

INVESTMENT DECISION – PROPERTY IS **LOW RISK**, **LONG TERM** AND **LOGICAL**

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Further to the economic turmoil of the global financial crisis, it was hoped by many investors that economic and investment fundamentals would settle down, stabilise and provide an environment in which logical, sound, long term, low risk decisions could be made for future medium to long term investment. Unfortunately this has not been so and economic turmoil persists typified by the American economic downturn, the European debt crisis and the consequent global share market volatility.

During this drawn out and extended period of investment challenge, cash has been favoured, as is usually the scenario when other markets become less reliable. This is particularly so in Australia, where the interest rates in global terms are relatively high, and the Banks and Capital Guarantee Institutions well governed and strong, in contrast to many alternatives overseas.

For this reason Australians have been saving more than ever and cash investment into Australia by overseas parties has also strengthened, one of the main causes for the Australian dollar maintaining above parity with the US for so many months.

Amidst the turmoil and uncertainly, we have noticed at Charter Keck Cramer, that beginning approximately eight months ago, there was a gradual turn to commercial

property by shrewd investors, a trend which has now strengthened significantly. So strong is this return in favour of property, that our services to provide Due Diligence to prospective purchasers is in greater demand than in any period for many years. Acting for both local and overseas investors, the focus is on the Australian East Coast – Sydney and especially Melbourne.

Recognising that there was a clear return of interest to property, we sought to specifically confirm what we observed, to better understand the reasons that may be driving sentiment and thus in August and September, updated in early October,

we maintained a questionnaire with Charter Keck Cramer clients including institutional investors, and high net wealth individuals. In an endeavour to keep the process simple, the survey was designed to recognise changing conditions in relation to a number of economic issues comparing conditions 12–18 months ago, with those now prevailing. Over that relatively short period of time there have been quite a few changes, which as summarised in Columns 1 and 2 on the following table, lead to the majority sentiment, summarised in the third Column. These causes and sentiment, are easy to follow, logical, and in part explain why there is a mounting surge back to the various East Coast Australian property categories.

CHARTER KECK CRAMER - CLIENT SURVEY - OCTOBER 2011

ECONOMIC ENVIRONMENT		SENTIMENT
12–18 Months Ago	July/August 2011 and Going Forward	Sentiment
1 Interest rates rising and prospect for further increases.	Interest rates stabilising and possibly decreasing.	Sentiment changing from very negative to neutral.
2 Share market recovering well post GFC.	Share market now losing ground, very volatile.	Increasing disenchantment with share market.
3 Debt and mortgage finance difficult to get – Banks cautious.	Banks marginally less dependent on foreign capital, higher domestic deposits – need growth – greater competition more willing to lend.	Marginally easier access to debt is improving sentiment.
4 Caution leading to downturn in consumption, thus increasing savings. Deposit rates attractive.	Savings at all time high but cash rates may ease. Tax on income higher than on capital gain.	Investors becoming bored with cash, itchy for something else, as cash rates may decline.
5 USA and Euro markets volatile, Australia has remained fairly stable, not as badly affected.	Australia still doing well and has good domestic fundamentals.	Investment in local markets appears attractive. Australia is the place to be. Strong interest in local real estate from overseas.
6 AUS\$ increasing against USA\$.	AUS\$ now relatively stable against USA\$.	Currency markets less volatile, now likely more stable.
7 Economic recovery, positive expectation.	Over-reaction to share market volatility.	Some calmness and confidence about to return but expectation is generally for a "low growth" environment.
8 Shares improving, property relatively stable.	Shares very poor but property stays reliable.	Property not as vulnerable to overseas but more domestic influences, less volatile, less worry.
9 Two speed economy.	Still two speed economy – manufacturing tourism and retail struggling.	Element of some uncertainty prevails but better understanding of issues.
10 Some investor optimism.	July/August PANIC and UNCERTAINTY.	Over-reaction starting to level out.
11 Population growth very strong.	Population growth slower but still strong.	Population growth drives strong domestic fundamentals particularly property demand.
12 No speculative construction, build levels declining.	Construction outlook poor.	Lack of stock but demand increasing – values to improve. Undersupply will support real estate values.
13 Australia seems a good place to be.	Australia definitely a good place to be.	Try and invest in local Australian markets. Strengthening return by local and overseas investors to the long term security and low commercial and sovereign risk of Australian property.
14 SUMMARY – Investor uncertainty with strong emphasis on cash.	SUMMARY – Uncertainty continues share market extremely volatile, but cash less attractive for longer term.	SUMMARY – Property becoming increasingly popular.

LOW RISK
LONG TERM
LOGICAL



Real Estate agents and Investment Advisors will always market properties based on their quality and tenancy mix, potential for high investment returns, suitability for leveraged tax models, negative gearing, tax deductible depreciation, etc. Whilst many of those propositions have merit, at Charter our approach as an independent and objective Analyst, is to look to the stronger economic and more reliable market driven fundamentals. Based on such a review, we believe that investors do have good cause for assurance that long term commitment in Australia and particularly to the property markets will provide the requisite returns by beating inflation by a good margin, attracting debt finance as may be required, retaining relative liquidity, and without risk of being devalued through over supply. There are a number of influences and conditions which support that forecast, and which generally, may be summarised as follows.

- A strong Australian economy, attracting significant long term investment with flow through effects to increasing Government revenue.
- Although population growth has slowed a little, it is still relatively strong, creating a robust and growing economy, and causing demand for all categories of property, residential, retail, commercial and industrial.
- The unemployment rate in Australia is low and according to all predictions is destined to remain tight.
- Interest rates may have peaked, and may even ease, circumstances which if to occur always have a favourable effect on the property market.
- Importantly, for the last three years since the beginning of the GFC, speculative investment and construction have been at extremely low levels, and the supply of property in all categories is becoming very tight. It will still take a few years before supply levels begin to increase and consequently for the next five years there will be strong rental growth for good quality properties in all categories.
- As interest rates remain low globally, and may also lower in Australia, investment returns generally will lower, which if to flow on to property will lead to a capitalisation effect which enhances capital value. The combination of low interest rates and higher income drive commercial property values
- Whilst cash may have been attractive, the rates of return may be lowering apart from which such income is subject to “income tax”, rather than lower “capital gain tax”. For this reason and because cash is becoming “boring”, many investors are becoming anxious to seek more meaningful longer term, higher, returns.

- The share market has become so volatile and for passive investors less reliable due to concerns about the profitability of larger organisations. If China slows, if India slows, global demand for commodities will soften and so will share values and dividends. Technology shares now have too much competition, “retail” is weak and financial products are viewed with caution.
- Underlying changes in our metropolitan centres will continue to create development opportunities particularly through urban renewal in established urban locations. Governments are creating opportunities for development and investment through de-risking opportunities. Continued volatility is expected.
- Investment in real estate involves a long term commitment and is a disciplined investment strategy, not easily changed and therefore not vulnerable to fluctuating sentiment on a daily basis, like equities.
- Another favourable influence which works to underpin the value of real estate, relates to the ever increasing “replacement cost”, a consequence of rising building prices, increasing labour costs and land servicing costs and availability.

In conclusion, is it really so surprising? If you were to have the benefit of considerable cash reserves at this moment, property would surely be a serious consideration. It provides higher returns than capital guaranteed deposits and is not volatile like the share market. Of course prudence and careful decisions need to be undertaken, but this can be assisted by analytical consultants and full due diligence. Most significantly, real estate is more affected by domestic rather than global issues and the outlook for the Australian domestic economy being strong, so too are the prospects for property. Don't be surprised if the property markets gain significant momentum over the next 12 months.

LOGICAL

LONG TERM

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