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What motivates households to invest in the private rental market?

THE PERCEPTIONS OF PROPERTY AS A LOW-RISK INVESTMENT, GUARANTEED TO YIELD LONG-TERM CAPITAL GAINS, ARE KEY MOTIVATORS FOR SMALL-SCALE PRIVATE RENTAL INVESTORS. HOWEVER, NOT ALL MOTIVATING FACTORS ARE FINANCIAL. PERSONAL GOALS AND PERSONAL OR FAMILY CIRCUMSTANCES ALSO PLAY A KEY PART IN INVESTMENT DECISIONS.

KEY FINDINGS:

- Investors are motivated to invest in the private rental market for a number of reasons. These include financial factors, personal goals (i.e. retirement home or future home for children at university) and household circumstances (i.e. proximity to their own dwelling). Many investors use their own measures of quality and personal preference when selecting a dwelling even though they will not be living in the property.
- Investors perceive property as a long-term, safe and stable investment that is low risk and will produce guaranteed returns. Investors largely expect capital gains from investing rather than rental yield and this is how success is measured.
- Sentimentality and informality characterise investors' approaches to the housing market. Property is considered familiar, relatively easy to invest in (not mysterious and complex like other investments) and something lots of people do.
- Age and personal circumstances (i.e. retirement), rather than market factors, appear to be the dominant considerations for those who had recently sold property or were intending to sell in the immediate future.

*This bulletin is based on research led by **Dr Tim Seelig** of the AHURI Queensland Research Centre and involving **Ms Alice Thompson** (Queensland), **Professor Terry Burke** and **Mr Sean McNelis** (Swinburne-Monash), **Dr Simon Pinnegar** and **Dr Alan Morris** (UNSW-UWS). The research explored the motivations, expectations, and experiences of rental property investors to better understand the contexts and circumstances in which investment occurs.*

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BACKGROUND

The private rental market makes up over 20 per cent of housing stock in Australia. Until recently Australian Governments reduced spending on, and investment in, social housing. They had come to rely heavily on the private sector to provide housing for low-income earners. In order to formulate policy that continues to encourage private rental investment, it is important to understand why and how investors purchase housing stock.

Understanding of the private rental system in Australia has improved considerably over the last decade. Literature discussing investor motivations and landlord typologies, however, dates back almost 20 years to the 1980s and early 1990s. Up-to-date research is required. In addition, much of the research has been conducted within an economic framework. It is assumed that investors exhibit rational market behaviour and their decisions are driven by financial considerations alone. This study attempts to gain new insights and understandings of investor motivations, expectations, experiences and behaviour.

METHODOLOGY

This qualitative study was conducted in Queensland, New South Wales and Victoria. Over 100 semi-structured interviews were conducted with both investors and industry professionals in the private rental market. A broad cross-section of small-scale rental property investors was garnered through referrals from industry professionals. A third of the sample owned one property, a quarter owned two properties and a further quarter owned between three and five properties. Within the sample there were investors that owned regional properties, and those that owned property in large metropolitan areas.

What motivates people to become investors?

Investors are motivated to invest in the private rental market for a variety of reasons, however, the perceptions of positive financial returns dominate. Commonly this represents households embarking on a clear plan of wealth creation, to develop long-term financial security and build an asset base, and to secure future retirement income. For others, it is connected to the need to diversify investments, to spread financial risks, establish an alternative to superannuation, and build a balanced portfolio. Financial capability or opportunity is critical and often respondents reported that accrued savings or equity (usually in their own home) led to a sense of 'needing' to invest.

However, other factors also motivate people to invest. These include a range of family circumstances and personal goals such as wanting a retirement home, a holiday home or future accommodation for children going to university.

Why property?

Most commonly, investors consider residential property a low-risk investment with guaranteed returns when compared to other options. The majority of investors identified long-term investing or capital gains as the most important reason for having invested rather than rental income. These considerations are fed by feelings that property is 'safe', 'stable' and not subject to fluctuating markets. Investors feel 'comfortable' and familiar with property, reporting they have more experience and a better understanding of the property market compared with other investment markets. Seemingly, property is widely regarded as easy to invest in and without the complexities of other investment options. However, the majority of investors also invest elsewhere — mainly shares — although this is of a smaller financial scale.

The dominant sources of information for investors in making property investment decisions are personal experience and intuition. Prior to purchase, investment and property professionals — accountants, estate agents and specialist advisors — were not commonly used amongst the sample as sources of information. Investors also feel a sense of control with property. It is a tangible product; one that can be seen and visited, and potentially adapted or used in various ways.

Overall, 'market conditions' (when in the property cycle people have invested, and what is happening in terms of property trends) are seen as being of some importance, but do not form the principal basis for assessing where and when to buy. For many, investment decisions are driven more by personal circumstances (i.e. proximity to their own home), the capacity to invest and the influence of family or friends. Observing the apparent success of others and reading investment books or attending seminars associated with wealth creation specialists are also factors. It appears that for some investors, there is no clearly developed strategy for investing other than 'feeling good' when selecting a particular property.

What factors shaped buying and selling?

Location is the dominant consideration when selecting a particular property but many other factors also influence an investor's decision. Inner-city dwellings are popular due to a perception of high demand and thus guaranteed capital gains; however proximity to the investor's residence is also cited as important for property management or surveillance purposes. Broader, long-term factors also influence investors' decisions, such as selecting properties with the prospect of children moving into them or as potential holiday homes. In such cases rental income and property value become secondary concerns.

When it comes to individual property selection, investors are generally concerned with the physical features and condition of a dwelling, and its potential for financial gain. However, how they feel personally about the place is also significant. Intuitive and emotional factors are clearly evident in the selection process, and many investors use their own preferences for property as a measure of quality, even though they are not going to be living in the property.

When selling, market conditions again appear less significant than might be expected. A critical factor is the age of the investor and proximity to retirement, or the formal planning for it.

Investor expectations

Investors understand property investment to be long term and many understand that costs may outweigh returns in the short term. Their key expectation is long-term capital gains. The expectation of rental income exceeding costs was a secondary consideration. In this context, tax relief has not represented a deliberate investment strategy for most investors and has not been a crucial factor in their investment decisions. However, nearly all regard tax incentives as a welcome and generous tool or added bonus, which they willingly make use of as much as they can, and clearly factor into their ongoing financial thinking.

Investor experiences

This research was conducted from mid-2006 to mid-2007 when most parts of Australia were experiencing a property boom. Nearly all investors report high rates of satisfaction with their property investment and report that they have experienced 'success'. Success is largely equated to capital gains (even if this is yet to be realised) but also includes rental yield and tenancy management. These perceptions provide an ongoing incentive for investors to remain in the property market, to increase their portfolio, to consolidate, or to start realising their assets as part of their investment strategy. Despite the added cost many investors in the sample decided to have their properties managed professionally post-purchase, citing a lack of time as the key reason behind this decision.

Generally investors were not keen on renting to students or group households, welfare recipients, sole parents and families with children. There was a perception that tenancy problems would arise if tenants did not have stable employment. Working families, couples without children, and older renters were clearly the most popular groups. This, in conjunction with a preference to invest close to their residence or in neighbourhoods they are familiar with, suggests a reluctance to invest in low-cost housing. There was also a perception that capital gains in these low-cost neighbourhoods would not be realised to the same extent as other neighbourhoods.

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POLICY IMPLICATIONS

This study improves our understanding of investment behaviour and the attitudes of rental property owners and, in so doing, raises important policy questions about the capacity of governments to shape investment patterns.

- Investors are not driven by economics alone. Situational circumstances and personal goals influence when, where and if investors buy or sell. Thus, the capacity to shape behaviour via economic policy is limited. When the economics are paramount, investors usually have their eye on the long-term capital growth picture.
- Negative gearing is not a critical driver for becoming an investor, but it is seen as an important component of the economics of property investment, so it may be hard to remove.
- It is unlikely that small-scale private rental investors will respond to incentives designed to help meet the demand from low-income renters. As such, governments may need to deploy other policy levers to encourage institutional investors to invest in affordable housing.
- If investor perceptions change as a result of cyclical downturn or volatility in the property market, there may be negative consequences, such as escalated falls in property prices and reduced rental availability.

FURTHER INFORMATION

This bulletin is based on AHURI project 20280, *Motivations of investors in the private rental market.*

Reports from this project can be found on the AHURI website: www.ahuri.edu.au

The following documents are available:

- Positioning Paper
- Final Report

Or contact the AHURI National Office on +61 3 9660 2300.

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