Property still pumped with cash

The property market is running hot following four years of strong stock market returns. James Dunn looks at what's going on with property investment and also the rush to sell property to put money into super.

BY JAMES DUNN

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The investment property market is awash with cash in all sectors, say market participants. Four strong years on the stock market - particularly in listed property trusts (LPT) - has many investors looking to divert profits into other asset classes and direct property has traditionally filled that role. Ken Atchison, managing director of property investment consultancy Atchison Consultants, is looking over the next three years for office property to earn returns of 10 per cent a year, industrial property to earn 9.5 per cent and retail 8.5 per cent. "With the stock market having run so strongly for so long, there are plenty of investors prepared to bite on those returns," Atchison says.

Investors are active in all sectors of the market, CB Richard Ellis regional director of Australia-New Zealand metropolitan investment Andrew Dawkins says. "The market is characterised by a stack of money and a bit of a frenzy. In Perth it is going berserk and reaching fever pitch; on the eastern seaboard the investment market is very solid. There is a lot of interstate buying, and still the adage that people from Sydney come down to Melbourne and are surprised at the value they can find compared to the Sydney market, which is tighter yields and higher prices - the same as residential."

Investment in non-residential property has opened up in the past five years as traditional residential investors have been induced to look at other asset classes by the minuscule rental yields on offer. "If you're comfortable owning a warehouse instead of a block of flats, you can spend the same amount of money and get a better yield," Richard Jenkins, head of research at Knight Frank in Melbourne, says. "You can certainly get a lot better yield for the same purchase price as you can in residential. A lot of investors who traditionally invested in residential have moved across to commercial for that reason."

The growth of strata titling has helped immensely to foster this interest, Dawkins says. "Strata is available in all sectors and it works to lower the entry price compared to direct property purchase. For the investor with $500,000 and upwards to spend, most of the options they have to look at would be strata," he says. "You might have strata office, where an office building has separate titles for each individual suite, and the investor buys a suite. For example, One Queens Road in Melbourne is fully strata, and each office suite - there's hundreds of them - is owned by individual owners. They could certainly get in at $500,000 or even less.

"Often in these cases the developer provides a guaranteed return for 12 months of about 7 per cent, and after 12 months, the investor is on their own - so they have to get in a tenant for the longer term. But a lot of investors like buying brand-new strata off the plan, because they have maximum depreciation and stamp-duty savings - it's before construction - and with guaranteed income for 12 months, they might think 'surely I can get a tenant within that time'."

Strata is common in industrial and retail as well, he says. "In industrial, you see a lot of 'factoryettes', or small office/warehouse units, where the developer might build 15-20 of them in a development. In retail, a developer might have bought an office building, for example, with retail on the ground floor, chopped the ground floor up into several shops with the office above, and sells each shop to individual investors. That kind of situation offers 5-7 per cent yields, and investors who like direct property are more than happy with that. The greater access that strata provides has helped a lot of people switch into the commercial property sector, or at least diversify into it," he says.

Ross Patane, head of corporate advisory at Brisbane chartered accounting firm William Buck, says savvy strata investors can stretch their yield into double-digits if they understand the market. "Generally you find that the property funds and the syndicates scoop up the investment-grade buildings, and the strata assets are sub-investment grade in an institutional sense, because either the quality of the property by virtue of its location, age or design isn't investment grade, or the quality of the tenants don't shape up as investment grade," Patane says.

This means the investor takes on more risk, but naturally, the yield will be better, he says. "For example, in Brisbane you can get into strata-titled industrial units for about the price of a median home in Brisbane, which is about $350,000. That's attractive in itself to investors, but it's even more so when you consider that the yield could be anything from 8.5 to 11.5-12 per cent, as long as you understand that the asset is sub-investment grade," he says.

"You might be taking the risk on having a single tenant who might not be a national name, who might not be considered a particularly strong tenant in terms of institutional grade, or the layout or the location or the age of the property might be the problem, but the double-digit yield generally justifies that risk. The good thing about this area of the market is that you're not competing with the investment banks and fund managers for those sorts of assets, just other investors."

Retail and office strata also offer good opportunities, he says. "Right now in this market, with the level of business activity, the office strata market has a strong resale outlook, because of the level of demand for office space in Brisbane. People are seeing value in moving from being a renter to an owner in their own business operation, and it's a similar story with small strata-titled retail premises. You could buy strata-titled retail in CBD or near-CBD locations on a gross return of 10 per cent in the $500,000-1 million range," he says.

Because prime retail strips are very tightly held, Jenkins says investors who want exposure to retail have to look to a secondary or emerging strip. "It may be just off the prime strip, or the demographics of the area is changing, getting wealthier and bringing people into the area. In any city, there are emerging hip suburbs and the opportunities follow on from this: people move in and the shops follow. You've got to pay attention to this: it's worth picking up research from the agents, because that will cover this," he says.

"It's the same in strata industrial: developers building those industrial parks with 16 units in a little estate are clearly aiming at service industry occupiers, so the investor has to look at the surrounding demographics and whether they think the support industries will follow in those areas." Someone who has $1 million-10 million can afford to look upward from strata, Dawkins says. "Generally speaking, private investors only used to be in at the bottom of the commercial property market, but they're coming right through. Investors we used to deal with who had $1 million-2 million to spend, the same people now have $7 million-9 million. They've really grown up with the market," he says.

This kind of investor is usually prepared to look at the potential upside as well as the existing income, he says. "Everyone these days is a 'developer' - they want to add value, and everyone's become a bit more savvy. People understand their investments a lot more. It might be that they have to refurbish and enhance the rent; it might be that it's under let at present and they're waiting for a market review so they can crank the rent up. They're a bit more experienced as property investors, and that's good," he says.

Just as in the wider investment market, property investors are becoming interested in alternative assets. "Things like retirement villages, childcare centres, medical centres and serviced apartments are all becoming more mainstream," Dawkins says. "They're still seen as alternative asset classes, but people are starting to move into things like childcare and medical because they have slightly better returns: medical centres offer yields of 6-7 per cent and childcare 7-8 per cent. A medical centre, for example, is often located close to a major hospital, and that is almost like having an anchor tenant. But investors probably should have experience in these asset classes.

"Childcare is a newer asset class and people need to be confident that it's a viable business, how many children can it cope with, what's its take-up rate, how strong is the operator - and is ABC Learning Centres going to open up around the corner, which is a potential category killer. There are still people who just see the return and jump at that, but you might have to be a bit savvier. The entry levels in alternative assets are certainly attractive to a lot of investors: childcare centres can be bought for around $1 million and medical centres can be picked up for less. Residential investors, if they're selling assets they've owned for a while, will find that very achievable - and they'll certainly get a return they won't get in residential."

Atchison says serviced apartments are also an emerging investment alternative. "There might be 80-90 apartments in the block and they're rented out for a week or longer. They have been sold off under strata and they're quite popular because they offer very secure rental streams," he says.