SKY-HIGH VACANCIES

Many investors look for properties with high capital growth opportunities but fail to recognise external factors that could increase their chances of experiencing rental vacancies, writes Cate Bakos

The world of property investing experienced numerous market shifts in 2013. Not only did we enjoy a turnaround in the capital growth trends since the inner suburbs' market dip of 2011/2012, we also saw a change in buyer mix, investor drive, auction clearance rates and our favourite of all, lending rates.

Yet there is one turnaround many investors fail to recognise year-in, year-out: the change in vacancy rates in some of our capital city areas.

Unfortunately in thriving markets, we need to see and understand the double-edged sword that threatens our returns and the viability of our investments. In this case, the double-edged sword is the increase in vacancy rates and the downwards pressure this places on rents.

Low interest rates attract upgraders and investors, but likewise they attract renters who wish to buy themselves a home and get out of the rental market.

Many longer-term renters, particularly in the unit markets, have taken stock of the opportunity to buy into a rising market and secure their home with attractive interest rates lower than the historical average.

When we combine this with the influx of investors who have decided to invest in property, we see investment stock levels in some pockets threatening rental growth and consistent leasing.

Investors have broadly decided that the property market isn't about to crash, lending is at an all-time low and property is a more resilient asset class than some of the other options that have shaken up many investors' portfolios. But there is one more challenge facing investors - aside from fellow investors flooding the market and renters deciding to become owner occupiers - and that is high-density development.

Detrimental development

High-density development represents change for an area, and this change is not always positive. New apartments often cannibalise potential tenant opportunities for established, older properties and this can be bad news for investors.

Not only do new apartments threaten older apartment rental prospects, they can change a streetscape or area for the worse by clogging up the surrounding streets with cars - it is quite rare for a new apartment to come with two car spaces - and they can overshadow existing buildings and block light.

The most detrimental outcome for an area that suddenly becomes inundated with high-rise and high-density living is that values of surrounding properties can be undermined by 'distress sales'.

For example, when a developer sells a project, it's not uncommon for the sunset (or completion date) to be up to four years away. Buyers can secure apartments on deposit bonds or by using small deposits. Over the course of the lengthy completion period, financial situations can change for these investors - personal circumstances, lending policy, lender's mortgage insurer rules, to name a few.

Unlucky buyers may find themselves scrambling to sell at a discounted price just to release

A big difference

Vacancy rates across the country can vary. The highest vacancy rate recorded by SQM Research in November was 41.1 per cent in Monarto in South Australia. At the other end of the spectrum, there were multiple localities with a low 0.1 per cent vacancy rate, including Woolaning (NT), Windale (NSW), Evans Head (NSW) and Munglinup (NSW).

themselves from the contract. In higher density buildings it's possible that multiple buyers are trying desperately to sell - all the while eroding each other's asking prices in an attempt to find a willing buyer.

Sales like these have a knock-on effect and translate into lower valuations for similar properties in any given area.

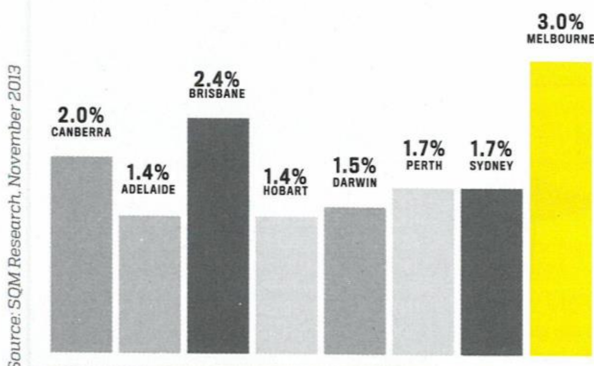
In most situations involving high density and new apartment releases, a majority of buyers are investors. The apartments tend to settle at the same time as the property is finalised and naturally, a flood of newly advertised properties hit the rental market. The pressure that a large volume of new-release property places on established stock is incredibly tough.

Many buyers don't realise the dangers involved with buying in areas without giving serious consideration to vacancy rates and tenant demand.

Let's take Melbourne as a case in point and look closer at some of the inner south eastern hotspots that traditionally attract buyer's advocates and 'blue-chip' investors. The missing piece of the puzzle in this market is the ease of finding a suitable tenant at a decent rental return.

Areas like Prahran, South Yarra, Richmond, Windsor, Armadale and St Kilda might be seen as lucrative options when it comes to capital growth, but are they likely to be leased quickly, with the right tenants at the right price?

At the moment, these areas are suffering gluts and rental decline - a nightmare for any investor who needs the returns. The question of vacancy rate and current returns is one that any investor who relies on consistent rental return should ask themselves.



The perfect property manager

There are two rudimentary ways to understand vacancy rates in any given area.

Firstly, a hands-on investor should check the number of available properties for rent through a common search engine. If you aren't sure about what figure constitutes a glut or a tight selection, all you have to do is benchmark against other suburbs in a similar radius from the CBD.

The next solution is to speak to rental managers in the area about vacancies, demands, tenant types and market cycles.

Whenever I select an area to target for a client, I not only focus on rental demand, current returns and days on market, I also look into target tenants (demographics of the area and pockets where tenants are paying premiums), and new and emerging high-density developments and apartment releases.

I do what I can in the negotiation and sale process to mitigate vacancy and, in most cases, I negotiate an opportunity for the purchaser to use the vendor's campaign photographs for the purposes of advertising the property for lease prior to settlement.

Where possible, I also negotiate an opportunity for the property to be opened for inspection prior to settlement. These front-footed steps don't assure any investor of a tenant, but they certainly enhance their chances of finding and securing a good tenant on or close to settlement day.

The other vital thing is the selection of a great property manager. The difference between an ordinary manager and a fantastic one doesn't just come down to vacancy period and rental amount; the real value is in the selection of a great, longer-term tenant.

After all, if an investor can have a harmonious rental arrangement with a great tenant over a long-term period, the asset can offer returns without a hitch and can be more or less left to do what it was meant to do in the first place - grow in value.

I have seen many investors over the years become despondent through lack of returns, troublesome tenants, 'slow to act' property managers and continual maintenance demands. What use is a strong performing capital growth asset if the cost of holding it is prohibitive, or if the stress involved is eroding the investor's comfort and confidence? And why do investors go to such lengths to secure a great asset, only to leave it with someone who won't manage it effectively?

Surely, if the financial difference between an ordinary manager and a great manager is around two per cent of the collected rent per annum, is a property manager who offers a discounted rate really worth it?

Property investing is difficult enough in this energetic market without taking on added risk or ignoring the warning signs. Remember: vacancy rates, mitigating risks and great property managers. Blue-chip areas and capital growth prospects are great but they aren't enough in their own right! ■

CATE BAKOS,
director, Empower Wealth