


# Older apartments keep their appeal as value buys

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Over the past few years I have observed a strong trend of investment-grade house prices growing at a much faster rate than apartments. It is true that all markets move in cycles and all cycles come to an end, eventually.

Buying a new-build apartment and an established apartment are materially different things.

Typically, a new apartment buyer is influenced by things such as its finish and building amenities such as theatre rooms, pools and gyms. In the beginning, these buildings present very well. However, they tend to wear quickly and these largely superficial attributes become far less persuasive (and costly to maintain).

In contrast, established apartment buyers rarely focus on these factors — mainly because older style buildings rarely offer such amenities. Instead, these buyers tend to focus on location, privacy, soundproofing, natural light, smaller blocks (fewer tenants) and so on.

Understandably, when you compare a new apartment with an established apartment, the shiny new object gets all the attention. However, because a newer apartment is no longer shiny after a few years of wear and tear, an older-style apartment starts to look comparatively more attractive.

I realise in early 2020 that houses are too expensive for many people.

About 10 years ago it was possible to buy an investment-grade house in Melbourne for around \$800,000. However, today, you need more than \$1m. Therefore, if your budget is \$800,000 you have two options.

You can buy an apartment, not a house. Or you can find a house in an adjoining, non-investment-grade suburb.

With house prices rising, many property buyers will be forced into the apartment market.

Keep in mind that approvals for construction of apartments have been falling dramatically over the past few years. In Sydney, the volume of new apartments approved has more than halved since its peak in 2016. In Melbourne, approvals have fallen nearly 40 per cent in the past 18 months. The Brisbane apartment market is almost non-existent with less than a quarter of the volume compared with the peak in 2016.

Keep in mind too that cladding and building quality issues make new apartments harder to sell.

Building quality issues in a few Sydney apartment complexes (for example, Opal Tower and Mascot Tower) were well publicised during 2019. It is unclear how much of the restoration liability rests with the owners, but it's safe to say they will likely suffer some loss.

According to the ABS, over the past eight years, Victoria's population has increased at a rate of between 100,000 and 150,000 people per year (rolling 12 months average) and NSW by between 75,000 and 130,000. Population growth in both states is driven heavily by overseas migration. Interstate migration is negative in NSW (minus 15,000-20,000 people per year) whereas it is positive in Victoria (plus 12,000-15,000 per year).

If this growth continues, and supply of new apartments fall as indicated above, this imbalance in supply and demand will inevitably translate to property price growth.

Also, it is important to exclude Brisbane from these general observations:

I do not advise anyone to invest in apartments in Brisbane (at the moment). Brisbane's population growth is mainly driven by overseas migration as interstate migrants, often retirees, go to the Gold and Sunshine coasts. Overseas migrants tend to be skilled workers and Brisbane has the best job opportunities in Queensland. These migrants tend to be young families and need a house, not an apartment. In addition, the apartment market is still in oversupply and it will take many years until this surplus stock is absorbed by demand (natural population growth).

That's Brisbane, but in any city, I would say that very few apartments can be regarded as investment grade.

It is my observation that apartments have dramatically underperformed houses over the past five to ten years.

If you look at history, property markets move in cycles. A high growth period of 7 to 10 years is typically followed by a low-growth period.

If we agree that the established (investment-grade) apartment market has recently been in a low-growth phase, that should mean a higher growth phase will follow.

I predict this growth phase will begin in the next five years, for the reasons discussed above.

In summary, the supply of new apartments is falling dramatically. At the same time, I expect demand for older-style apartments will increase. That's because they compare favourably to apartments that are only a few years old from a liability perspective. Plus, fewer people today can afford houses in blue-chip suburbs.

All markets move in cycles and you are well served if you are able to invest just before the growth cycle begins. Arguably, investment-grade apartments exhibit the best growth prospects in capital cities.

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