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THE NATIONAL CAPITAL GROWTH GRID

IB.005

INVESTING IN RESIDENTIAL INCOME
 PRODUCING PROPERTIES

Is it possible to estimate the long term growth in the value of houses anywhere in Australia? The short answer is "Yes!"

For the last 120 years the average compound growth rate in the value of homes has been a little over 10% per annum.

As an investor, *you need to target for areas with a 15% compound growth per annum potential.*

Historically there has been about six very small areas within Australia which have achieved these solid results.

Fifteen per cent per annum means that the value of your investment will double in value every five years on average. In ten years it will *double double*, that is, it will be fourfold in value.

Per Annum	Zero Year	Five Years	Ten Years
15.0%	\$100,000	\$200,000	\$400,000
12.0%	\$100,000	\$176,200	\$310,600
11.0%	\$100,000	\$168,510	\$283,940
10.0%	\$100,000	\$161,050	\$259,370
9.0%	\$100,000	\$153,860	\$236,740
8.0%	\$100,000	\$146,930	\$215,890
7.0%	\$100,000	\$140,260	\$196,720

This chart demonstrates the impact of a few per cent per annum on your investment, over a ten year period.

For example, if you invest in an area which is growing at 7%, when you could have invested in an area growing at 12%, over a ten year period you will have ripped up approximately \$114,000, based on an initial property value of \$100,000. On a property initially worth \$180,000 then the differential being ripped up will be \$205,000.

The Gurus out there say that because we now have a low inflation economy, this kind of growth will not occur. Rubbish! **Property values have always been driven by supply and demand.** Every year there are a lot more of us and every year there is no increase in the available land.

It is interesting to note that between 1962 and 1972 the average annual increase in house prices in Sydney was 11.5%, compared with an inflation rate of 3.3% (*Hooker Nationwide Housing Report*).

Ever hear of the 'Capital Growth Grid'?

Probably not, because it is a term I coined as a result of an amazing discovery I made after spending literally thousands of hours reviewing residential property value movements.

Here are some interesting facts:

- o The centre of the capital city is typically where the highest growth in the value of homes occurs.
- o As a rule of thumb, when you move out from the centre of the city the value growth will drop down by 1% for every 6 kilometres from the GPO or Central Business District. The further you go, the more you lose! As you move out from the city to the provincial cities along the coast, the growth in values will further deteriorate, until you reach about mid way between the two capital cities. At that point, the growth in values will start to climb until you reach the centre of the next capital city.

Try and imagine a 'spoon' shape spread along the coast lines:

Adelaide	to	Melbourne
Melbourne	to	Sydney
Sydney	to	Brisbane
Brisbane	to	Cairns

You also have the same effect with

Melbourne	to	Canberra
Canberra	to	Sydney

Now imagine the 'spoon' again. As you go inland from the coast you will find that value growth 'spoons' down further in relation to the nearest coast city.

Thus you can now grid the whole of the country in your mind's eye, and be relatively accurate as to the expected growth in value in any city, suburb or town in Australia.

The '*spooning effect*' relationships will not change very much over time. A high value growth area does not grow in size, that is, the surrounding area does not catch up.

Where are the highest value growth areas?

Where do people want to live? People simply want to live close to their work. Where are the largest employment sectors? They are the Central Business Districts (CBD's) of the capital cities.

People are willing to pay more for the inner city property to reduce their costs of travel to and from work and reduce the time to go to and from work.

To sustain the premium growth in the value of the homes within the targeted six kilometre zone, you need a feeding stream of jobs. To ensure a long term platform of new jobs you need committed investments in excess of \$2 billion in new industrial and commercial projects within this zone now.

The \$2 billion will take up to tens years to spend, underpinning that job growth throughout the decade. New jobs result in new housing demands putting pressure on the existing tight market throughout the period of consideration for your investment - ten years. Smaller investment stimulus to jobs will result in spasmodic jumps in housing values - that is speculative. We want stable, strong, long term growth.

Remember that I have qualified the high growth areas to be about 6 km. in radius, and attracting in excess of \$2 billion in commercial developments. Within these criteria, we add the associated job creating investment, within the historically high value growth area. How many areas are in Australia to fulfil all that? Not many - in fact there are less than six such areas in Australia, and the land mass of all such areas combined would hardly make a mark on the Australian map!

Bottom line: No **new** job growth no **premium** capital growth.

The Higher the Population = The Higher the Cost.

The larger the population mass, the higher the cost of property in the inner city high value growth zone. That is, the larger the city, the higher the cost of central city property. The extreme inner city areas of Sydney and Melbourne are very expensive. This is a reflection of the pressure put on these property markets by the enormity of the population of each of the two cities.

Around those cities, satellite central business districts can raise the growth lines upwards by a about 1.5% compound growth per annum. **However, remember that as you move out from the CBD by a further 6 km. you are forfeiting 1% compound growth per annum for each such sector.** Also, the influence of the satellite central business district covers only a very small area, sometimes less that the suburb in which it is located.

Perth, Adelaide and Brisbane are roughly similar in size.

Question: Which one is achieving the strongest capital growth?

Answer: Brisbane.

Why? Because it has the highest growth rate in jobs and population.

Likewise, Canberra, Wollongong and Gold Coast have similar population bases, but again, the city with highest job creation and population growth is the top performer. Can you guess which one???

Variations From the Average.

Each city has an average recorded sale price, or 'mean recorded sale price of all dwellings', as per the Valuer General's Department or Land's Department of each state. These reports are not valuations, rather they are the results of recorded contracts of sales of homes.

The larger the city, the greater are the variations from the average - the wider the 'variance from the recorded sales mean'. Consequently, the CBD sector growth rate could be substantially higher than that recorded for the whole city, should the city have a large population.

Are Financiers Aware of the Capital Growth Grid?

Of course they are in fact their lending policies reflect it! They lend a larger percentage of the valuation of properties close to the CBD, but the percentage will drop off as you move away from the CBD and out to the provincial cities.

So, in their own way, the providers of funds contribute to the strength of the inner city zones by their willingness to lend, and also by their willingness to lend high percentages of the valuation.

Capitalisation Rate - Rent Yields in Different Capital Growth Areas.

As we have already discussed, the growth in the property value deteriorates as it moves further and further away from the GPO. However, the income in the form of rent or business profit is usually higher. **Does this higher rent yield offset the loss of capital gain? No way!**

Commercial properties are valued on their return. The stronger the market and its potential, the higher the capitalisation as a result of expected high growth in the value of the business. Let's use an example to illustrate this: Assume three motels, at three different market values, are generating \$100,000 profit:

Location	Capitalisation	Value
Inner City	15.0%	\$666,666
20 kilometres out	17.5%	\$571,430
500 kilometres out	25.0%	\$400,000

Market pressure would see the *inner city motel double in value in less than seven years*. The *provincial city property will take more than ten years to double*. The higher return on the provincial motel will not compensate for the loss of capital growth there.

This '*spooning effect*' continues through all types of investment property.

Inner city rents on residential homes are 5% to 7%, with the capital growth over the long term of 12% per annum. Go inland 500 kilometres and the rent yield can be as high as 15% per annum, but your long term capital growth would not reach 7% per annum.

Upward rental movements follow the upward value movements of the residential property, trailing

behind by about one year. This relationship between the respective values is why residential leases are often written for short term, enabling frequent reviews.

What Does All This Mean?

All the signs are pointing towards a solid renewal in the property market. The combination of rent yields and projected capital growth make it a viable investment alternative over the long term.

If you intend to invest in property, doesn't it make sense to **maximise** your return?

You can if you invest in the select areas that have consistently shown high returns. My research has detected them, and in this report I have given you a brief synopsis of the key elements. Those elements are:

- Location
- Population trends
- Developments (planned and in construction)
- Timing

Timing Is Important.

Lower interest rates, disenchantment with other investment options and a significant lowering of the Australian dollar are seeing the property market begin to move. All indications suggest that the time is NOW!

This report has been prepared by John Doel ACA. John is a Chartered Accountant and property analyst for Finance Facilities Pty Ltd. For the past three decades he has been researching property investments throughout the Pacific basin, for companies and private trusts. The past ten years has seen John focus on Residential Income Producing Investment Properties.

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