

More is less! But why?



Tyron Hyde investigates why cheaper properties tend to have higher yields and often a higher depreciation ratio in relation to the purchase price

Most of us know that higher priced property tends to rent on a yield far less than lower priced property – don't we?

But why is this the case? Why doesn't a luxury house in Vaucluse rent on the same yield as a house in St Marys?

Let us first confirm this theory based on some data obtained from *Your Investment Property* February issue. (Being in Sydney, I have chosen Sydney and NSW areas.)

Area	Median price	Yield
Palm Beach	\$2.7m	1.25%
Rose Bay	\$1.7m	2.86%
Double Bay	\$2.0m	2.79%
Bellevue Hill	\$3.2m	2.32%
St Marys	\$275k	5.48%
Penrith	\$300k	5.03%
Quirindi	\$159k	6.03%
South Grafton	\$195k	6.40%

Yep – looks like the theory is correct. So, to help me on this topic I sought the advice of experts in the field.

First, I asked RP Data to explain why higher priced property had a lower yield.

Cameron Kusher, senior research analyst at RP Data, made the following observation: "From a cash flow perspective higher priced properties used

for investment purposes tend to record yields which are well below average due to the fact that the price paid for purchase is high, and although rents tend to be relatively high compared to rents of lower priced properties, relative to the purchase price the returns are not generally strong."

Yes... but why?

So I turned to Residex for further help. John Lindeman, head of research, said: "Rental at the high priced end of the market is a very discretionary affair, but demand for rented properties at the low end of the market is high and constant, because accommodation at the low end is sought by households who have no other option but to rent privately."

So, who are these tenants? Lindeman says, "New Gen Y households in WA suburbs such as East Perth, West Perth and Perth CBD are bumping up unit rental yields; in fact, these are now the highest in Australia, easily topping 8%. This is a segment who are prepared to pay high rents to enjoy the benefits of independent city living."

Lindeman says high yields can also be found in areas favoured by recent migrants, such as Berala, St Marys and Mt Druitt in Sydney; here, rental yields are over 7%. "This segment has no choice but to rent and the locations they choose are determined by work availability and good public transport."

Similarly, Chris Gray from Your Empire points out the supply and

demand equation issue. "I believe it's a simple fact of supply and demand.

"At the more affordable end there are a lot of people who want to rent as they either don't have a deposit or don't want to tie themselves to a long-term commitment. With increased demand and limited supply of properties in the areas close to work and leisure, rents increase," Gray explains.

"As you get up to the more expensive end, most people can afford to buy and often want that security for their families. Therefore there's less demand and so the price drops."

I agree – the supply and demand equation is a big factor. But to properly work out why high-end property has a lower yield, I think we need to explore why demand isn't there.

Why would people pay a 7% mortgage when theoretically you could rent the same house and pay 1.5% via rent?

My next stop for further explanation was Mark Armstrong, CEO of Property Planning Australia, who said: "To understand why lower priced property has a higher rental yield we first need to look at how property is valued.

"Property can be broken up into two components – the land and building. From an investment point of view land appreciates in value and forms the capital growth component of the investment. The building, on the other hand, generates the rent and forms the income component," says Armstrong.

"Property that sits on cheap land will be lower priced. In this case, the land to asset ratio is low and the building value makes up the largest percentage of the overall asset. For example, if a property is worth \$400,000 with land value at \$100,000 and the building is worth \$300,000, then the land to asset ratio is 25%. In this case, the rental yield is likely to be high because 75% of the asset is producing income. Capital growth will be low because only 25% of the asset is appreciating.

"Property that sits on expensive land will be more expensive. In this case, the land to asset ratio is high and the land makes up the value of the overall asset. For example, if a property is worth \$700,000 – the building is worth \$300,000 and land value is \$400,000 – then land to asset ratio is now almost 60%. Only 40% of the asset is producing income so the yield will be

