

What really causes prices to soar?

Understanding the factors that trigger price increase will ensure you always pick a winning investment. *Jeremy Sheppard* explains



There are really only two factors affecting price change: demand and supply. Prices will rise if demand is high relative to supply. With high demand for property from buyers they'll push prices higher as they compete with each other in order to get what they want so dearly. With limited supply, the fight to get what they want is made all the more intense because there is less available.

As property investors, we want to find markets to buy into that have a high demand to supply ratio at the point in time when we're ready to buy. We want to see some capital growth immediately to create the equity we need to buy again.

These locations with a high demand to supply ratio will not last forever. As prices rise for property in a suburb, demand will subside. And over time, developers who have realised the high demand will complete projects adding to the supply. Over time the market will re-balance the demand to supply ratio. Good investing has a lot to do with recognising and capitalising on imbalances.

But what indicators do we have to determine when demand is exceeding supply and by how much, so we can compare suburbs accurately?

Indicators to watch

1 DSR The key indicator to watch is the DSR – the Demand to Supply Ratio. It is an accurate measure of the gap between demand and supply. The DSR rolls up the following statistics into a single figure representing the demand to supply ratio:

- **DOM** – average number of days a property spends on market before it sells

- **Discount** – average discount from the original asking price to the eventual sale price
- **ACR** – Auction clearance rate
- **Vacancy** – the proportion of rental properties that are currently vacant
- **Renters** – the proportion of renters in the market (as opposed to owner-occupiers)
- **Gross yield** – the rental income as a percentage of the property's value
- **SOM%** – Stock on market as a percentage of total properties
- **OSI** – online search interest, the number of online searches compared with the number of properties for sale

Trends to keep an eye on

- If demand exceeds supply, buyers will quickly snap up available property so the amount of time a property spends on the market decreases resulting in low DOM.
- Sellers will drop prices to attract buyers if demand is weak. So a low discount means demand is actually strong.
- A high auction clearance rate means demand from buyers is strong.
- A low vacancy rate means that there is a shortage of rental accommodation for the number of tenants in the market.
- Owner-occupiers generally take better care of their properties than tenants and landlords. Renters are also often in a lower socio-economic demographic than owner-occupiers. A lower number of renters in a market means there is less competition among landlords to find a tenant, so a low proportion of renters is a good thing. This figure is effectively a reflection of the supply of rental accommodation.

- A high yield is a precursor to capital growth. I'll explain this in more detail in a minute.
- A low SOM as a proportion of total properties in an area means that properties are tightly held by owners and snapped up by buyers when they do come on market.
- If there are a large number of people searching for property in a location where there is not much property for sale, then the demand exceeds the supply and the OSI will be high.

See the data section at the back of this magazine for recent DSR values. For more details about the DSR and the statistics it uses, see DSRdata.com.au.

2 Rental growth

Rent increase is another good indicator to keep an eye on for the potential of capital growth. Rent increase in a market is a pre-cursor to capital growth.

Tenants are more agile than owner-occupiers. Not only is it a big decision to buy a property, but it's also easier to get a lease than it is to get a mortgage. So when a location becomes popular, tenants will be the first to move there. This places stronger demand on rents, initially pushing them up.

Then investors wade into the market attracted by the higher yields. And then the owner-occupiers finally get their act together. Some of the renters by this stage may decide to buy. All this buying activity now places pressure on property prices.

As an example, from October 2010–October 2011 rent for units in Hurstville, NSW, grew from \$400/wk

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to \$442/wk. This is a 10.4% increase over 12 months. Over the same timeframe prices of units only grew by 4.3% (Source: *DSRdata.com.au*). This is a good example of the kind of rental growth to watch out for.

Another good example: the rent for houses in Wanniasa, ACT, grew from \$403/wk to \$453/wk over the 12 months to November 2011. This is a 12.4% increase. Over the same timeframe house prices grew by less than 1% (Source: *DSRdata.com.au*).

3 End of a bad cycle

If a market has fallen out of favour with buyers, it is only temporary. Eventually, that market will recover. And if the period of poor growth was a lengthy one, the market may rebound suddenly.

But tough times can last longer than you think. Don't bet on where the bottom of the market is – make sure you know it has definitely passed. It is much better to enter a market a little late than try to predict the exact bottom of the cycle. So wait for some clear signs of recovery, that is, prices growing slightly.

An indicator that times have changed is the first sign of capital growth after a prolonged period of negative or flat price movement. Chart 1 shows the last three years of price changes for houses and units in Newstead, which is a suburb of Launceston, Tasmania (7250).

Unit prices (the orange line) have shown some volatility over the period. But you'll notice that they haven't really gone up much over the last three years. They've averaged only about 3% growth per annum. And recently there has been some decent growth. Perhaps this is the start of a surge in prices to make amends for the last few years.

Another example can be seen in chart 2, which shows the change in prices for Glenelg, SA, 5045.

Notice that there has been very little price change for units and what little change there has been was negative. This may be a suburb to keep an eye on for the first signs of recovery. If there are half a dozen months of upward price change, it may mean that buyers have realised the unit market is undervalued.

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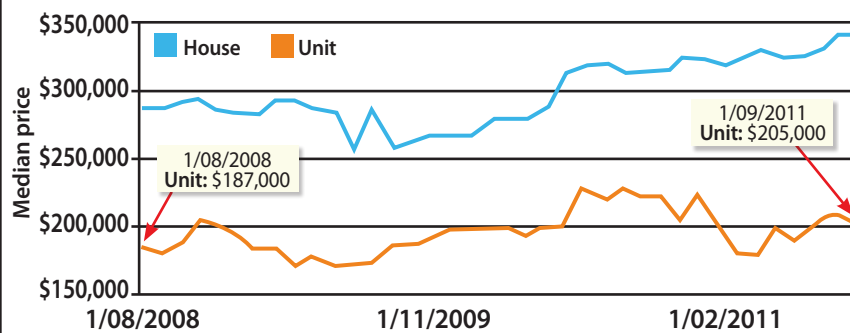
4 High number of sales by auctions

Real estate agencies will often sell properties by auction when the demand for property is strong. This allows potential buyers to outbid each other and push prices up for the seller. So an increasing number of auctions may be a sign of a market heating up. Note

that this is different to the auction clearance rate. An increasing auction clearance rate will also help indicate increasing demand to supply.

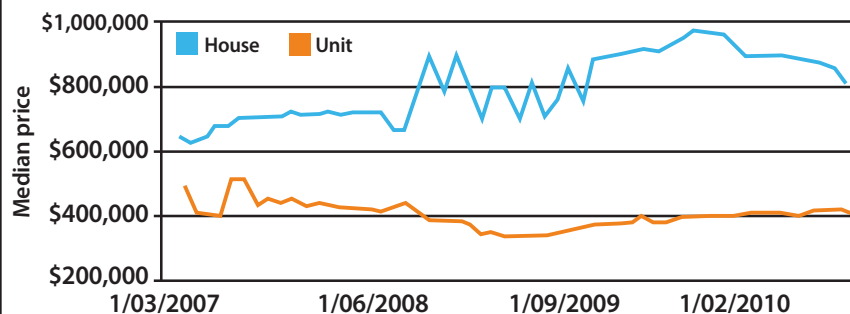
Table 1 lists some suburbs that have had a significant increase in the number of auctions in October 2010 to the number in October 2011.

Chart 1: Price changes for Newstead, Tas 7250



Source: RP Data

Chart 2: Price changes for Glenelg, SA 5045



Source: RP Data

Table 1: Suburbs with large increases in auction

State	Postcode	Locality	Auction count Oct 2010	Auction count Oct 2011	% change
NSW	2148	Blacktown	9	17	89
Vic	3163	Murrumbeena	5	9	80
NSW	2223	Oatley	8	13	63
NSW	2071	Killara North	5	8	60
Vic	3051	Melbourne	9	14	56
NSW	2190	Greenacre	17	26	53
Qld	4005	New Farm	10	15	50
Vic	3129	Box Hill North	6	9	50

Source: *DSRdata.com.au*

5 Increasing sales volume

Increasing sales volumes can be an indicator of capital growth in the immediate future. However, there are circumstances where it can be misleading.

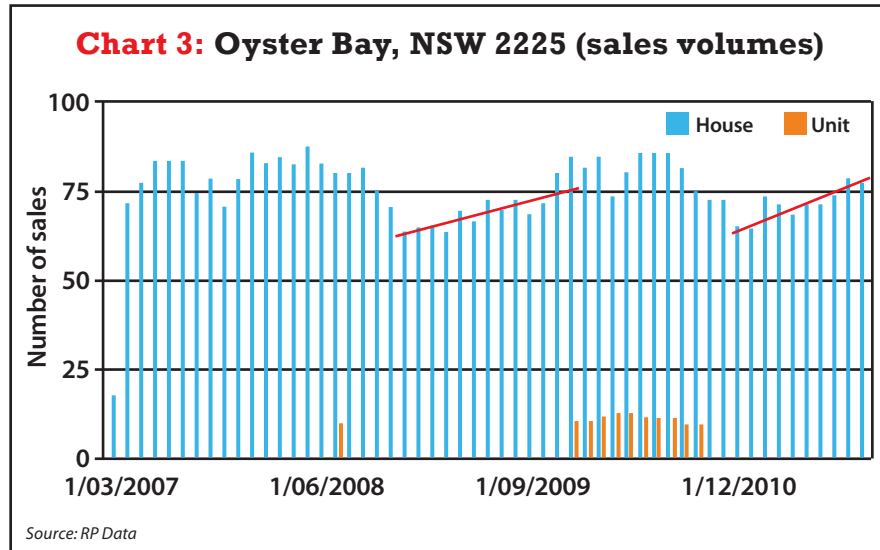
If demand is strong, then the volume of sales should be higher than usual. However, if brand new stock comes on the market, for example, via high developer activity, a higher sales volume could be misleading, and an over-supply may be imminent.

An example of some upward trending sales volumes is that of Oyster Bay, NSW 2225. See chart 3. I've drawn with red lines where there are clear trends of increasing sales volumes.

Timing your entry

I was recently asked to perform an appraisal on a suburb on the Gold Coast, Queensland that had a poor DSR. The client had experienced little to no capital growth in the short years they'd owned the property and wanted to know if it was worthwhile hanging on to the property.

The area they chose will have good capital growth again one day. But they bought at the wrong time. My advice



To time entry into the market of your choice, you should be looking for indicators moving from an average value into a better than average value over the last six–12 months. Six months gives plenty of time for short bursts and anomalies in the data to even out and show a clear trend. Anything shorter than this could be a red herring.

Any one of the following may mark

single digit positive growth over the 6–12 months, about 3–9% growth

- 50% increase in the number of auctions over the last 12 months
- 25% increase in sales volume over the last 6–12 months

The more of these statistics that a market has favourable values for, the more likely it is the right time to enter your chosen market.

It's important to pick the right time to enter the market. Generally, favourable market moves will give you plenty of time to arrange finance and do thorough research

was to sell if they were ever lucky enough to get an offer.

It's important to pick the right time to enter the market, that time when the fundamentals are influencing the demand and supply stats. Fortunately, this doesn't come down to weeks, so you don't have to go rushing around. Most market moves will give you plenty of time to arrange finance and do thorough research. Despite this, many investors still get it wrong.

Positive fundamental changes either reduce supply or increase demand. Then prices change to re-balance the demand-supply equation. The imbalance is temporary unless more fundamental changes can keep occurring.

a change in fortunes of property prices in your target location:

DSR rising above 30. Breaking down the stats that the DSR is based on:

- **DOM dropping below 90**
- discount dropping below 5%
- ACR rising above 60%
- vacancy rates falling below 2%
- gross yields rising above 4.5% for houses and 5% for units in metro areas. Gross yields above 6% for regional areas
- SOM% falling below 1%
- OSI rising above 20
- **Rents growing by around 10%**
- a long period of flat or negative growth (several years) followed by

Conclusion

When researching your next investment property, don't rely on only a few stats, you must look at many.

Given the volatility of some of this data it is important to view a chart and look at the trend in general rather than the individual monthly figures.

Putting it all together requires a decent understanding of what each statistic represents in terms of supply and demand.

If most of the stats look good, it's time to perform some fundamental research. 📌



Jeremy Sheppard is director of research for DSR Data and a keen property investor, having bought 16 properties over nine years, seven of which doubled in value in less than three years. He created the Demand-to-Supply Ratio (DSR) and is the author of 'How to Find Property Hotspots'. Visit DSRdata.com.au

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