Aug 21 2014 at 12:05 AM | Updated Aug 21 2014 at 5:08 PM

Landlords hit by glut of apartments

In Melbourne, the New York-style incentives that have started to creep in. **Photo: John Woudstra**

by **Michael Bleby**

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Jason Plevras paid $600,000 for a two-bedroom apartment in Melbourne's Southbank last May. The off-plan unit was one of 237 in the 15-storey Sunday Apartments on - Coventry Street that went on the market around the same time.

The real estate agent assured him he would have no trouble finding a tenant, Plevras says. "I remember when I was signing the contract to buy, I made clear that I was worried we won't be able to rent it," the 33 year old says.

"They said 'renting will never be a problem. You'll always have tenants'."

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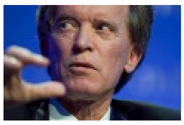

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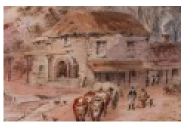

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Gross rental yields (%)

	Jun 2013	Mar 2014	Jun 2014	% YoY change
Sydney	4.53	4.29	4.32	-4.6%
Melbourne	4.33	4.16	4.21	-2.8%
Brisbane	5.13	5.04	5.04	-1.8%
Adelaide	4.86	4.88	4.96	+2.0%
Perth	4.96	4.73	4.67	-5.8%
Canberra	4.73	4.58	4.46	-5.6%
Darwin	5.28	5.19	5.33	+1.0%
Hobart	5.39	5.71	5.65	+4.8%

SOURCE: AUSTRALIAN PROPERTY MONITORS | RESEARCH: EDMUND TADROS | GRAPHIC: LES HEWITT

He waited three months before advertising the unit. His starting price was $600 a week, but that went down to $525 before it rented. It's been a "yo-yo" of tenants coming and going ever since, Plevras says.

"Because it's so competitive, we're almost putting anyone we can in."

For Plevras, the news is not good. The pressure on prices will only grow as more stock comes to the market. Weekly advertised rents have fallen 3.6 per cent in Docklands and 6.4 per cent in - Southbank over the past 12 months while they have stayed still in the central business district, RP Data figures show. Over the past five years, rents in Docklands have fallen 8.6 per cent.

In Sydney, Hugh Eriksson tells a similar story.

The marketing executive, who owns a townhouse in Neutral Bay, says he has bent over backwards to keep rents near to stable and has even allowed pets.

"There might be low vacancy in the inner city but renters are still in a position where they can choose," he says.

Sydney's competitive rental market means rental returns at Eriksson's townhouse have averaged below 3 per cent a year and a new property he is looking at in Balmain in Sydney's inner-west is likely to generate only enough rent to cover his costs.

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In Melbourne, the New York-style incentives that have started to creep into the soft market, such as offering the first month rent-free, will grow as investors and their agents seek to draw tenants into dwellings without affecting all the other rents in the same building, says buyers' advocate Paul Osborne.

"Investors will be caught in a very competitive market needing to offer pricing discounts to lure tenants," he says.

Central Melbourne has over 17,000 new apartments in the pipeline and 5260 are under consideration for development approval, the city disclosed last week when it passed a resolution asking Planning Minister Matthew Guy to impose a $900-per-apartment levy.

"There's chronic oversupply," say Margaret Lomas, a founder of property consultancy Destiny. "There's an increasing demand for inner-city living, but the supply is going much faster than that demand."

Without rental growth or capital growth, the prospects for many investors are bleak, Lomas says. "What normally comes next after this, as those people become more and more distressed financially, they begin to need to sell as well.

"Then you've got the double whammy of not achieving a rental yield, but you can't achieve anywhere near the price they've paid to go in. You start to see them dumped. Prices topple."

That's not necessarily the case, says RP Data's Robert Larocca. "I don't think it is in the city's or economy's best interests to predict a general collapse," he says.

Without knowing the financial circumstances of all purchasers of apartments, including the proportion of foreign buyers, it was wrong to predict a meltdown, Larocca says.

"The evidence before us says that it's OK and right across Melbourne we see investors buying into residential real estate knowing there is comparatively low yield and fully aware of the supply scenario," he says.

In Sydney, the benefit of owning an apartment comes from renovations that add capital value, Eriksson says. "You don't just buy property for rent – you buy it for the capital growth," he says.

"You use the rent to cover the holding costs while you get the DA approvals for renovations."

Once the renovations are done, he sells. "You get your capital gain that way," he says. Back in Melbourne, Plevras is better off than many. Having bought after saving a $120,000 deposit, rent covers his mortgage payments and he doesn't have to put in much extra. But his dream of capital growth may take years to realise.

"You're not going to get a lot of growth in the short to medium term," says Larocca.

Melbourne

A weaker rental market may just do for Melbourne's apartment market what the city's architects have been lobbying for: stricter design and size standards.

Even when rental prices are falling, people will pay for good-quality dwellings, buyers agent Paul Osborne said.

"Our advice is to stick to property that has certain unique characteristics such as a great view, spacious interiors, good design, quality build and natural light," he said. "As these are the minority, the rental demand is extremely strong. However, investors that have purchased a pure commodity of an apartment will find it hard to either establish tenants or future buyers."

Some people don't even see a problem. Real Estate Institute of Victoria figures – volunteered by its own members – show rents of most apartment types in Southbank and Docklands continue to rise, in contrast to RP Data figures showing them flat or declining.

"The indication is while there's a lot of apartments being built in the planning stage, the market, on the rental side, appears to be taking it well," REIV president Neville Sanders said. "We're not hearing agents saying they're struggling to let them." But some are. "A lot used to go almost immediately, within a week or so," Melbourne City Real Estate's Paul Flynn said. "Now it's taking a month or so. You've got to factor that into the loss of rent." **Michael Bleby**

Sydney

While Sydney has enjoyed the most buoyant market in the country in the past year, rising prices have caused rental yields to cool.

APM research showed gross yields fell 4.6 per cent in the 12 months to June, and 5.6 per cent for units.

APM senior economist Andrew Wilson said shrunken yields reflected house price growth, which had taken Sydney and Melbourne's yields to the lowest of all the capitals for units and houses.

While yields have softened, there has been some increase in asking rents and Sydney's units command some of the highest prices in the country at $500 a week.

That price was up 5.3 per cent year on year and was only marginally less than the $510 median weekly asking rent for a Sydney house.

Sydney's vacancy rate was 1.8 per cent as of July this year, the same as July 2013, according to SQM Research figures. High purchase prices mean that investor expectations have tended to be higher than the prices tenants are willing to pay, said Belle Property Surry Hills senior property manager Jaime Pratt.

Ms Pratt said a scarcity of three-bedroom properties had attracted the highest demand, largely from groups wanting to split the higher cost of an inner-city rental.

Ms Pratt said a two-bedroom apartment in the area tended to be let at about $800 a week, and three bedrooms for about $900 a week and up.

"The low interest rates have also meant a lot of tenants at the higher end of the rental market have chosen to buy," she said.

“The past two or three months have been challenging, there is a lot of two-bedroom stock on the market.

“It comes down to tenants and pricing, if the asking rent is realistic we can still fill it, but investors who have paid a high price can be pretty disappointed if they can’t get the yield they were expecting." **Rebecca Thistleton**

Brisbane

Brisbane was the only eastern capital city where apartment yields dropped over the last quarter as higher prices offset falling rents.

A large value gap between Brisbane and Sydney and Melbourne is being exploited resulting in rising prices. The yields on Brisbane units and houses were still the highest of the eastern capital cities at 5.27 per cent and 5.04 per cent respectively, according to Fairfax ’s Australian Property Monitors.

However, the fundamentals behind the investment have just started to show signs of weakening, with the median asking rents for units dropping 1.4 per cent in the June - quarter to $365 and house rents showing no growth at all.

PRDnationwide’s Jaimee Faulknor said investors are paying higher prices for the same, or slightly less rent than they were obtaining 12 months ago.

“Yields have slipped as a direct result of less income. However the yield will be reduced further by the increasing values of new property," Ms Faulknor said. “The sales marketplace has also caused a disproportionate amount of tenants to leave to buy first homes, which is also creating higher vacancies," she said. Asking rents have had to come back to be able to let property in a reasonable time frame.

“Higher vacancy rates, and availability of investment property have slowed the rise of rents for a short period of time."

A large percentage of new-build unit developments are being sold to investors. “Investors are also having to compete pricewise to secure a property, which again results in their acquisition cost being higher, reducing their immediate return," Ms Faulknor said.

In response more developers are building apartments. Managing director of Tessa Group, Brendan Tutt , who oversees the management of $200 million worth of apartments in Brisbane said quality product was attracting good rental demand.

He said that on the first opening day of Cambridge Towers in Brisbane’s Fortitude Valley, there were 50 approved applicants ready to move in to the 160 apartments.

He said the majority of those renters had not even inspected the units.

“We do see demand for these buildings at all time highs because they are in key locations. people do like to live and work in the same area," he said.

While there was still strong rental absorption across the board, those units with more than two bedrooms were taking much longer to rent.

Mr Tutt also said the expectation of further price growth would result in further yield compression. "We believe it is a very stable market but we think yields will decrease with price increases. We are seeing this already." **Matthew Cranston**

Perth

Perth rents recorded some of the biggest rent cuts in the country during the past year, as a period of rapid rent increases came to an abrupt end and new apartment and housing stock started hitting the market.

The trend is expected to continue, particularly among inner-city units, as apartment projects commissioned during the resources boom period are completed and negotiating power shifts to buyers.

Australian Property Monitors research showed asking rents for houses and units in Perth fell 6.6 per cent and 5.9 per cent, respectively. The only other state or territory capital to suffer a similar-sized cut is Canberra.

The pullback has moderated yields for owners of investment homes and apartments, with Perth now offering returns above Sydney and Melbourne, but below high-returning areas such as Darwin and Hobart.

RP Data research found that apartments located in the inner-city and southern Fremantle hub have experienced the biggest rent decreases in recent months, while some of the city's outer suburbs, such as Joondalup and Cockburn, still recorded increases.

RP Data senior research analyst Cameron Kusher said a pullback in the resources sector had a knock-on effect on rentals.

"It's partly a story of getting new supply and partly about getting less demand for executive rents from the resources sector," Mr Kusher said. "

In contrast to other capital cities, first home owners were still actively buying in Perth, which meant they were not in the rental market, he said.

There are a record number of multi-residential dwellings under construction in Perth, according to the Real Estate Institute of Western Australia (REIWA), exceeding the peak of 7299 in 2008.

Much of that work is expected to be completed during the next 18 months, which has prompted fears of an apartment oversupply.

REIWA executive manager of research, Stewart Darby , said the completions coincided with diminished demand. "The current investment cycle is occurring in the midst of slowing economic activity and falling population growth due to lower migration which is significantly reducing demand for rental property," Mr Darby said.

Australian Bureau of Statistics figures show the unemployment rate in the state recently rose from 5 per cent to 5.2 per cent, which is below the national average but higher than the two territories. Population growth peaked in WA in September 2012.

WA budget figures forecast a year-on-year decline in business investment – namely resources project expenditure – ranging from 8.5 per cent in 2014-15 to 1.25 per cent in 2017-18. **Jonathan Barrett**

Adelaide

Subdued growth in property prices in the Adelaide market means investors are still earning solid yields, even though rental prices for standalone houses are the most affordable of all the mainland capitals.

For those who have already amassed a sizeable investment property portfolio, the ideal combination they seek is good capital growth in the value of their properties, along with strong growth in the rents they are able to charge.

Both have been somewhat elusive in Adelaide according to experts, but for those still eyeing an entry into the market, the opportunities are there and the trends are going in the right direction.

The increase in gross rental yields for units in Adelaide was the strongest of all capital cities over the past 12 months.

Phil Harris, the managing director of Harris Real Estate said there had been subdued growth in property prices in Adelaide and this presented a good value proposition for investors. “We haven’t seen property prices increase much and there’s definitely good value in there for investors,” he said.

The $400,000 to $800,000 price bracket for houses had experienced strong demand, and much of it was driven by investors. There is also a shortage of stock in the market.

The latest Australian Property Monitors rental report figures indicate that in the June quarter of 2014 gross rental yields were at 4.96 per cent for houses, up from 4.88 per cent in the March quarter of 2014. Gross rental yields were at 4.86 per cent in June 2013.

For units, gross rental yields in Adelaide were 5.39 per cent in the June quarter of 2014, up from 5.18 per cent a year earlier. The year-on-year growth in gross rental yields for units of 4.1 per cent was the highest of all of Australia’s capital cities, eclipsing Hobart’s growth of 3.9 per cent.

Dr Andrew Wilson – senior economist with APM and the Domain Group, owned by Fairfax Media – said in a report that Adelaide house rents weakened over the June quarter and remained the most affordable of all the mainland capitals for tenants. The median asking rent is $345 a week for houses, up 1.5 per cent on a year ago, and $285 a week for units, up 1.8 per cent on a year ago.

Jock Gilbert, principal of Jock Gilbert Real Estate, said the Adelaide market was coming off a low base but for properties that were located in inner-city suburbs there was strong demand and multiple offers being made. “Buy close in and preferably a place you can value add by renovating," he said.

He said his agency had just sold for almost $1.7 million a house, in the leafy eastern suburb of Leabrook, which had received many offers for the large block of 1600 square metres, with buyers lured by the large land holding. **Simon Evans**

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