USING UNITS TO BUILD YOUR FORTUNE

Prefer units to housing? API investigates how attached housing stacks up and whether brand spanking new or slightly more weathered provides the best investment option.

ANGELA YOUNG [@DepEdAPI]

While some investors swear by houses, believing land to be critical to capital growth, more and more people are opting for apartments and units as the mainstay of their portfolios.

With the population – and consequently our cities – growing at a rate of knots, the appeal of the convenient, lock-up-and-leave apartment with no lawns to tend and minimal maintenance required, continues to grow.

From an investment point of view, units offer the investor without too much cash to splash a nice, affordable buy-in option, so they can be particularly great for first-timers needing to target lower price points (without having to go too far out into the sticks).

Another appeal is their rental yield – returns tend to be better with apartments, not least because units are often the more appealing option for non-home owners or those looking for lifestyle locations (i.e. closer to city centres) – and sharing your site's rates bill with multiple owners also helps.

Renovations, too, can be considerably more affordable within the confines of a smaller floor space, and don't forget there's little or no exterior to worry about.

So, if it's units you're choosing over houses, where should your money go? Into that shiny new block that's still just an artist's impression, or will a well-worn, more traditional but slightly dated abode suit?

WHAT'S IN AN AGE?

Ultimately there are pros and cons to buying both brand new and older units, although Melbourne-based buyers' agent Cate Bakos is a firm believer in buying established.

"Whether they're three years old or 100 years old, as long as the title type, location, internal condition, outgoings, floor plan and aspect are desirable," she says.

A key consideration for her, too, is the land-to-asset ratio.

"If the dwelling component is of greater value than the relative land value, the property's rate of appreciation will be hampered," she explains.

"A brand new dwelling will have the strongest depreciation and may also offer stamp duty benefits, however its ability to grow in value is contingent on the land appreciating – and if the land component of the sale price is smaller than the dwelling, the property will be losing value in the initial years while the building depreciation outstrips the rate of the land appreciation."

Brisbane buyers' agent Karen Young also tends to prefer older units, but she sees the pros and cons in both.

"I would never say there's one strategy that fits everyone," she says. "For some people a brand new unit is a good option as they prefer to invest in inner-city locations, have good rental yield and have higher depreciation allowances.

"In saying that, personally I prefer older style units in small blocks with some add-value potential. In my experience, new units don't show the sort of capital growth I'd be wanting to see as there's a premium for buying new."

When it comes to yields, Young admits the newer units often provide better returns, but adds that by simply renovating an older unit, you should be able to match those higher levels.

With cranes gracing the skyline as far as they eye can see in both Melbourne and Brisbane, these two buyers' agents can envisage their cities facing the potential for unit oversupply.

"I believe we are looking at an oversupply, particularly around some inner-city areas, inner Brisbane, Fortitude Valley and even West End," Young says.

"There are many high-rise/high-density developments coming to market now and in the near future, and I think investors need to be mindful of this."

Bakos also believes an oversupply is looming, though not across the board: "Mainly the inner-city, Docklands, Richmond, Abbotsford, St Kilda, South Yarra, Prahran and Brunswick," she says.

Investors are warned to exercise caution when it comes to a glut of brand new units, as there's a risk of prices falling thanks to too much choice and no unique selling point/scarcity, as well as the potential for mass departures from a block when a market turns.

SUITS YOU, SIR

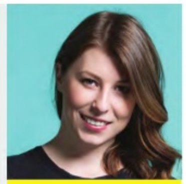
If there's a "type" of investor that suits brand new units, Young believes it's the yield hunters.

"Personally I prefer older style units in small blocks with some add-value potential."

KAREN YOUNG

INVESTOR SNAPSHOT

Something old, something new



Name: Amy Mylius
Age: 29
Lives: Seddon, Vic
Invests: Victoria
Properties: 2
Strategy: Buy and hold.

Testing the waters with both the old and the new, Melbourne girl Amy Mylius is making the most of the positives that can come with both types of investment.

In November 2014 she purchased an off-the-plan freestanding unit in a block of three in Newport for what she believes to be under market value – she paid $400,000, while the others in the block went for $420,000 and $430,000. It has recently been valued at $467,000.

"The plan of subdivision hadn't occurred at the time of purchase," she explains, "so while it was 99 per cent completed, it was technically 'off the plan'."

Six months later, Amy then ventured into older unit territory, securing a two-bedroom apartment in a boutique block of eight in the suburb of Seddon for $380,000.

She describes it as a "very daggy '70s property, but in one of Seddon's most premium streets".

"I was lucky enough to have my loan approved just prior to the APRA changes coming into place, so I was able to borrow 95 per cent of the value plus capitalised LMI [lenders' mortgage insurance]," she says.

The original plan for the retro pad was to renovate and rent out, but Amy then decided to take advantage of the stamp duty concession for first homebuyers by moving into the property for 12 months and undertaking a full internal renovation, with a budget of $25,000. With money saved from the concession – $10,000 – plus her savings, she expects future rental to be around the $340-per-week mark – considerably more than the $275 it was fetching in daggier times. She says that even if she hadn't been embarking on a major reno, she still would have at least "put in fresh carpet, paint and general tidy up".

While Amy's not completely stuck on units (she concedes her next purchase will likely be a house for diversification purposes), her philosophy is that buying in a premium location is preferable to buying land for the sake of having land.

"Tenants rent the property not the land, so the bigger the land size the lower the yield will be, and therefore the higher out-of-pocket cash flows," she says.

"I bought a unit and apartment because they were within budget, both in fantastic locations and had very affordable cash flows, meaning I've preserved savings and serviceability for property three."

Despite having a brand new property in her portfolio, Amy does admit that she'd usually never buy new, or even a one-bedder.

"The Newport property's on 110 square metres of land and had a decent size yard plus a study for extra living space – so it ticked a lot of boxes and didn't have a terrible land-to-asset ratio," she says.

"The 'newness' of it also meant that when I factored in depreciation, the property's pretty much neutrally geared, which was a huge bonus for me... it meant I could continue building my portfolio more aggressively."

Nevertheless, without the mitigating circumstances, she usually prefers to buy old.

"It's had time to depreciate, therefore I'm not paying a premium price for a new and shiny build," she explains. "Older properties are usually in smaller, more boutique blocks, with much more common space – particularly units built in the '60s to '80s.

"The owners' corporation fees are generally very reasonable in older blocks and the internal floor plan dimensions are more generous," she adds.

Amy found one of the drawbacks to buying new involved issues with the builder.

"They promised to finish everything prior to my final inspection but kept delaying the date," she explains, "and when I did the inspection a few days prior to settlement there were still numerous things that hadn't been completed (appliances installed, hot water system hooked up, a few fixtures and fittings, installing the side gate)."

For Amy, the most important factors to consider when purchasing a unit are simple.

"Strong growth drivers and plenty of tenant appeal," she says, "but which also fits in with your lifestyle and cash flow constraints."

Amy's older unit investment

"Theoretically, brand new units tend to be attractive to high income earners looking for depreciation benefits, good yield, low maintenance and attracting professional people as tenants," she says, adding that "older style units appeal to those looking for capital growth".

Bakos points out that older units often appeal to a handy investor with either the skill and the time or the spare cash to make some cosmetic improvements.

"A period-style property (such as an art deco-era apartment) is tightly held and will come at a premium price," she says.

"This may suit a more cashed-up/high-equity investor, as the entry costs can sometimes compare to that of a townhouse in the same area."

She does, however, concede that yields with older properties are not as high.

"An unrenovated, older style unit will suffer with lower rental yields," she says. "They'll have lower demand from tenants, too, and as such may not attract the highest calibre tenant."

Bakos goes on to point out, however, that new apartments often have rents adversely affected by competing units in the same building that aren't differentiated.

"As such the rental yields can be disappointing for these units, too – and particularly more so if the purchase price was an inflated, off-the-plan purchase price."

The strongest yielding properties, she says, are usually those with optimum floor plans, room sizes and internal styles.

"New or old, if the internal renovation quality is high and the property has a unique advantage, a rental yield will be higher. An older, well renovated property has a better chance of being unique *and* having a stronger rental yield."

SIZE MATTERS

One thing most experts agree on with units is that size matters or, in the words of Adelaide valuer Bill Waterhouse, it's all about the "liveability" factor.

"Whilst they are investment units, you've still got to look at them and say, effectively, would I be happy [or would I be happy for my kids] to be living in it?

"If you've got a small unit with three bedrooms it's crazy because you're just not going to have three people in it if it's not big enough," he says.

"You'd be better to have better living areas. Sometimes there's no need to go to three-bedroom options – you stick with two bedrooms and have more appealing living areas, you get better rent, you get better tenants."

Concerns about size have become more relevant over the last few years, as developers shrink floor plans to squeeze more units into a design, leading Metropole's Michael Yardney to predict potential "slums of the future".

For Melbourne valuer Tony Kelly, emulating the apartment lifestyles of London and New York should be key for Australia, and ever-decreasing internal spaces doesn't fit into that aspiration.

"Some developers are building simply for the student market, so very small apartments," he says, adding that they're a cheaper build and generally purchased off the plan, often by overseas investors.

"That's not the sort of apartment living that you find in New York and London and places like that – it's bigger apartments, well located, and we have some of those [in Melbourne] as well… I think they'll hold their value long term and do very well."

OFF THE PLAN?

If you're considering buying brand new, off-the-plan (OTP) is one of the more likely paths you'll head down.

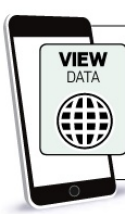
As with all aspects of property investing, every strategy needs thinking through thoroughly, but it does seem as though OTP gets short shrift from most experts. So, is it really all that bad?

There are, of course, pros and cons. Grants and tax benefits are there for OTP purchasers, as is the appeal to a large proportion of (mainly city-based) future tenants of the shiny and new.

For Waterhouse, one of the significant risks with buying something that hasn't been built yet is the difficulty assessing the end value of the project.

"There's a risk attached to it, but it can go both ways," he says.

"Not knowing your ongoing liabilities, in terms of strata fees and



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INVESTOR SNAPSHOT

Off-the-plan fans

Name: Chris & Emily Alexander
Lives: Sydney
Invests: Sydney and Melbourne
Properties: 5
Strategy: OTP.

Forty-nine-year-old Chris and his wife Emily have just put down a deposit for their ninth off-the-plan (OTP) property in nine years, so it's safe to say they're fans of the new.

"Our strategy, like most people, was never to heavily invest in or show a preference for off-the-plan properties but we somehow fell into it and then became quite comfortable with the form of buying," he says.

"OTP purchasing has many pitfalls but it can also be extremely rewarding."

With five properties in their current portfolio, four of which were bought off the plan and most of which are units (a mixture of one, two and three bedrooms), the pair employ a pretty strict set of rules to keep themselves covered.

Along with ticking off location (they stick to Sydney and Melbourne properties less than 10 kilometres from the CBD) and aiming for the best apartment in the block rather than the smallest and cheapest, they also try to ensure there's no chance of views being eroded: "Purchase a property that can never be built out, i.e. opposite a park, beach or harbour... [it's] becoming more and more of a priority, especially in Sydney where there's significant development and many buildings being demolished in favour of apartments."

Most significant of all their due diligence, however, is the background check on the builder involved in the development.

"The builder's crucially important and extensive research is required on their past builds and reputation... many have gone bust during a development build," Chris explains.

The couple also tends to choose smaller complexes – no more than 100 units – and low strata fees.

"Within the complex we always take into consideration the quality of finishes and the design of the building, especially common areas such as foyers," Chris adds.

Strong rental returns are part of the checklist, taking into consideration how long it will be before they reach a cash flow neutral (or positive) position, and they also strongly consider capital growth, researching information on five- and 10-year patterns.

While the Alexanders are aware of oversupply concerns, they feel confident that they've chosen wisely.

"For Sydney especially, with the amount of infrastructure and building going on in the city – everything from roads to Darling Harbour to Green Square to hospitals – there's a real building boom going on here so we're really comfortable investing in Sydney at the moment."

While conceding that OTP investing doesn't suit everyone, Chris believes your first experience can often be key.

"If your first one's a winner it just gives you the confidence to go forward with your next one and your next one."

Compared to the established unit in the couple's current portfolio, Chris feels the positives with new stack slightly higher.

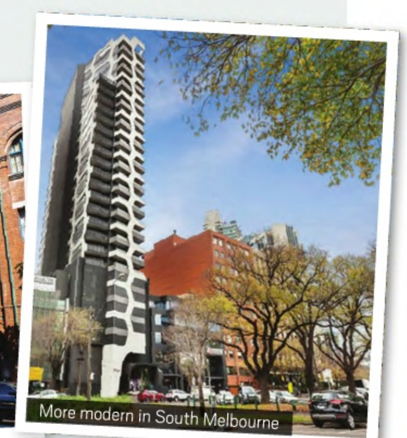
"The established one, which is in Ultimo, has done really well for us," he explains. "That particular one is in a well managed block and it's got a pool and everything, so I suppose that helps, but strata fees are very very high.

"It helps if you can get onto the owners' corporation committee like I have with two of them – you can control things a little bit better. You know what's going on.

"We really like the idea of purchasing a property that's never been lived in before.

"Brand new's obviously, for a lot of people, better than established or used, especially if they know they're the first tenant going in."

The Ultimo unit



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