

What makes a landlord decide to invest and dis-invest in private rental housing?

LANDLORD INVESTMENT DECISIONS ARE LINKED TO FINANCIAL COSTS AND RETIREMENT STATUS. TAX, MONETARY AND RETIREMENT INCOMES POLICIES ARE ALL RELEVANT TO INCREASING THE SUPPLY OF PRIVATE RENTAL INVESTMENT.

KEY POINTS

- Financial factors are the most important determinants of both the propensity to invest in rental housing and the length of time typical landlords hold on to their property investments.
- Attitudinal and demographic variables also play a significant role in driving investment decisions. Passing the retirement age is particularly significant. Landlords that have reached retirement age appear more likely to exit the rental property market. Australians over 64 years of age also seem less likely to become landlords.
- About one-in-four property investments are withdrawn from the rental market within 12 months. Thus tenants of approximately one quarter of all rental properties occupy insecure accommodation. Low income, and negatively geared property investors, are more likely to make early exits from the rental housing market: negatively geared investors appear to move in and out of property investments.
- Monetary policy and reforms to the taxation system are likely to have important impacts on the supply of rental housing. Superannuation is a substitute for rental housing investments in personal wealth portfolios, but there is uncertainty about the strength of this relationship.

*This bulletin is based on research by **Professor Gavin Wood** of the AHURI RMIT Research Centre and **Dr Rachel Ong** of the AHURI Western Australia Research Centre. This study empirically examines the factors shaping Australians' decisions to invest in, and retain rental housing.*

CONTEXT

The supply of private rental housing has become more prominent in debates around affordable housing as market rents have spiralled. Research by Yates et al. (2005) shows that affordability outcomes were the worst in the private rental market.

In this project, we explored the role of different variables in shaping the supply decisions of typical private rental investors. The empirical work provides insights into how policy initiatives, such as tax reform measures, might impact on the after-tax economic costs of landlords and how this will in turn affect their propensity to invest in and hold onto rental property portfolios. It also addresses the question of whether private landlords typically offer permanent rather than temporary rental opportunities by holding on to property investments for many years.

METHOD

The analysis is conducted using waves one to six of the nationally representative Household, Income and Labour Dynamics in Australia (HILDA) Survey, covering the period 2001 to 2006. A sample of 1570 investors in rental properties were tracked from the start of their first spell as rental investors through to the end of the data collection period (2006). The sample comprises adult individuals with complete records from waves one to six. Regression modelling techniques are employed to help us to unravel why landlords entered and exited investments and in particular the role of personal characteristics and financial variables. Different modelling approaches were used to test for statistically significant factors in choosing to invest in and realise private rental housing investments. Our approach involves constructing measures of variables that might motivate investment in rental housing and measures of variables that might prompt landlords to realise rental property investments. A variety of different model specifications and estimation methods (using ordered and non-ordered probit models) were used to identify the most important motives shaping investment decisions.

KEY FINDINGS

What factors shape the decision to become an investor in rental property?

Financial variables are generally statistically significant in determining whether a person becomes an investor in private rental property:

- The most important driver of rental investment behaviour is a person's after-tax economic costs (user costs of capital). This is in turn related to their income and tax bracket as well as the interest rates they face.
- Superannuation and rental housing are substitutes in wealth portfolios, but the substitution effect seems to be weak, so that growing superannuation balances are unlikely to threaten rental housing supply.
- Unsecured debt restrains plans to invest in rental housing as lending criteria become more difficult to meet, but again this variable has modest effects.

These results stress the importance of economic variables in driving the supply of private rental housing. This seems at odds with other research by Seelig et al. (2009) which asked private rental investors their motivations for investing and found that non-economic drivers such as personal or family circumstances were as important as financial incentives in investment decisions. On using a different modelling technique, involving a different theoretical model of tenure choice, this study also revealed that demographics, attitudes and saving behaviour matter in addition to the economic factors. Personal characteristics that were significant included their age (the typical investor is middle aged), whether they were retired and the continuity of their employment record.

What makes a landlord exit their investment?

- Retirement age appears to be an important factor prompting exits from the rental property market. It is not clear whether this is because retirement prompts a rebalancing of wealth portfolios toward more liquid assets, or is due to pension asset tests that motivate retirees to cash in assets captured by these tests.

- The other group more likely to realise property investments at any point in a spell of rental investment are younger, negatively geared investors, with relatively low levels of income and human capital. For example, the Figure shows that after one year, half of all negatively geared investors have exited their investment. By contrast, it takes four years before half of un-geared investors exit their investment.

We find that in general the personal characteristics and attitudes of investors do not influence decisions about when and whether to realise property investments. Retirement status is an important exception. However, financial variables do matter:

- The property's gross rental yield has a statistically significant negative effect; since properties with higher gross rental yields typically have lower expected rates of capital gain, some investors appear to realise their property investments if expected capital gains are low.
- An investor's after-tax economic cost of supplying rental housing is even more influential; its negative impact implies that higher after-tax economic costs eat into returns and persuade investors to exit the market.

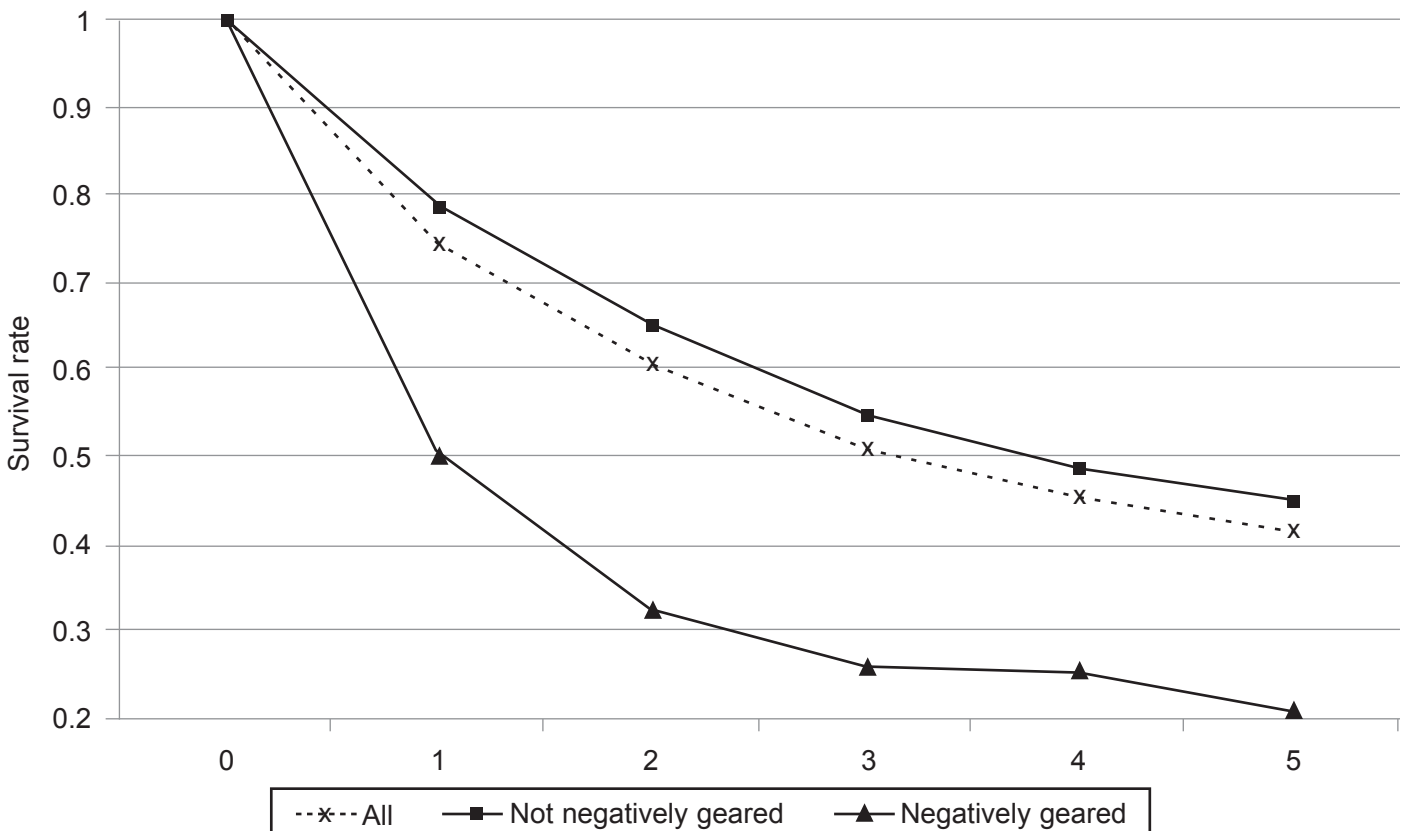
- Negatively geared investors are more likely to exit the market. These investors might be churning in and out of rental properties. There are mixed views on what this means for the functioning of rental markets. While churning can adversely impact on tenants because their housing circumstances become more precarious, it will make the supply of rental housing more responsive to changing market conditions with potential efficiency gains.

The rental market is polarised into secure and insecure accommodation

Of those rental landlords beginning their investment over the data collection period:

- One in four landlords exit within one year of investing in rental accommodation. For the tenant that places a high value on a secure residential address, there appears to be a worryingly high probability (25%) that they will need to search for alternative housing opportunities within 12 months.
- After year one there is a steep decline in the rate of exit from the rental property market. Hence, there appears to be a second group of investors

FIGURE: RATES OF SURVIVAL IN FIRST SPELL OF RENTAL INVESTMENT ACCORDING TO WHETHER THEY ARE NEGATIVELY GEARED OR NOT



that *stay the course*, and are a source of secure accommodation.

POLICY IMPLICATIONS

Changes to policy that impact on the after-tax economic costs of rental investments will have major effects on the propensity to invest and the willingness of landlords to remain in the market:

- Monetary policy will therefore have potentially significant impacts and hence strong cyclical patterns to rental investment can be expected. We might be witnessing this at present with a strong rebound in investor activity following a period of very low interest rates brought on by the Global Financial Crisis.
- Both federal and state governments set tax parameters that will determine landlord after-tax economic costs. Reforms to tax policy are likely to have large effects on rental supply regardless of whether they are motivated by housing market considerations.

Retirement status is evidently an important influence shaping decisions about the propensity to invest as well as the timing of (dis-)investments. Government policies that impact on retirement decisions might therefore influence these decisions:

- While the evidence is not conclusive, there is a suggestion in the findings that pension asset tests are prompting retired investors' realisation of rental property investments. The charting of portfolio decisions and changing spending patterns that older Australian landlords choose as they make transitions into retirement, would help us to uncover alternative explanations and establish their importance.

There does appear to be only a weak inverse relationship between superannuation and private rental investment decisions, so policy reforms affecting the attractiveness of superannuation as a vehicle for wealth accumulation may not impact private rental housing supply. However, this study timeframe is not contemporary enough to capture more recent policy changes that occurred in the 2007 financial year.

FURTHER INFORMATION

Seelig, T., Thompson, A., Burke, T., Pinnegar, S., McNelis, S. and Morris, A. (2009), *Understanding What Motivates Households to Become and Remain Investors in the Private Rental Market*, Final Report Series of the Australian Housing and Urban Research Institute, AHURI, Melbourne.

Yates, J, Wulff and Reynolds, M. (2005), *Changes in the supply of and need for low rent dwellings in the private rental market*, Final Report Series of the Australian Housing and Urban Research Institute, AHURI, Melbourne.

This bulletin is based on AHURI project 30521, *Movements in and out of housing affordability stress and dynamic modelling of initiatives to improve the supply of affordable housing*.

Reports from this project can be found on the AHURI website: www.ahuri.edu.au or contact the AHURI National Office on +61 3 9660 2300.

www.ahuri.edu.au



HEAD OFFICE Level 1, 114 Flinders Street Melbourne Victoria 3000 TELEPHONE +61 3 9660 2300
FACSIMILE +61 3 9663 5488 EMAIL information@ahuri.edu.au WEB www.ahuri.edu.au

ACKNOWLEDGMENTS This material was produced with funding from Australian Government and the Australian States and Territories. AHURI Ltd acknowledges the financial and other support it has received from the Australian, State and Territory Governments, without which this work would not have been possible.

DISCLAIMER The opinions in this publication reflect the results of a research study and do not necessarily reflect the views of AHURI Ltd, its Board or its funding organisations. No responsibility is accepted by AHURI Ltd, its Board or its funders for the accuracy or omission of any statement, opinion, advice or information in this publication.