Why Invest in Residential Property

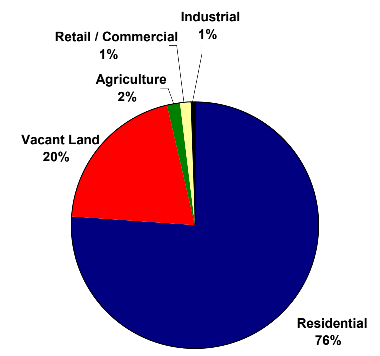
Sept 2004

Brief

The saying “All good things must come to an end” is a commonly used statement to describe a ‘high turned low’ disappointing situation. Research figures for 2004 indicate that the majority of Australia’s residential property markets are cooling. However, does this mean that one of Australia’s greatest ever property booms has officially ended - and if so, where does this place the residential investment property sector for the future?

The purpose of this report is to examine the benefits of investing directly in Australian residential property. With the real estate market now returning to a normal state it becomes increasingly important to examine and revisit some interesting facts/characteristics which relate to residential investment property that are often overlooked. For the purpose of this report investing in residential property is defined as, “the direct purchase of freehold or leasehold property, with the view to renting it to individuals or organisations thus receiving regular income”.

Queensland Property Sold in 2003
Major Land Use Classifications



Source: RP Data

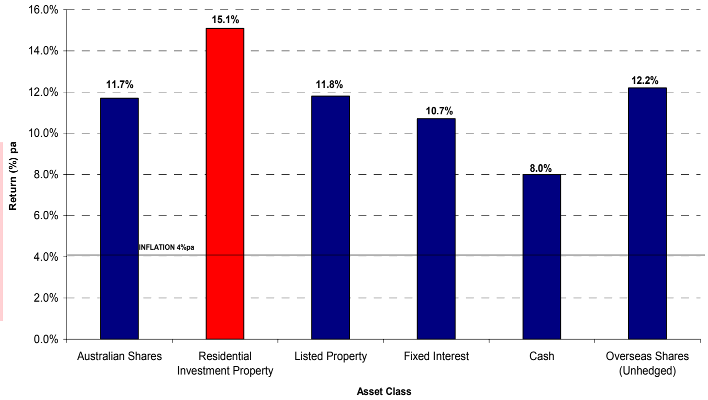
Types of Direct Property Investment

There are four main types of direct property in which Australians commonly invest - these being residential, retail, industrial and office. Each property investment type has its advantages and disadvantages over the others however, the majority of Australians choose to invest in residential property. The reason for this is simply that people feel most comfortable investing in something that they understand and encounter regularly in their daily lives. Australians are often reluctant to invest in other property sectors as they don’t understand concepts such as the detailed cash flows often associated with multi tenanted retail/commercial properties.

Residential Property Vs other Asset Classes

When comparing the financial performance of residential investment property with other asset classes it is important to examine performance over a substantial period of time. The graph located right tracks annual gross returns from various asset classes over a twenty year period to December 2003 and highlights that residential property outperforms all other investment types. Residential investment property achieved annual gross returns of 15.1% during this twenty year period, with its closest rival overseas shares returning 12.2%.

Gross Investment Returns Per Annum
Twenty Years to December 2003



Source: Towers Perrin

Advantages of Investing in Direct Residential Property

Most financial advisors suggest that a successful investment portfolio should consist of a variety of asset classes in order to minimise risk and maximise returns. Residential property is an asset class that is often part of a successful investment portfolio. However, as is the case with any investment, decisions to purchase residential property must be well researched and an element of risk is always associated. The major advantages of investing in direct residential property are listed below:

- **Control:** The owner of an investment property determines how the asset is managed and decisions are not left in the hands of a large corporation (such as shares and listed property trusts).
- **Understanding:** People understand how residential property operates as accommodation is considered as one of life's necessities.
- **Safety:** People feel safe investing in residential property as it is an asset that is tangible (something they can see and feel) and is relatively free from uncontrollable external forces.
- **Asset Performance:** Residential investment properties are an income producing asset which also have the potential to provide steady capital growth over a substantial period of time. It is also worth noting that a negatively geared property can become cash flow positive, based on the original purchase price, over a certain period of time via rental increases.
- **Leverage:** Financial institutions offer attractive loan to valuation ratios for residential properties meaning “other peoples money” can be used to leverage an investment thus yielding a higher return.
- **Tax Advantages:** Residential investment properties can be negatively geared or depreciated for tax purposes which provides significant monetary benefits.

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Investment Strategies & Property Cycles:

Residential property is an asset that is best held with a mid to long term investment strategy. Rapid capital growth over a short period of time is not a permanent occurrence for residential property and it will only happen when the market is at the right stage of the property cycle. Property markets are cyclical in nature and over a certain period of time there will always be both 'highs' and 'lows' experienced. The residential property cycle is generally believed to pass through all its various stages between a period of 7 to 11 years dependant on various factors.

The graph below right tracks median house prices for capital cities located along the eastern seaboard of Australia from March 1982 to March 2004 and provides an example of the simple concept that in residential property, "time can usually heal most wounds". These markets have experienced various price upturns and downturns over a substantial period however, if a house was held with the right investment strategy (mid to long term) the negative financial impacts realised from these downturns may have been ameliorated over time.

Changing Demographics & Residential Property Investment:

It is common knowledge that Australia has an ageing population. In the future Australia's senior population is projected to increase due to factors such as improvements in medical technology and personal health. The Australian Bureau of Statistics assumes that life expectancy for men will increase to 92.2 years of age, and 95.0 years of age for women by the year 2050. The median age of Australia's population is currently around 36 years of age and this figure is also projected to increase to 46.7 years by 2050.

Therefore people must accept that they will live for longer which poses some challenges in relation to financial freedom and the enjoyment of retirement. The Australian Bureau of Statistics indicates that 71% of Australians aged over 65 are living on incomes of less than $15,548 per annum. People must now start to think as to whether they will work for longer or acquire better long term investment assets (to accompany superannuation funds) if they wish to retire comfortably.

Based on what has been discussed in previous sections of this report, purchasing residential property may be a wise investment strategy to contributing towards financial independence upon retirement age.

Did you know?

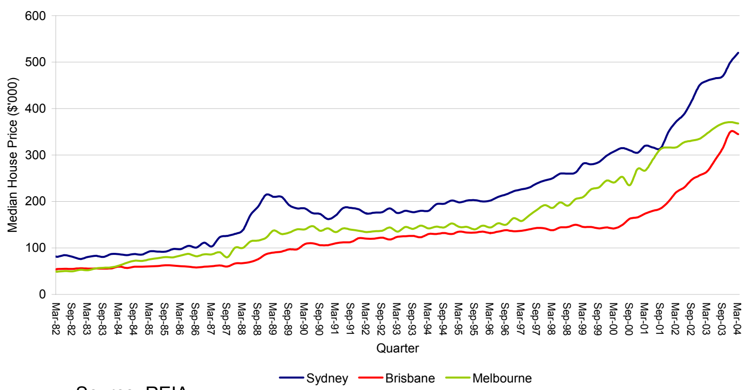
Let us consider 100 people who start out on their working life, and think about where they will be at retirement, for example.....aged 65.

Present statistics show:

- 38 will be dead
- 62 will be alive
- Of those 62 that are alive:
- 38 will be broke
- 16 will still be working
- 7 will be retired on a livable income
- 1 will be wealthy
- Of those 100 people, only 8 will reach financial independence.

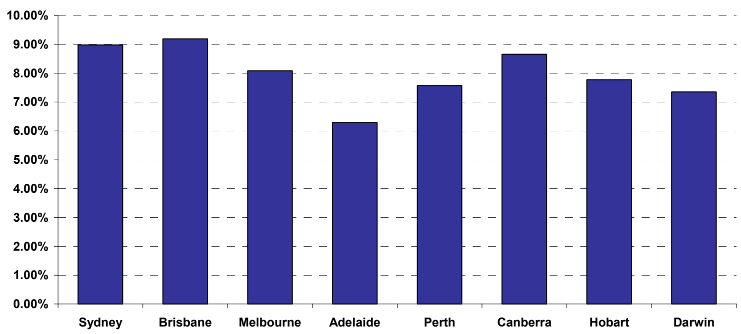
Source: Wilson HTM Investment Group.

Median House Price by City



Source: REIA

Australian Capital Cities
Annual Median House Price Growth
March 1991 - March 2004



Source: REIA

Projected Ageing Population by State/Territory

	Population aged 0 -14 years		Population aged 65 years and over		Median Age	
	2002	2051	2002	2051	2002	2051
NSW	20.2%	14.2%	13.2%	26.9%	36.1%	46.7%
VIC	19.7%	13.6%	13.1%	27.3%	36.0%	46.9%
QLD	21.0%	14.3%	11.8%	26.8%	35.3%	46.8%
SA	19.1%	13.0%	14.8%	31.1%	37.9%	50.0%
WA	20.7%	14.1%	11.2%	26.9%	35.2%	46.8%
TAS	20.7%	13.3%	14.0%	33.8%	37.7%	52.4%
NT	25.7%	20.4%	3.9%	12.1%	29.9%	35.8%
ACT	20.2%	14.3%	8.8%	23.5%	33.5%	43.5%

Source: Australian Bureau of Statistics

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Sources: Australian Bureau of Statistics, RP Data, REIA, Wilson HTM Investment Group, PRDnationwide Research & Towers Perrin.
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