

Journal

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rain, hail or shine

Hail storm
frustration
for property
managers

**Top five
mortgage
trends**

**Growing
your
rent roll**



Houses vs units



BY CHRIS GRAY

Land accumulates and buildings depreciate – follow that rule and most investors would always buy a house. But is it really that simple?

For every dollar spent, houses do have more land content. And with limited supply, land prices will continue to rise. Over the long term, a typical house may grow at 8-10% while units may grow at 6-8%.

Deciding between the two mostly comes down to affordability. Buyers might not be able to afford a house in a high-growth area (that is, 5-15km from a CBD), so may need to look for:

- a house in a low-growth area; or
- a unit in a high-growth area.

These might achieve similar capital growth.

Remember that rent is what provides the cash flow that will finance an investment. Rental returns mainly depend on the property's value and its suburb. The statistics show that both a house in a low-growth area and a unit in a high-growth area might get a 4-5% rental return. It's in higher value properties that things start changing.

Let's compare a \$1.5 million house with three \$500,000 units. Most people that can afford to rent a \$1.5 million house can afford to buy one, and as most people are emotional about their own homes they would very likely buy. As a result, there isn't a lot of demand

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for expensive rentals and that often drives the rental return down to only 2-3% or about \$600-900 per week. (Executive rentals, a niche market, do get higher rentals but they are often more susceptible to volatility.)

Compare that to buying three \$500,000 units and getting three \$400-500 rents per week. That equates to \$1,200-1,500 per week.

In this case, you would need to weigh up buying a house and getting maybe 12% capital growth and a 2-3% rental return, or buying three units and getting 10% growth and a 4-5% rental return.

The answer for most buyers comes down to cash flow. If they buy the expensive house, are

paying a mortgage at around 9% interest and are only getting 2-3% in rent, they will need to fund the difference of 6-7% (that's \$60,000 to \$70,000 per million dollars borrowed before tax for a potential capital gain of \$120,000). However, the three units would only cost 4-5% (\$40,000 to \$50,000 per million dollars for a potential gain of \$100,000). It all depends on the investor's long-term strategy.

Chris Gray is the Property Expert on Channel 9's MyHome TV, and author of Go For Your Life: How to Turn Your Weekdays into Weekends Through Property Investing. For more information and for Chapters 1-3 of his book for free, visit www.goforyourlife.com ♦