really, a headline like “The Death of Capitalism” is taking it a bit too far. The end of the financial world has been falsely proclaimed for hundreds of years, but capitalism isn’t dead yet. In fact, what has happened in the last few weeks is actually capitalism at work. The sky, regardless of how dark the horizon looks, is not falling in.

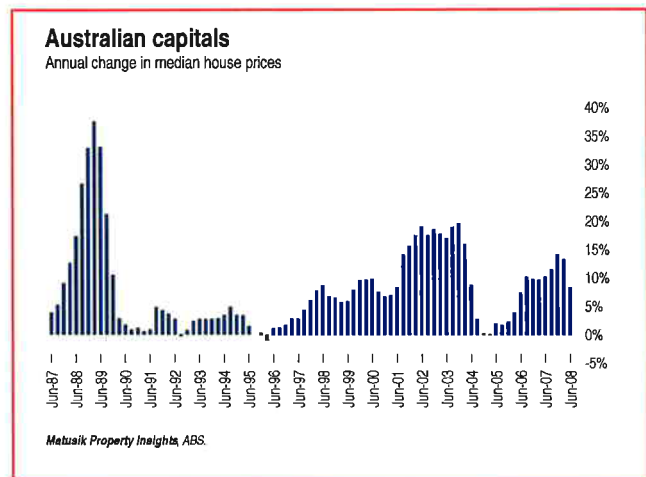
Nor is the Australian residential property market likely to implode. Calls of substantial price drops due to the “global financial meltdown” are also ill-founded. While the events of last week have unsettled some property buyers, the fundamentals supporting Australian residential property remain robust. Without wanting to sound like a broken record – migration/population growth is rising; our economy is stronger than most; unemployment is low and we have an undersupply of new stock. While the traditional spring selling season may not be as strong as many would like, that does not mean that prices are likely to fall.

In fact – and despite being reported as a bad result in some newspapers – auction clearance rates over 50% (and especially in Sydney and Melbourne) translate to price growth.

It is timely therefore to take a step back and look at how residential property actually performs. In our last Snapshot we outlined that Australian residential property has out-performed most other assets over the short, medium and especially long-term. That statement, along with the accompanying table, solicited numerous requests from subscribers (and others) for permission to republish the data. So given that interest, we felt it was appropriate to take a more in-depth look at residential investment returns across Australia.



Our first observation, as shown in the **chart below**, is that residential returns are cyclical. On average, prices double every nine years, equating to capital price growth of just over 8% per annum. Secondly, and whilst there are low periods, it is rare that nominal prices actually go backwards on an annual basis.



On occasions, it is true that residential property over the short-term does enter negative territory. The **table overleaf** shows that houses went backwards by 2.5% during the June Qtr and attached dwellings fell by -0.3% over the same period. But when taking a longer-term view, the average total return for a house was 11.4% across our capital cities during 2007/08 and was 11.3% for attached product. When looking at a medium time frame (last five years), houses returned 11.0% per annum and units 9.9%. The ten year average was 13.4% for detached product and 12.8% for attached dwellings. To repeat, “all investment markets gravitate towards their long-term average overtime.”

The information in the table overleaf comes from the REIA and incorporates the growth in overall median prices (capital growth as shown in the chart above) together with the percentage returns derived from net rental income for three-bedroom houses and two bedroom attached dwellings. Capital growth is derived for each city from quarterly median prices.

Net rental income is before tax and is based on median quarterly rent adjusted downwards by 20% to take into account costs including interest, maintenance, insurance and agency fees that are associated with ownership of an investment property.

This data series, which unfortunately is not as widely reported as the quarterly price results, provides us with two further observations about residential investment returns. Firstly, that detached and attached residential property now show similar total returns. Many still believe that detached houses, given their land content and freehold ownership, are better investments. But given the generally superior location of many apartments (and in particular new product) and the lower maintenance required, attached product often provides better net rental yields than detached houses.

A second observation is that most locations – and especially over the mid-to-long term – also show similar returns. Too much time and effort is spent by those in the property business arguing why a certain area or product is hot, whilst the stats show that over the long-term investing in either Brisbane, or say

Adelaide, offers a similar return. Sydney, however, appears to be an exception to this trend. Over a ten-year period, Sydney's returns are somewhat comparable to the other capitals but over the last five years they are abysmal. Hopefully, things might be changing for the better; investor confidence in the Emerald City is on the increase, prices are rising in the more affluent areas and prices are starting to stabilise in the west/south west. The now chronic undersupply of new stock across Sydney should see better investment returns in the years to come.

Looking forward, investment in direct property should pick up given the recent stock market fluctuations. A stampede to property similar to the late 1980s is, however, unlikely; but the increased traffic through open houses last weekend suggests that investors are again looking to invest in residential property.

Investors should not regard the recent ups and downs of the market in determining value, but rather consider the medium-to-long term potential.

To quote another wise man, and this time Warren Buffet, "Our favourite holding period is forever."

### Residential investment returns

Capital cities

Returns (%)	Location								Weighted average
	Sydney	Melbourne*	Brisbane	Adelaide	Perth	Canberra	Hobart	Darwin	
<b>Three-bedroom detached houses</b>									
Qtry return (March 08 to June 08)	-1.4%	-7.8%	0.9%	1.0%	-2.9%	-2.4%	-2.1%	2.0%	-2.5%
<b>Annual return (June 07 to June 08)</b>	<b>4.2%</b>	<b>16.7%</b>	<b>18.3%</b>	<b>20.5%</b>	<b>0.4%</b>	<b>9.1%</b>	<b>8.6%</b>	<b>12.1%</b>	<b>11.4%</b>
Average return over last 5 years	4.2%	8.2%	17.1%	16.0%	21.6%	15.6%	20.0%	19.2%	11.0%
Average return over last 10 years	11.0%	12.5%	15.3%	16.1%	16.4%	15.5%	16.2%	13.7%	13.4%
Median price '000 (June 08)	\$542.0	\$451.0	\$420.3	\$366.0	\$443.0	\$450.0	\$325.0	\$423.3	\$459.2
Median rent (June 08)	\$330	\$280	\$325	\$270	\$350	\$380	\$290	\$510	\$312
<b>Two-bedroom attached dwellings</b>									
Qtry return (March 08 to June 08)	0.4%	-3.1%	1.5%	0.7%	0.9%	-2.2%	5.0%	3.2%	-0.3%
<b>Annual return (June 07 to June 08)</b>	<b>3.4%</b>	<b>19.2%</b>	<b>18.9%</b>	<b>19.2%</b>	<b>5.9%</b>	<b>9.8%</b>	<b>11.1%</b>	<b>23.2%</b>	<b>11.3%</b>
Average return over last 5 years	4.3%	9.5%	17.9%	16.6%	21.5%	13.9%	21.6%	20.0%	9.9%
Average return over last 10 years	10.0%	14.4%	14.7%	15.4%	18.9%	15.9%	17.5%	n/a	12.8%
Median price '000 (June 08)	\$364.0	\$370.1	\$356.0	\$276.0	\$374.0	\$353.0	\$260.0	\$329.0	\$357.4
Median rent (June 08)	\$380	\$295	\$320	\$230	\$320	\$370	\$250	\$380	\$335
Total vacancy rate (June 08)	1.1%	1.0%	2.2%	1.5%	2.8%	2.0%	2.4%	0.3%	1.4%

Matusik Property Insights, September 2008. REIA.

\* Based on quarterly and annual returns ending March 2008. See text in Snapshot 381 for further information.

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