

## 6. Rental Yield ~4.3%



It is not only the ability for an investor to achieve capital growth that makes property investing exciting, it is also the fact that a regular and constant income stream can be derived from that property that make it a sound investment choice for many investors.

The rental income derived from a property is a cash flow tool that is used to assist fund the property, pay down debt and eventually replace other personal income streams. The rental yield is quite simply the annualised rental income expressed a percentage of the value of the property. For example:

On a \$375,000 property, the weekly rental of \$320 equates to an annual rental income of \$16,640.

Calculated as a percentage, this equates to a rental yield of 4.4%.

This is an important percentage as not only does it determine the Return On Investment so that the cash flow requirement of servicing and maintaining the property can be calculated, it also provides important information about the rate of future capital growth.

An investor's initial reaction would be to try to achieve an as high as possible rental yield, however, this may not always be what is best for the investor.

Our research at Property Choice has indicated that an area that has a high rental yield will, generally speaking, have a low capital growth rate and alternatively an area that has a low rental yield will, generally speaking, have a higher capital growth rate.

The reason for this, we believe, is that the property investment market is always striving to reach a state or equilibrium or balance.

When rental returns are high (that is, greater than a 5% rental yield) investors are willing to accept a less than average capital growth rate. On the other hand, when the rental yield is low (that is, less than a 3% rental yield) investors need to be compensated by achieving a greater than average capital growth rate.

The market always strives for balance and the investor needs to make a choice between a little more money now (higher rental yield & lower capital growth rate) or a lot more money later (lower rental yield & higher capital growth rate).

That is the reason why Property Choice recommends a rental yield range between 3.9% to 4.7% as being the most ideal. This range, which fluctuates around an average of 4.3%, would indicate an area that is achieving a moderately solid growth rate, is relatively balanced and has an acceptable cash flow income stream by which to assist in the servicing and maintenance of the investment property.

Using ratios and numbers like this when assessing a property opportunity, enables an investor to make a logical decision without the interference of personal emotions clouding what represents a good or not-so-good investment decision.

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