Yields From Property Investment Begin To Tighten

By Michael Mata

The "golden years" of high returns from property investment may be over as yields begin to tighten, according to a recent survey of property fund managers by Atchison Consultants for the Property Funds Association (PFA).

Save one year, the Australian property market has generated a return of 9% to 10% annually since 1997.

Atchison Consultants, which surveyed 27 fund managers and the 66 unlisted property funds they manage, found that returns turned negative for these funds in 2009. Volatility of returns was attributed to the capital return component, which has fluctuated between -12.4% and +11.8% annually.

Property income returns remained relatively stable, with a return of 7.2% annually, and a volatility of return of 0.5% over the same period, Atchison Consultants said.

"An absolute return of between nine and 10% per annum, which was achieved historically, is unlikely over the next three to five years," the report said.

Over this period, "Based on the forecast property return of 7.4% and income return of 5.9%, a forecast absolute return is 6% to 7.5%. An absolute return of 6% to 7.5% per annum may be achievable reflecting rental income yields and moderate gearing."

"This range would be an appropriate absolute hurdle rate of return for fund managers. A great challenge for both managers and investors in an era of very low interest rates is the changing view of appropriate benchmarks and hurdles."

Direct property remains an attractive investment asset class to hold in the current low interest rate environment as it still offers attractive yields, according to Lev Driker, investment analyst at Atchison Consultants.

"Low domestic interest rates and strong investor demand have placed downward pressure on capitalisation rates resulting in rising capital values," he said.

“Some markets including Sydney and Melbourne have seen yields tighten considerably, providing little room for further contraction. However, with improving economic conditions there is upward pressure on rents providing some room for capital growth.”