
Four things that matter for property investors

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Not more than seven months ago, according to the most media reports, investing in property was no longer a smart way to build wealth. Labor wanted to ban negative gearing, and increase capital gains tax, economists were predicting property prices would crash by more than 20 per cent and banks were tightening lending standards. Since then, the world has returned to “normal” as most of these concerns have abated. The world is again flush with positive predictions for the property market.

Of course, Labor losing the federal election in May did help the property market because it meant any changes to negative gearing and CGT were off the table. However, if it had won the election, I doubt Labor would have been able to get these proposed changes legislated. And even if they did get them legislated, I stand by my view that, while these changes would have materially reduced after-tax returns, it would not have rendered property investment uneconomical. In the long run, investing in the right property still would have been a viable investment.

I was reading an article by an investment manager that I respect greatly a few weeks ago. His thesis was that it was too early to call a recovery on the property market because of the fall in construction volume (of new dwellings). He went on to explain that a depressed construction market will create negative consequences for economic growth, unemployment and therefore property.

While I don't disagree with this author's economic reasoning, I was left pondering what use this information had to an individual investor. That is, if I'm contemplating an investment in a blue-chip, investment-grade location, do I care that construction of new dwelling has actually fallen by 40 per cent from its peak (especially when new construction occurs in locations far removed from investment-grade locations)?

If I invest in property for many decades, it is likely that I will experience various economic cycles including changes in unemployment, interest rates, construction volume, consumer sentiment and so on. The trick is to invest in a location and asset type that will, in the long run, weather any storms.

In reality, much of the content produced by the media should not inform your personal property investment decisions. The media tend to run stories that they consider newsworthy. Newsworthy often means that the information is time-sensitive, for example what happened yesterday or what will happen tomorrow. This short-term information does not help you make what should be considered a long-term investment decision.

Of course, when contemplating an investment, there are a number of property-specific factors that you must consider. However, in terms of macroeconomic factors, there really are only a handful of important considerations.

Population growth

Long-term population growth is a very important factor. There's only a limited number of investment-grade locations (so the supply-side is fixed) and if population is growing, this will increase in demand, which then translates into upward price growth pressure.

Natural changes in population (births and deaths) are relatively stable. The main changes will be driven by overseas and interstate migration. Some capital cities are projected to benefit from higher levels of migration than others. For example, the Australian Bureau of Statistics predicts Melbourne will be Australia's largest capital city, surpassing Sydney in 2031.

Money supply

The flow of money into the property market will have an impact on growth rates. Money can flow into the market mainly through borrowings and from overseas sources (that is, non-resident investors). It has been well documented that the government has restricted supply from both these sources in recent times. Arguably, the government has been too aggressive with its approach and I predict that bank lending policies will continue to gradually loosen over the next few years. However, if money supply remained constricted for an extended period of time, this would probably have a negative impact on property price growth.

Job opportunities

You must invest in a location that has diversified employment opportunities. Doing so means no one industry can materially affect the overall demand for property and therefore demand is sustainable and relatively stable. It has been well documented how the mining industry has affected property prices in Perth, for example.

Infrastructure

Infrastructure is important to the extent that it can reduce the impact of living further away from the CBD (that is, in the outer suburbs). That includes reduced travel times, better access to employment prospects, recreational resources and so forth. In my view, Australia is unlikely to make any material advancements in this regard, and that's why inner-city, blue-chip suburbs will continue to outperform.

Finally, apart from the above four considerations (population, money supply, employment opportunities and infrastructure), my advice is to ignore all other media "noise" when making personal property investment decisions. A lot of quality media is thought-provoking and interesting. It's just that most of it isn't very helpful to property investors. If anything, it can encourage you to make mistakes, such as promoting short-term thinking and/or procrastination.

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