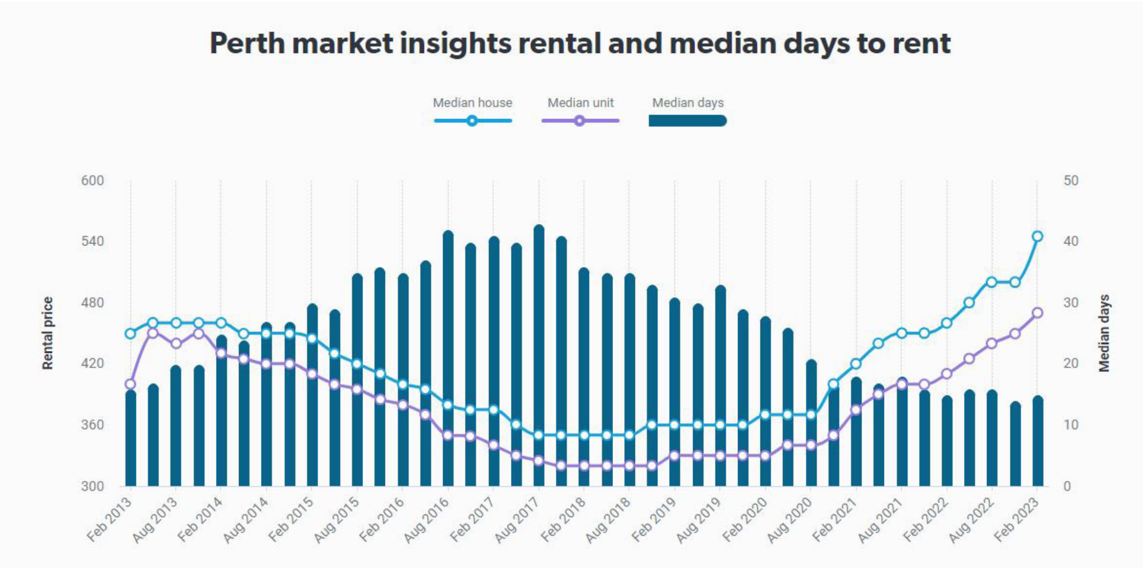
Western Australia - Residential 2023

Perth and regions

With Perth being the cheapest capital city to buy property in Australia, it is certainly a market constantly under consideration by investors. Affordable stock, low vacancy rates and a strong economy are all factors that have made the Western Australian property market an attractive proposition in recent times and due to these factors, investor activity has certainly been present throughout the length and breadth of this great state. In this edition we are going to break this down to see where investors are active, what property types are catching their attention, what factors are driving or slowing investor activity and how these factors may influence the market moving forward.

Towards the back end of 2022, the Western Australian property market appeared to be far more resilient than many areas in the eastern states, particularly on the back of interest rate hikes throughout 2022. This resilience appeared to be largely driven by investor activity from both local and interstate investors as owner-occupier activity slowed, so let's start by taking a look at the factors that are driving investor activity in the Western Australian market.

A key factor worth mentioning first is the vacancy rate in Perth. In December 2022, the vacancy rate for the Perth metro region was just 0.6 per cent (as per REIWA), the lowest recorded since 1980 when REIWA began keeping these records. With a balanced rental market believed to show a vacancy rate in the range of 2.5 to 3.5 per cent, it is clear to see that landlords are in a great position right now. Given the record low vacancy rate, getting a rental at the moment in the region can be very difficult and this is allowing landlords to increase rental payments as many tenants are not in a position to look elsewhere as there is no certainty of finding a new rental. This cycle actually started well before the impact of COVID-19, but was exacerbated significantly by the pandemic.



Perth Rental Data | Source: REIWA

The above graph demonstrates the effect the vacancy rate is having on rental values. We can see the steady increase in rental prices for both houses and units as well as the decrease in time for rentals to be snapped up after coming to market. The latest figures have the Perth median rental amount for houses at $545 per week (this was only $370 per week in mid-2020), while for units the rental amount per week sits at $470, a large increase on the median price of $340 per week in mid-2020. These figures demonstrate why the Perth market is seeing good activity from investors at the moment. The situation is not helped by the slowdown in construction throughout 2022 due to an escalation in construction costs and supply issues, meaning an increase in new stock on the market to relieve vacancy rates could be some time away and, in the meantime, new housing starts are not keeping up with net migration figures.

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Another key driver of investor activity is the relative affordability of the Perth market in comparison to the eastern states. The median house price in January 2023 across Australia's combined capital cities was $849,666, however for Perth this was only $585,326. For houses, this makes Perth the most affordable capital city in Australia, and it is this affordability that has driven activity from eastern states buyers who have likely been priced out of the market in their home states or see Western Australia as an opportunity to get more bang for their buck. Our valuers in the field are reporting high levels of eastern states buyer activity when sighting contracts of sale. This is particularly evident in some of Perth's outer suburbs where dwellings are very affordably priced, however the rental returns are often still solid. Suburbs such as Armadale, Gosnells, Baldivis and Midland all have good levels of stock available for under $400,000 and you can pick up a solid brick home on a 700 square metre allotment - almost unheard of in key eastern states markets.

Net migration is another key point to mention when assessing the investor market in Western Australia. Across 2021-22, Western Australia's population grew by 35,448 with a natural increase of 16,179, net interstate migration of 10,791 and net overseas migration of 9,502 (as per Government of Western Australia). For the following two financial years, the state government is forecasting population growth of 1.5 per cent. As previously discussed, the state is already seeing record low vacancy rates and data like this will only place further strain on the housing shortage across the state. But what does this mean for investors? Well it places some certainty on achievable returns. A shortage of supply means a strong rental market which places landlords in a better position. It just remains to be seen when construction issues ease allowing for an increase in new stock to potentially ease the pressure on a very tight rental market. We don't see this occurring in 2023.

The discussion so far largely revolves around rental returns, but many investors are also interested in capital growth on their properties. In the last edition of the Month in Review, we discussed how we expected the market to track throughout this year and we anticipated a steady year with potential for marginal growth in most areas. We stand by this call and believe the lack of supply on the market and cost to build will continue to drive up values at a steady pace. The thing holding the growth back is the key factor of interest rates. Demand from owner-occupiers appears to have eased on the back of significant rate rises, so the capital growth levels of 2021 and early 2022 appear to have eased. However, with supply issues still prevalent and many people put off the idea of building due to substantial construction cost increases, we believe there is still potential for capital growth within the metro market moving through 2023, particularly as renters try to escape the rental cycle or are forced to buy a home just to secure accommodation.

What returns you can expect and whether they are largely driven by yields or capital growth is heavily influenced by the market in which you buy, so let's look further into some specific markets within the Perth metro region to see where investors are active and what is driving investors in these areas.

We'll start our analysis in the Peel region, south of Perth. The Mandurah region has been a real hotspot for investor activity of late. Investor activity in this region has largely been driven by purchase activity on affordable stock that offers above average returns. Areas such as Greenfields, Lakelands and Coodanup all offer a wide range of affordable stock on the market. Meanwhile in the oceanside suburb of Halls Head where typically more of a premium can be expected, there are still some great options for investors to be found. 7 Napier Close in Halls Head is one example of this. The property comprises a 1986 built, four-bedroom, two-bathroom dwelling on 850 square metres of land. The property sold for $478,500 in October 2022 and was leased not long after the sale for $580 per week, which equates to a yield of 6.3 per cent.

7 Napier Close, Halls Head — Source: RP Data

Mandurah is also a fast-growing area and there is a large amount of new land coming to market in areas such as Madora Bay, Lakelands, Dawesville and South Yunderup. Our valuers are noticing large volumes of eastern states activity when completing construction valuations in this area, which shows investors are not only looking for established stock. Building in Western Australia has become a far more expensive option in the past 12 to 18 months due to significant supply and labour shortages, however it appears eastern states investors are less deterred by this, potentially due to the fact it still represents a far more affordable option than purchasing on the east coast. It remains to be seen how effective this is for investors, with current market conditions likely to generate good returns on a new build in these areas, but with good levels of new stock expected to hit the market later in the year, supply issues may ease and this may result in rental relief for tenants and potentially a drop in capital values.

The Rockingham region is a similar story to the Mandurah region. Affordable stock and strong rental demand make this region a popular investment location. As per 2021 census data, 36.8 per cent of dwellings in the suburb of Rockingham were used as rentals. Cooloongup is a suburb to the south-east of Rockingham and has proven to be a popular area in recent times. REIWA data shows this suburb has a median sale price of $390,000 and a median rental of $450 per week, making yields of above five per cent common in the area. 9 Helena Road is an example of this having sold for $357,000 in November 2022. This three-bedroom, one-bathroom property currently rents for $420 per week which shows a yield of 6.1 per cent.

9 Helena Road, Cooloongup Source: RP Data

Mandurah and Rockingham have both had good levels of development sites hitting the market in recent times, however this form of investment activity has been relatively subdued due to the escalation of construction costs, with investors appearing to be wary of high costs limiting profits. Another factor limiting this activity is concern from investors that the market may have turned by the time their product hits the market, particularly due to the current lag in construction times. An example of a typical development site in this region is 35 Cooper Street in Mandurah. The property is a 1012 square metre rectangular lot zoned R60 in close proximity to the Mandurah foreshore. The property sold for $355,000 in September 2022.

Moving to Perth's south-east corridor, investor activity has eased of late. Areas such as Gosnells and Armadale have good levels of development sites available however activity in this sector appears to have significantly eased. These areas are typically characterised by smaller developers whose potential profitability would be taking a hit following the rise in interest rates and construction costs. It is likely many investors purchasing this stock now would be focused on locking up this stock while it is available and sitting on rental income from the single dwelling on the site until we have relief on construction costs allowing them to develop the site and achieve a greater profit. Corner lots in the Gosnells region are a popular product with the dual street frontage and zoning benefits making these a desirable choice for investors.

Bentley has long been a popular investment location due to its proximity to Curtin University. As per REIWA, 59.4 per cent of properties in this suburb are used as rentals and this rental market is largely driven by students. This is an area that has seen strong rental and capital growth in recent times. At the start of 2020, the median rental for Bentley was $380 per week. This is now up to $440 per week, while the median sales price has risen form $430,000 to $528,000 in the same period. Sales volume has been very strong in the region, however has dipped in recent times, however this is likely largely due to a lack of supply and not a lack of demand. Investment properties in this area are seen as a strong investment option particularly with the return of international students to Perth after the easing of border restrictions. Areas like this potentially provide a safer investment option in the longer term with student housing always necessary in comparison to the outer suburbs of the metro region where demand may weaken once supply increases on the market. 32 Mckay Street is a three-bedroom, two-bathroom survey strata dwelling located within walking distance of Curtin University. The property sold for $430,000 in October 2022 and has since been leased for $450 per week which is a return on investment of 5.4 per cent. This sale represents a typical purchase for the area and these purchases are usually driven by the long term rental returns that investors can expect, with demand in this area generally reasonably strong.

32 Mckay Street, Bentley Source: RP Data

In the north-western suburbs of the metro region, investors and owner-occupiers are largely competing for a similar product. Suburbs such as Karrinyup, Carine and Duncraig are the types of suburbs where investors are competing for a similar product, with these properties generally being well-kept dwellings on decent land holdings where rental returns are solid and there still appears to be room for capital growth. We consider capital growth to be a driver for investors in these regions given the lack of supply available which is continuing to drive prices up despite the heavy gains of the past 24 months. Areas like these have strong demand due to the proximity to the city centre, Perth's coastline and amenities available, which makes them likely to be a more resilient investment option in the longer term in comparison to some of the fringe suburbs where demand may drop once supply increases. Current rental rates in these areas for a four-bedroom, two-bathroom dwelling are typically between $700 and $900, which is a handy additional income stream for those buying for capital growth.

Moving to the outer northern suburbs, we have noticed this area has been quite popular with eastern states investors. Housing stock in the area is dominated by family houses on 300 to 550 square metre lots.

Just like the southern suburbs, we are seeing a large amount of construction valuations coming through from eastern states buyers, who still see value in constructing new dwellings despite the construction cost increases, but we are also seeing several contracts come through for existing dwellings being purchased by east coast investors as well. Agents and investment consultants in the eastern states appear to be driving a lot of activity in this area and this heavily influences the trends in the local market. We have had discussions with agents who claim particular suburbs are achieving sale prices above the surrounding area and inconsistent with the usual pattern because of the hype that agents and investment consultants are giving a particular suburb. Local research is extremely valuable!

There has been an increase in dual key dwellings being constructed in the far north-west metro area as well. This activity is being driven by east coast investors who see the increased earnings potential from having the two dwellings on one title. We have noticed that some of these are in slightly out of place locations or areas we wouldn't expect to see this product. We note that these products have a limited buyer profile and are unlikely to sell for a strong price compared to a typical five-bedroom, two- or three-bathroom product as they mainly appeal to the investor market. There has traditionally been weak demand for this product due to the limited buyer profile, however with greater activity appearing in this sector of the market, it will be interesting to see how capital values of this product perform moving forward.

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The Serene. Home Design by New Choice Homes Source: New Choice Homes

Investors in the outer northern suburbs are mainly yield driven as opposed to seeking capital growth. With the rental market remaining in a pretty dire situation for tenants, good yields are still achievable for investors.

Now let's move to the units and apartment market in the CBD and surrounding area. We have noticed that in particular, older units and apartments have started to attract interest from interstate investors, mainly due to the good rental returns on offer as opposed to the potential for capital growth. Investors are beginning to be attracted to the affordability of inner-city units through East Perth offering returns of six to seven per cent and above in some cases. For example, a circa 2008 built, one-bedroom, one-bathroom apartment in East Perth which sells for around $300,000 would have potential rental income of $400 per week, demonstrating a yield of 6.9 per cent. Another example of a recent sale is 58/149-151 Adelaide Terrace in East Perth. This is a circa 2008 built two-bedroom, two-bathroom apartment with river views which sold for $470,000 in November 2022. We would expect this property to provide a rental income of circa $550 per week, which demonstrates a return of 6.1 per cent.

58/149-151 Adelaide Terrace, East Perth Source: realestate.com.au

We are starting to see a lot of interstate buyers purchasing these properties sight unseen, which indicates that they are just attracted to the rental returns on offer and are not so concerned about the condition or features of the property. With record low rental vacancies and almost no supply of inner-city apartments hitting the market in the first half of 2023, we can't see this demand slowing down in the short term - barring some unexpected drastic economic changes.

Now let's have a look at what's happening throughout the regional areas of Western Australia, starting in the north of our state in Broome, where we have seen a decline in investor activity. This is mainly due to the capital growth that Broome has

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enjoyed over the past two years which has resulted in a high entry cost and rents appear to be reaching an affordability ceiling. Whilst the gross returns on offer appear good, once other holding costs such as insurance and council rates are taken into consideration, the net return available is not as appealing as what can be achieved elsewhere.

If capital values start to trend lower over the next 12 months, then investing in Broome may become attractive to investors again, as rents are unlikely to decrease anytime soon. A lot of the Broome market is also influenced by the tourism season. We have noticed some businesses have reported cancellations for peak season due to the road damage that has occurred in the area. If cancellations are occurring in peak season, this will mean the businesses may not need the staffing requirements they expected, which will have a flow on effect to the rental market.

Traditional investor stock in the market is mostly lower to mid-tier, newer style smaller houses and units. Low maintenance is always preferred for investors in harsh environments such as the Kimberley. That being said, there is slightly more stock on the market now than there was six months ago, meaning investors have a bit more choice of what they want to invest in. The lower end of the market is getting snapped up quickly due to it being a more affordable proposition to owner-occupiers as opposed to renting. This means investors looking to get in at the lower end of the market will be competing with owner-occupiers. We have noticed there are still a few near new houses for sale that are being marketed below replacement cost, so these appear to be representing okay value within the current market conditions.

Moving to the town of Port Hedland, we have noticed that investors from over east are still active in the area, especially for properties with an existing lease longer than 12 months. Capital values have stabilised while rents have increased, so yields are certainly growing for investors. Properties with an existing lease are generally fetching more of a premium from investors with anything with a lease of 12 months or longer seeing strong demand in the current market. The investors in the area are definitely seeking good yields more than capital growth. Generally modern properties are outperforming older stock on the market.

The City of Karratha has not seen a notable change in investor activity over the past six months or so. The most active investors are still locals who are generally purchasing multiple properties using the equity from their own homes.

There are a few major projects kicking off this year in Karratha, with one being Woodside's Pluto Train 2. A lot of locals are hoping this will potentially lead to an increase in capital growth due to the number of jobs this project will bring in, however this is always contingent on the size of workers' camps and whether companies in town maximise the use of their existing housing stock.

The typical investor stock in this market is basic houses, generally three-bedroom and one-bathroom and small survey-strata developments.

Any units that have large strata fees are not as sought after by investors. There is still some reasonably priced stock on the market with good yields being achieved, mainly three-bedroom dwellings which can offer gross yields in excess of eight per cent.

An example of this is 20D Kallama Parade, Millars Well. The property is a survey-strata, three-bedroom, two-bathroom dwelling which sold for $430,000 at the back end of 2022. At the date of sale the property was being leased for $700 per week, which represents a yield of 8.5 per cent.

20D Kallama Parade, Millars Well Source: RP Data

Investors are seeking both good rental return and capital growth in this region. Some investors are trying to find good houses to park their money in for a couple of years that offer a better return than other investment opportunities such as shares. Other investors are waiting for the next supposed boom when the projects that are kicking off are in full swing in a few years.

There is a good opportunity for investors who are quite handy, as there is stock available that can be tidied up and sold later for a profit. There is an extreme lack of trades in the area and therefore it is extremely hard to rely on people to complete renovations. It is much more cost effective to do it yourself and potentially make some profit.

Moving to the Geraldton and mid-west region, there is still a large undersupply of housing. Rental vacancies are still incredibly low and good returns are available to investors. As with most of the state, there is a real lack of labour available in the region. Properties requiring work may suffer in capital value as construction costs are still increasing and time delays also provide more uncertainty. This may present an opportunity for investors who are quite handy and can renovate a property themselves to potentially generate a profit.

As discussed in our previous Month in Reviews, there are a few projects that may get underway this year including the Oakajee Strategic Industrial Area. Locals are hoping this will help bring more people to the region and potentially lead to an increase in capital growth.

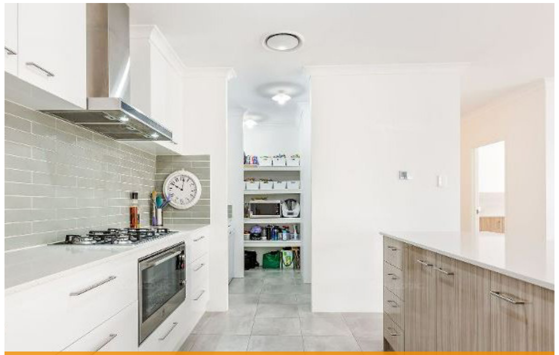
Similar to Geraldton, Kalgoorlie is also experiencing an undersupply of rental properties, leading to strong investor activity in the market. Demand is expected to remain strong for the foreseeable future with local businesses continuing to try to attract workers to the town and this demand will likely continue throughout the course of this year.

It is common in the area to see rental yields in the range of eight to ten per cent, however investors should be cautious given the fact that Kalgoorlie is a mining town and long term stability of the market is not guaranteed. A great example of this is 7 Buller Street, Kalgoorlie. The property is a circa 1945 renovated four-bedroom, two-bathroom dwelling that sold for $345,000 in December last year and has since been rented for $700 per week, which is a return on 10.5 per cent.

7 Buller Street, Kalgoorlie Source: RP Data

We next take a look at the south-west region of Western Australia. In the wake of several interest rate increases since May 2022, the market in the south-west has remained buoyant. There is still a large amount of demand for affordable housing in the area. Capital values have continued to increase in most areas and rental vacancies remain very low which has seen rental values at record highs in most areas. The typical investor stock in the region is relatively newly built three- or four-bedroom, two-bathroom project style homes on 350 to 600 square metre lots in the outer areas of the major centres.

In the more affluent coastal towns such as Dunsborough and Yallingup, there has been some investor activity, however mainly from Perth investors with an eye to moving to the region at some stage in the future. The high capital values are limiting the potential return on investment in these areas and limiting appeal for investors. The heat in the rental market appears to have come off slightly in these more affluent areas where some long-term rentals are becoming available, having switched back from Airbnb use due to a forecast potential drop in demand for short term accommodation, particularly over the winter months. An example of typical investment stock in the area is 12 Cabot Close which is located in the Dunsborough Lakes development. This project style 2018 built four-bedroom, two-bathroom dwelling sold in December last year for $780,000 and has since been rented out for $780 per week. This represents a yield of 5.2 per cent which is a strong return on investment, or as discussed above could be a handy income stream while holding the property for future use.



12 Cabot Close, Dunsborough Source: RP Data

In the more affordable areas such as the outer areas of Bunbury, Margaret River and Busselton, investor activity is slightly higher with better return on investment and some investor activity coming from the eastern states. Affordability as well as return on investment are both considered to be factors for investor activity in these markets, particularly in comparison to the high values in the Sydney, Melbourne and Brisbane residential markets. 3 Silvereye Street, Kealy recently sold for $505,000. The property represents a typical four-bedroom, two-bathroom dwelling for the area, situated on 404 square metres of land. A property like this would be expected to generate a weekly rent of $600 per week. This represents a yield of over six per cent which shows why this cheaper stock is seen as a more popular investment option.

3 Silvereye Street, Kealy Source: RP Data

Further north, there has been significant investor activity in Australind (Treendale), Millbridge and Eaton recently with much of this coming from eastern states investors. Again both affordability and return on investment seem to be the reason for investor activity on the back of good employment opportunities in the area. Projects include the lithium processing plant in Kemerton, the construction of the Bunbury outer ring road and increased activity in the Bunbury Port. Interestingly some of the investor activity appears to be coming from investor groups which have earmarked this locality as a potential hot spot. Project homes selling in these suburbs are likely to generate yields in the six per cent range with strong demand being shown from tenants due to the lack of supply. This is slightly higher than the other areas in the region, hence there is more investor activity in these suburbs.

Moving south to Esperance, it has become extremely difficult for eastern states investors to get hold of quality stock at their desired return (despite the strong rental market) due to the level of competition from owner-occupiers and local employers looking for staff accommodation.

The market in Esperance is heavily influenced by the strength of the local economy and performance of the agricultural sector. Some of the larger local employers and government agencies (such as Freight Lines Group, Minerva and GROH for example) require staff accommodation and are currently willing to pay attractive rents to house their employees. Farmers with spare cash will also look to invest in the local market so there is likely to be more or less activity from them as a result of how they have performed in any given year.

Traditional investment stock in this market is units. Those close to the beach in the Esperance town centre and in Castletown also provide opportunities to generate short stay income (Airbnb, Stayz etc.). Family homes (three and four bedrooms, two-bathrooms in good locations) have been targeted more heavily over the past 18 to 24 months due to the strong rental demand for these products. We have heard stories of exorbitant rents being asked and subsequently being achieved for these products.

Investors are typically seeking rental returns for this area. The fringe suburbs of Nulsen and Sinclair offer cheaper properties which are generating higher yields presently due to the strong rental market and high rents being achieved. These areas have been targeted due to that factor but previously investors have left those areas alone. For example, 10 McCudden Street in Nulsen is a renovated duplex that provides two two-bedroom, one-bathroom units on a 998 square metre block that sold in November 2022 for $268,000, with both units having a long term lease in place. This duplex provides a total rental income of $480 per week, equating to a yield of 9.3 per cent.

10 McCudden Street, Nulsen Source: RP Data

There are potentially some opportunities still for investors at present. Green titled duplex and triplex unit developments do go to market every now and then and provide opportunities for investors to generate a diverse income stream between standard residential leases and short stay tenancies, however there is no quality stock at present. There are some beachfront serviced apartments on the market at present, but it does not appear these are being targeted at the moment. Two in the same complex sold very quickly last year so maybe these aren't as desired now due to the rising cost of money and with income likely to be seasonal.

So there you have it! There is an abundance of opportunities for investors within our great state. The fundamentals of low vacancy rates, an undersupply of housing and a strong economy leading to positive net migration are continuing to drive investment activity within Western Australia. Many investment options are showing that strong returns are there to be had, particularly in the rental space, however there are still opportunities for capital growth in the right markets. As always, we advise any investors to do their own due diligence, however our team is always here to help provide some local knowledge if required.

Chris Hinchliffe
Director

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