

Perspective

Investing in property

– more than a roof over your head?



Traditionally, residential property has been seen as a safe and essential component of any long-term wealth creation strategy. *Buy the house, pay it off and then think about investing.*

Today however, there is increased diversity of the types of property available – supermarkets, office towers and industrial parks are all accessible to the potential property investor via various types of investment options. No longer does owning property simply mean buying the roof over your head.

So what are your options? And what are the advantages or disadvantages of each option?

Direct property ownership (residential)

There are many advantages to buying your own home. These include security of tenure (you are the landlord), the ability to do what you want with the property (install a new kitchen, update the bathroom or landscape the backyard) and perhaps most importantly, there is the capacity for your home to appreciate in value over time.

However, while residential property has historically been a good investment, it is important to remember all markets change. So although there are many tangible advantages to home ownership, it is also crucial you understand the underlying dynamics of the residential market.

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Inflation and interest rates

In the days of high inflation, buying your own home, paying it off and borrowing again to invest in another residential property worked – prices and rents went up. Fifteen years ago, for example, it was possible to buy a property in any major city on a yield of 6%. This meant annual rental income was 6% of the value of the property. Certainly helpful in paying off the loan.

The shift from a high inflation environment to a low inflation environment

In the early 1990's the shift to low inflation was enormously beneficial for residential property. Why? Because as interest rates fell (from highs of 15% to lows of around 6%) the capital value of most properties rose. Furthermore, because money was cheap, investors could rent their properties on yields of 3% to 4%. This helped ensure a steady supply of potential tenants.

Low inflation and rising interest rates

Fast-forward to 2005 and property investors have had to consider rising interest rates. Rents should increase in order to pay the mortgage. But this has not always been the case, as many tenants are not willing to pay more. As a result there has been a pullback in the price of housing with declining auction rates and static rental yields.

What about other property investments?

More investors are realising that there are other property markets beyond residential. The essential features of property investment are still present: steady growth in capital values with growing and often tax-effective rental incomes. However, these increasingly sophisticated property markets come with some advantages not available to the average residential property investor. A useful classification of these various investment vehicles include:

- Listed property trusts
- Direct property (unlisted) funds
- Combination property funds
- Mortgage funds

Listed property trusts

Listed property trusts offer investors exposure to a variety of property sectors and, as the name suggests, are listed on stock exchanges.

The advantages of listed property trusts include liquidity (the ability to buy and sell quickly) and access to a wide range of properties in both domestic and international markets.

Interest rates and yields

The sector is presently trading on an average yield of around 7%. However, if interest rates continue to rise it is likely the price of some trusts will fall. And investors will have an opportunity to purchase a share of the rental stream at bargain prices.

However, before investing it is important to remember that the purpose of a listed property trust is to provide a reliable source of income. And in the same way residential property investors will need to manage their debt, so too will listed property trust managers. Buying into a trust with unmanageable debt will be no different to purchasing a house with an unmanageable mortgage.

Direct property funds

Direct property funds also offer investors an exposure to different property sectors such as office, industrial and retail. But, unlike property trusts, they are not listed on stock exchanges. Instead they offer investors the opportunity to invest via a Product Disclosure Statement, with a view to selling it at a later time for a profit. In the meantime, the rental is distributed to investors on a regular basis.

The advantage of direct property funds is that the holdings are valued as they appreciate in value and they are unaffected by any short-term fluctuations of the sharemarket. A disadvantage of some direct property funds is that you cannot access your money quickly, as some direct property funds may be deemed to be "illiquid" and units can only be redeemed at pre-set times.

Combination property funds

As the title suggests, these are managed funds that invest in a combination of direct property (including unlisted property funds) and listed property securities.

This approach has many advantages. The direct holdings are valued as they appreciate in value, independent of any short fluctuations of the sharemarket. While the money invested in listed property trusts provides the fund with the necessary liquidity to take advantage of investment opportunities.

Also, investors have the ability to buy or sell units on a daily basis, as well as the services of a professional fund manager.

Mortgage funds

Mortgage funds enable investors to lend their money to other investors for property purchases. Investors in a mortgage trust therefore stand to receive income in the form of interest payments (usually on a monthly basis). All mortgage funds are unlisted. The main advantage of a mortgage fund is your capital remains stable.

In summary

Creating long-term wealth as a property investor is all about identifying those assets with reliable and growing rental streams. With reliable rent, a steadily appreciating capital gain should follow. So whether you choose to purchase your own home or invest in alternative property investments, it is crucial you understand the underlying dynamics of your chosen market.

More information

If you would like to know more about the different ways of investing in property, talk to your financial adviser. Before making any investment decision it is important to seek professional advice to ensure you make an informed decision, and one which fits with your financial situation and objectives.