



Final Report

Understanding what motivates households to become and remain investors in the private rental market

authored by

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EXECUTIVE SUMMARY

What motivates people to become rental investors? What factors drive or shape their investment behaviour, and how are their experiences and intentions as rental investors linked? This paper reports on a qualitative study of rental investors in Australia, which has sought to pursue these questions.

While our understanding of the private rental system in Australia has improved considerably over the last decade or so, most of the literature discussing investor motivations and landlord typologies dates back to, or is drawn from, data relating to the 1980s or early 1990s. Gaps in our knowledge and understanding of the providers of rental housing remain, and an up-to-date analysis of investors operating in contemporary rental housing markets is required.

Analysts typically view housing investment through the prism of orthodox economic theory about how markets operate. This leads to an assumption that the behaviour of rental investors is economically rational, and driven by financial considerations alone. However, as Diaz (1999) suggests, “The essence of property is human behaviour...Economic activity is human behaviour ...”. The present study was principally concerned with gaining new insights into the motivations, expectations and experiences of rental property investors in a more social behavioural sense, and in exploring the implications of those investment motivations and behaviours for the future of rental housing investment. The project sought to:

- explore the varying motivations, expectations and experiences of rental property investors, and consider how these might vary between investors
- assess how the motivations, expectations and experiences of rental property investors shape investor behaviour
- assess how investors perceive investing in the lower end of the rental market
- provide a better understanding of investors' experiences, motives and actions, as well as the perceptions of investors' behaviours among other key players in the rental sector.

Why become an investor?

This study suggests that there is a range of motivators for people to become investors, including financial factors, personal goals, and personal and family circumstances. In some cases, the motivations are strong and clear; in others they are much less so, being more speculative or exploratory.

For some investors, seeking financial gain through investing is about embarking on a clear plan of wealth creation, developing long-term financial security and building an asset base, and securing 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 in both cases: having accrued enough savings or equity (usually in their own home) over time, or having access to funds after the sale of property, led to a sense of the ‘need’ to invest.

For other investors, the motivation to invest appears to be less planned. In some cases, this is because the capacity to invest is linked to having unexpectedly come into assets or funds via inheritance, or changes in personal circumstances, such as re-partnering or geographic relocation.

What's the attraction of property over other areas of investment?

This study indicates that the binary of choosing to invest in property, rather than some other area of investment is, in practice, misleading: most of the property investors interviewed also invest in other areas, mainly shares. It's not an either/or decision for many people. However, shares are generally seen as being of a different (ie, lower) order and scale to property, and are treated accordingly. It also transpires that many investors have previously lost money in shares, and are not keen to repeat the experience. Regardless of whether they have owned shares or not, there are several reasons behind investors' choice to invest in property over other forms of investment.

The most crucial perception is that it represents a good (long-term) investment, with a sense of 'low risk' and 'guaranteed' return. Most investors have identified 'long-term investment' or 'capital gains' as the most important reason for having invested in property.

A related significant factor is that investors report feeling 'comfortable' with property: it is safe, stable, and familiar (particularly when compared with shares). Indeed, sentimentality and informality appear to be important, for property is widely regarded as something relatively easy to invest in (not mysterious or complex like some other investments), with the general impression that 'lots of people do it'.

Personal experience and intuition are reported as the dominant sources of information for investors in making property investment decisions. Accountants, estate agents and specialist advisors are much less commonly used (if at all). Investors also feel a sense of control with property: a tangible product; one that can be seen and visited, and potentially adapted or used in various ways. Overall, 'market conditions' – where in the property cycle people have invested, and what is happening in terms of property trends – are seen as being of some importance, but are often linked to the other factors mentioned above.

For many, market timing issues are countered by the greater significance of personal circumstances, and the capacity to invest. Indeed, it is important to acknowledge that financial motivation is only part of the overall story! There is also a mixture of other motivators for having entered the investment sector, including direct encouragement by family or others, such as estate agents or developers; observing the success of others (ranging from siblings, parents and children to accountants, friends and employers); and having read investment books or attended seminars associated with wealth creation specialists. Some simply have had 'the means and the opportunity', but little clearly developed strategy other than 'feeling good'.

Factors shaping where and what investors bought

This study suggests that location is an important consideration, but often only one of many factors which influence investment decisions. There are also competing priorities in terms of location. Overall, there is a desire for the property to be close to transport and services – factors considered attractive to tenants. Some see inner-city areas as best, offering guaranteed occupancies due to the demand for inner-city living, and also the certainty that property prices would always increase. However, this is not a universal preference. Some select other urban and regional areas, either through choice or because of the comparatively higher prices of inner-city property. There is also a desire to be close to the property for self-management or surveillance purposes, so the location of the investor's residence then dictates the location of the investment property. For others still, there are broader or longer-term considerations: the prospect of a future or present home for kids at university, or a holiday/retirement home, and familiarity and comfort with specific areas. In many of the latter cases, projected property value or rental income is not the primary consideration.

When it comes to individual property selection, investors are generally concerned with the physical features and condition of a dwelling, and its investment economics, but how they 'feel' about the place is also significant. Personal, intuitive and emotional factors are evident in the selection process, and many investors use their own preferences as a measure of quality, even though they are not going to be living in the property.

Investor expectations and experiences

This study illustrates how investors' motivations are linked to a degree with expectations, and that for some, they are also connected to past and present experiences as an investor. Investors view 'success' in different ways, but most commonly, capital gains over the longer term is what they expect, and this is how success or otherwise in property investment is assessed.

Investors generally accept that costs may well outweigh returns initially, and that positive returns are unlikely until a number of years down the track. In this context, for most participants, negative gearing is not a deliberate investment strategy, and has not been a crucial factor in their investment decisions. However, nearly all regard it as a 'welcome and generous tool' or 'added bonus'. There is also the 'succour of success': previous and current experience has kept investors in the property investment market. Nearly all who had been in the market for several years, and many of the more recent investors, have experienced what they regard as 'success' (mostly in terms of increasing property values).

New and seasoned investors alike report very high rates of satisfaction with various aspects of their property investment, including yield, capital gain, and property 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.

Investment attitudes over time

For some investors, time brings shifts in motivation and emphasis. In some cases, these are due to greater experience and increased level of knowledge, where the rationale and objectives of being a rental investor becomes more nuanced over time. For others, changes in personal circumstances and concerns, or financial or other objectives come to the fore. A common critical factor is age and proximity to retirement, or the formal planning for it.

Most investors see capital gains as more important than rental income over the short, medium and long term. Indeed, nearly all regard property as the 'best investment', and some said they would still invest in property, even if returns were clearly higher in other areas (eg, shares). However, they are split pretty evenly on whether they would have invested if negative gearing had not been available.

These sentiments then raise the question: Why sell? Some investors we spoke to had recently sold property/ies or are either considering or intending to sell in the immediate future. Others are not intending to sell in the near future, but have considered the factors or circumstances that might lead them to do so. The critical deciding factors varied, but age and personal circumstances appear to be the dominant considerations for all these groups. Market conditions proved less significant than might be expected.

Making sense of all this to comprehend investors and their decision-making

This study contributes to 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.

It would seem that the picture of the sophisticated, well-informed and economically rational investor does not well describe the norm among rental investors. A mix of 'bounded rationality' and 'emotional opportunism' is perhaps a better descriptor of how people approach the housing market as prospective rental investors.

Investors come in and out of the market all the time, driven by a mix or array of financial incentives, situational circumstances, market conditions, personal goals and other influences. They are not driven by economics alone, and so the capacity to shape their behaviour (and thus present investment patterns overall) on that basis is often limited. When the economics are paramount, investors usually have their eye on the long-term capital growth picture.

It would therefore appear that private rental investors are a difficult group when it comes to pinpointing opportunities for interventions, particularly financial ones, as economics is only part of the story. The very 'amateurism' of many investors can be problematic policy-wise, because investors are not easily susceptible to policy levers. But it can also be a positive, in that many such investors appear not to be as reactive to market fluctuations or poor short-term returns as more professional investors, when weighing up the attractions of rental housing as an investment proposition. We may have supply problems in today's rental sector, but how much worse would it be without investors who base decisions to invest in property on a number of personal, emotional and intuitive factors, as well as their own financial as well as broader economic considerations?

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. Investors are not driven by any sense of moral or social imperative to provide housing as a social service! Aversion to low-cost rental housing is not necessarily by design, but is more an effect of housing markets, investor economics, location choices, and possibly the broad availability of negative gearing without strings. Targeted tax incentives are thus clearly one option for directing more investment to the lower end of the market.

1 INTRODUCTION

1.1 Introduction to the Final Report

This Final Report is the concluding output of a research project examining the motivations, expectations and experiences of rental property investors, and analysing the implications of investment motivations and behaviours for the future of lower rent housing.

The earlier Positioning Paper provided the background to the study and how it was to be conducted. That paper (Seelig et al 2006) also positioned the study within specific housing policy, housing market, and housing research contexts, and explained the importance and significance of gaining a better understanding of private rental investors as a way of appreciating the processes of rental supply and management. The earlier Positioning Paper can be found at the AHURI website: www.ahuri.edu.au

This Final Report has been structured as follows: The remainder of this introductory chapter lays out a brief overview of the study, including the main ideas behind the research, the central research questions, and other considerations involved in conceptualising the study. Chapter 2 lays out the methodology for this study, including how the research was conducted, and the challenges encountered in conducting the research. Chapter 3 considers the policy and research background to the study, and summarises relevant housing policy, taxation and legal issues, and previous analyses of rental investors.

Chapters 4, 5, 6, and 7 report on the main findings of the study, examining the profile and characteristics of investors interviewed, the critical factors behind decisions to invest, the experiences of investors, and their intentions respectively. Chapter 8 concludes the report by summarising the overall behaviour of rental investors, and the policy implications of the findings.

1.2 Overview of the study

This has been a qualitative study of rental investors which aimed to gain a better understanding of investors' experiences, motives and actions, as well as the perceptions of investors' behaviours among other key players in the rental sector. Some data regarding types of investments and investor characteristics were also collected.

The study was principally concerned with the motivations, expectations and experiences of rental property investors, and the implications of those investment motivations and behaviours for the future of lower rent housing. The project aimed to:

- explore the motivations, expectations and experiences of rental property investors
- consider how these factors vary according to length and timing of investment, geography, cost segmentation, investor type and scale of holdings
- assess how the motivations, expectations and experiences of rental property investors shape investor behaviour
- explore the institutional context which generated the rapid growth in rental investment including the nature of new lending instruments
- examine the implications of investment motivations and behaviour for the future of lower rent housing and the stability of the private rental sector.

Traditional analysis of rental investors in Australia has stressed the significance of the small-scale, sometimes shorter-term landlord, who owns one or two properties. Their main reasons for investing are connected to anticipated capital gains rather than rental income, and they are attracted by the capacity to negatively gear rental losses to reduce income tax. This study offered an important opportunity to test some of these impressions in a contemporary context. At the same time, previous research on rental investment has tended to use economics as the main explanatory framework with its emphasis on the main demand and supply drivers and the changes therein over time. This analysis, however, tends to downplay the actual decision-making behaviour of investors so the focus of this research has been on such behaviour. The literature that informed this behavioral view was discussed in the positioning paper.

Given the potential risk, uncertainty and illiquidity of residential property investment, and the lack of objective market information about rental markets (Seelig et al 2006), understanding the motivations of residential property investors is both an interesting and a challenging task. Existing investment theory with its emphasis on informed and self-regulating markets does not provide us with an adequate framework to analyse investor behaviour and rental markets and, as this study suggests, it is important that we are not limited by pre-conceived assumptions about how rental markets work, nor by how rental investors ought to behave, according to standard investment models. While this study was undertaken before the financial collapse of 2008, the latter vividly illustrated to the world the limitation of existing investment theory and the need to have a better understanding of what drives the behaviours of investors.

The main part of the study, which involved interviewing rental investors, property managers and other relevant stakeholders, has therefore been guided by consideration of the decision-making elements, constraints, and likely behavioural responses that might be observed among rental investors.

The study also represented exploratory research, which sought to test a range of methodologies designed to ascertain the views of investors and other key agents at the rental sector coalface.

It was hoped that the findings from this study would provide rich material on the rationale, motivations and experiences of private rental investors, across factors such as time, investor type, and geography. It was also hoped that the findings might enable governments and others to have a clearer understanding of current and potential investment in the rental sector, and inform discussion on policy interventions that would preserve existing investments and encourage an increase in the supply of lower priced rental property.

1.3 Original research questions and themes

This study was conceived around four broad topics, as follows:

1.3.1 *Investor motivations*

- What motivations do investors identify as key factors in their investment decisions, and do these motivations change over time?
- How do investment motivations vary according to discrete groups or types of investors and their scale of investment holdings?
- What role does location play in motivating rental investment within metropolitan areas and between metropolitan and regional areas? Do the motivations of investors vary according to different types of housing markets?

- Do particular groups or types of investors focus on specific cost segments of the market? Do any target their investments towards the lower cost end of the market? What are their main reasons for doing so or not doing so?
- Are there critical differences between post-2000 investors, and those who invested in earlier periods, including but not limited to those who have been investors for a longer period of time?
- Has the post-2000 boom in rental investment involved existing investors expanding their property portfolios, and/or has it attracted groups or individuals new to property investment? If the latter, what motivated them to choose to invest in residential property?
- What role do government incentives (eg, tax concessions and negative gearing) play in motivating investors to purchase properties for rental purposes compared to other potential factors?

1.3.2 Investor expectations and experiences

- What expectations do property investors have of rental returns, capital gains and other benefits? Do investors believe such expectations have been met, and how have they changed over time? Have expectations influenced their future investment intentions?
- What expectations do rental investors have of the costs associated with tenancy management? To what extent do investors use professional managers versus more informal management arrangements? What experiences have investors had of tenancy management in terms of professional property managers and tenants? Have these experiences influenced their future investment intentions?
- What sorts of legal and financial instruments have investors used to enter the rental market? What were their experiences of lending institutions and sales agents?

1.3.3 Investor behaviour

- How can we understand the behaviour of rental investors with reference to investment motivations, and to what extent is their behaviour influenced by initial expectations and ongoing perceptions and experiences?
- How do investors select the area and type of housing they invest in?
- What drives investment into or out of specific segments of the rental market?
- How has investor behaviour been impacted on by recent property cycles? How have these impacts varied across different types or groups of investors, cost segments and housing market location?

1.3.4 Institutional context

- What changes in the institutional environment helped to create the upsurge in private rental investment?
- What new lending products were created and how did these products work?
- What was the role of investment brokers and spruikers in shaping attitudes to residential investment?

2 OVERVIEW OF HOW THE STUDY WAS CONDUCTED

This chapter provides a summary of the planned approaches and eventual conduct of the study, particularly in terms of how the primary research interviews with investors, and estate agents were conceived and undertaken, and the challenges and issues which emerged.

2.1 Research design

2.1.1 Methodology

The original brief for this project required the study to be qualitative in nature and accordingly, the research was designed around qualitative approaches. Following a detailed critical review of previous rental investor research – reported in the project's Positioning Paper (Seelig et al 2006), – the main phases of primary research for this study were agreed as follows:

1. Semi-structured interviews with key informants in the rental industry, including representatives from the Real Estate Institutes and Property Owners' Associations in Queensland, Victoria, NSW, Tasmania and Western Australia.
2. A series of semi-structured interviews with leading rental property managers in a number of metropolitan and/or a regional area in the study states.
3. In-depth face-to-face or telephone-based interviews (30-40 in most cases, but in Tasmania and WA, only 20) with individual rental investors, selected to represent a broad cross-section of rental property owners in the study states.

At the very start of the project, it was acknowledged that a number of methodological challenges associated with attempting to conduct primary research with individual investors, would most likely present themselves. The main anticipated difficulties concerned the recruitment and active participation of investors: they are not easily identifiable in the general population, and may also not be attracted to participating in academic research, especially in a market downturn.

Early on in the study, the senior researchers met to discuss options for creative and experimental approaches to securing the direct involvement of investors. While various approaches were identified, as outlined in the Positioning Paper, it was agreed that the preferred approach would be to use referrals from estate agents and Property Owners' Associations interviewed as a means of facilitating access to investors. Thus, following their own interview, agents and landlords' organisations would be asked to assist the study by making contact, via individual letter, email or newsletter, to a sample of investors.

Sampling of estate agents was to be conducted iteratively, through a process of identifying key players in the study areas who would be willing to participate in the study. Although slightly different approaches would be required in individual states, the broad process would involve consultation with the respective Real Estate Institutes to identify the larger managing agencies (in terms of rent rolls and experience), along with contact with the head offices of larger real estate franchises and others. In selecting suitable agencies, consideration was also to be given to where lower cost housing might be located, although one of the challenges in this regard is the fact that the investors in lower cost rental housing may or may not be located in the same geographic area as the dwelling. Another related challenge was that lower cost rental housing might not be managed by estate agents, being self-managed instead.

This approach was chosen as it overcame problems with maintaining consistency in approach which existed with other options, such as use of residential databases, which, because of privacy law constraints, could only have been used in some states but not others. Clearly, there was considerable risk that the recruitment of investors might turn out to be a 'hit-and-miss' affair in terms of whether an appropriate mix of investors could be secured for the study.

It should be noted that during the course of the research, the geographic scope of the study was reduced. The Tasmanian leg of the research was not able to be pursued due to research staffing issues. In WA, only a small number of interviews were able to be scheduled, and these proved unproductive in terms of follow-on investor recruitment. In the end, it was agreed that both the Tasmanian and Western Australian components of the study be excluded, leaving the research focused on Queensland, NSW and Victoria.

2.1.2 Development of research interview/survey questions

A separate series of questions for estate agents, investors and other key informants were developed early on in the study, and tested against the issues raised in research for the study Positioning Paper. It was decided that agents and other key informants would be asked a series of semi-structured questions in an interview format, while investors would also be asked to complete some additional questions laid out in a more quantitative-style survey format. This was done in relation to questions where answers are more predictable, and/or more amenable to rapid data entry and analysis prior to interview.

The questions were designed to allow for either face-to-face or telephone interviews, and both the questions and survey instrument were tested in the field prior to full use, but remained unchanged from their earlier format. The Investor interview and related survey questions are provided in Appendix 1, while the interview questions for estate agents and other key informants are in Appendix 2.

2.2 Estate agent and other key informant involvement

2.2.1 Estate agent recruitment and interviews

A broad range of real estate agents involved in both the property managing and the investment property sales areas were successfully recruited and interviewed for this study. In Queensland, NSW and Victoria, targets of up to ten agency interviews were eventually met. A process in each state was initiated to identify who the larger property management rent roll agencies were (both large franchise and independent), and where suitable locations of interest lay and, once this was followed up, relatively little difficulty was encountered in gaining access to those invited to participate.

In the end, a selection of areas was targeted in an attempt at capturing not only geographic variation, but also submarkets based around cost, dwelling type and renter demographics. These included inner-city locations, representing both traditional rental residential and new-built/apartment development areas in Brisbane, Sydney and Melbourne, middle or outer suburbs including outer southwestern areas and Ipswich in Queensland, western Sydney, and Greater Dandenong in Victoria, and regional centres, Toowoomba, Bendigo and Coffs Harbour. It was also recognised that this spread would allow for a variety of managing approaches and perspectives to be included. Wherever possible the agency principal was interviewed because this guaranteed insights across both investment sales and tenancy (including landlord!) management, although senior property manager staff also proved to be good sources.

All the agent interviews were conducted face-face. The agents were generally helpful, candid and informative, and the semi-structured interview questions facilitated discussions about the motivations and experiences of investors. Enlightening material pertaining to the kinds of issues and pressures estate agents themselves face in working with investors, through sales and property management, was obtained through the interviews.

In the end, however, the investors themselves produced such a wealth of insights into their own thinking, much of it backed up by the views of the agents, that their views rendered a large part of the agent interviews as useful supporting material which was not required as a primary source. This report thus focuses mostly on the first-hand accounts of investors, supplemented in places with the perspectives of estate agents.

2.2.2 Other Key Informant recruitment and interviews¹

In addition to speaking with individual estate agents, interviews were successfully undertaken with their peak bodies (the Real Estate Institutes) of the three study states, and with the Property Owners' Associations in Queensland and NSW. The entire key informant interviews were conducted face-face.

Again, these key informant interviews were generally very helpful in gaining insights into how rental property investment representative groups view the motivations and experiences of investors, although they were mostly reiterated by investors themselves in subsequent stages of the research. The Property Owners' Association in Queensland also provided assistance with directly recruiting individual investors through its membership newsletters and other contacts, and a small number of investors were eventually recruited this way. Similar attempts were made in NSW, but were not successful.

2.3 Individual investors

2.3.1 Investor recruitment and interviews

The most important, but also the most problematic part (as anticipated) of this study concerned the recruiting and interviewing of individual rental investors. Success in this regard varied significantly by study state. The main issue arising from the approach used (referrals and 'snow-balling') was the amount of time taken to secure participants, and the overall delay in arriving at target numbers.

In Queensland, a total of 40 investors were interviewed, with the bulk of respondents coming from Brisbane and Ipswich, and a smaller number recruited from Toowoomba. The Queensland component also connected with several investors who resided outside of the state, but who had investment properties in Brisbane. The investors interviewed were recruited through a mixture of direct referral from managing estate agents (the initial strategy, which proved to be useful but very slow) and through invitations to participate which were included in electronic newsletters from two large agencies, and also the Property Owners' Association. The majority of interviews were conducted face-face, but a number were done over the phone, either to suit the availability of the investor, or because of locational considerations.

In NSW and Victoria, however, significant problems were encountered in timely recruitment, and target numbers were not reached. This was despite considerable effort to pursue investors as originally planned, and subsequently through several

¹ It was originally envisaged that representatives of property investment finance lenders and residential finance journalists from key business and investment media would be interviewed. This proved to be unnecessary given the wealth of information provided by key informants, estate agents and investors themselves.

other attempts to secure interviews with investors. As with the approach in Queensland, the primary route used to reach individual investors was through seeking the assistance of estate agents. This did not yield sufficient participation, and in response, in NSW for example, articles about the research were published in various local and regional newspapers. In addition there was a special mail out to investors in Sydney through a residential investment company. Similar efforts were investigated in Victoria, but eventually it was agreed by the research team as a whole that ongoing recruitment efforts might prove unproductive. It was also acknowledged that while much smaller numbers of investors than originally intended had participated, the material gathered nevertheless was rich and represented a wealth of insights about issues relevant to the study.

2.3.2 Selection bias

Given that this study was qualitative in design, true representativeness of investor participants was not a central concern of the study, although it was anticipated that investors selected 'randomly' through managing agencies and other sources would represent a spread of investor types. It was agreed that some sense of matching profiles between this study and previous research would be desirable to allow for some generalisation of findings. In practice, it was not possible to control for some level of selection bias at the agent level, nor at the point of self selection in terms of those investors who decided to participate.

2.4 Thematic analysis and interpretation of interview materials

The investor and agent research interviews generated an enormous amount of materials, which had to be transcribed, thematically organised, and then analysed and interpreted. In total, the research produced some 30 key informant interviews, and just over eighty investor interviews. A Brisbane-based professional transcription service was used to transcribe the interviews. These were then coded and analysed thematically using NVivo (a qualitative research tool program). Survey responses, meanwhile, were initially entered and analysed quantitatively in SPSS, and links were made between interviews and survey-based responses, to allow for finer-grained analysis.

These processes were followed by an in-depth analysis of the thematically organised responses by senior team members. This involved grouping issues and responses around particular components of the research, and generating common themes and other frameworks for the eventual synthesis of materials into findings.

One of the challenges concerns the sheer volume of interview material which has been generated, and how best to summarise and present the varying views of the many participants in the study. Inevitably, it was impossible to capture all of the individual stories, perspectives, and experiences in one report.

In practice, it has been feasible to articulate a series of more common pictures and patterns of investment behaviour because, despite the volume of material generated through the study, a number of consistencies and harmony emerged from the investors themselves. Nevertheless, it is acknowledged that some of the more unusual personal accounts were subsumed by a desire to construct the more common and dominant issues.

On a related issue, various expressions are used in this report to capture aspects of the commonality or otherwise of the views of investors on a range of matters. As a qualitative study, it was deemed inappropriate to default to specific percentages or fractions. As an alternative, the terminology adopted here refers to 'all' or 'almost all' in

the rare cases of a universal or near universal position; 'most' or 'many' to indicate a significant commonality; 'some' where there were several people, but fewer than 'many'; and 'one' or 'very few', when a very small number or one were involved.

It was also originally envisaged that a more geographical level of analysis would be applied to the analysis. However, this aspect became superfluous following data analysis, as the level of variation between locational submarkets turned out to be much lower than anticipated. Accordingly, geographically-disaggregated materials have not been included in this report, although more localised analyses arising from the materials gathered during the course of this study may be reported elsewhere at a later stage.

3 RESEARCH AND POLICY CONTEXT FOR THE STUDY

The private rental sector has always been an important part of the Australian housing system, but as Beer (1999: 255) suggests, it has “often been considered the ‘lost child’ of ... Australian housing studies”. Our understanding of the private rental system has certainly improved through research of the last decade (Yates 1996; Beer 1999; Berry 2000, Wulff Yates and Burke 2001; Yates et al 2004), and a number of AHURI studies have helped to begin to fill important gaps in our knowledge of the rental housing system and of housing market dynamics.

This chapter seeks to provide a précis of the main policy and research issues that concern private rental housing and investment in this sector, drawing on the more detailed analysis included in the Positioning Paper (Seelig et al 2006). The aim is to provide some context to the findings of the study, based on the direct interviews with investors (supported by those with estate agents), which are presented in Chapter 4 onwards.

3.1 The market environment

How the broader housing market is performing, and the signals that it appears to give out, does not escape the attention of investors even if, as discussed later in this report, the actual level of influence is less than might be expected. More importantly, how property values move over time has a big influence on the capacity of rental investors to realise capital gains and to make a profit from sales of property, both in terms of the properties they buy for investment purposes, but critically also in relation to their own homes, where acquired paper-based wealth is important for prospective new investors or those seeking to expand. Market conditions also impact on overall levels of supply and demand in the private rental sector, which can also have a direct impact on individual investors in terms of rent trends, and the capacity to make certain recurrent rates of return. Finally, events in the non-market sector – growth, decline or stagnation in social housing – may also have some bearing on demand at the low income end of the scale.

As it turned out, this study took place at an interesting point in housing market activity, and developments directly prior to, during, and since the research interviews have provided important context-setting considerations. The period leading up to the mid-2000s, when the study was commencing, was a time when Australia had experienced a significant boom in housing market activity, particularly in terms of major increases in real house prices, the volume and value of housing loans, and relatively high levels of dwelling construction. Investment in private rental property made up an important component of the boom.

This boom, which was broadly consistent in most major capital cities, peaked in mid-late 2004 and, on some indicators, subsequently stabilised for a period of time. The end of the boom created some initial uncertainty as to the future direction of the property market, with the potential for this to flow onto the decision-making of investors. However, by the time of the estate agent and investor interviews for this study (roughly mid-2006 to mid-2007), there were signs of further rising activity in some locations.

The impacts of these phenomena have been since felt via an overall drop in the availability of rental housing vis-a-vis demand, although up until the end of 2007 there continued to be quite strong volumes of lending finance for investment properties suggesting that the supply of rental housing had not so much collapsed as merely

slowed down. The slowdown resulted in the rental market no longer being balanced with demand exceeding supply in many areas. The resultant rising rents and declining affordability for tenants has of course meant increased rental income for investors, although, as will be discussed later in the report, in many cases this is not a crucial factor in making investment decisions.

The broad trend in investment lending in NSW has been down, although there were short spikes in mid-2006 and mid-2007. In Queensland and Victoria, meanwhile, after falling somewhat in the mid-2000s, lending finance rose dramatically during 2007, with levels significantly higher than previous peaks. The only area of housing market activity that has clearly not recovered well since the 2003/04 boom has been in housing construction. NSW has experienced a major collapse in building, while Queensland and Victoria, although they experienced a slump, have both recovered and by late 2007 were at boom construction levels.

Longer term impacts of these trends on the rates of return to investors, and effects on industry stability remain yet to be assessed. However, it is worth noting that in Brisbane and Melbourne, house prices have trended strongly upwards since the mid-2000s, suggesting that capital gains continue to be made in practice, and fuel expectations of such for current owners and investors alike. Sydney is the only capital city to have experienced sustained and meaningful declines in house prices during this time.

Although this is evidenced by much of the housing market and rental investment activity data that has since been collected (see Appendix 3), it was instructive to note that the sense of potential increased opportunity and rebounding (albeit mild) optimism in the rental investment and broader housing market was not completely obvious from many of the estate agents who were interviewed for this study.

Although agents in Queensland remained confident about investment trends and the prospects for housing (and their own businesses), their southern counterparts in Victoria, and especially in NSW, were much more pessimistic in terms of whether the period of 2004–2006 had been a good time to buy investment properties, and whether they expected to see a change (positive) in housing market activity in their respective states. On a number of occasions, agents in NSW and some in Victoria identified Queensland as not only running on a different type of market cycle, but also believed this had dragged local investors and property investment funds up north into Queensland. Some agents in NSW clearly understood that mid-late 2006 might actually prove to be a good time to buy investment properties on the basis that the market had ‘bottomed out’, and rents might be on the rise, but there was a sense that the market was unlikely at that point to shift dramatically in a way that might stimulate a significant resurgence of new or expanded investment in the rental market.² Meanwhile, a number of the agents in Victoria believed that many investors, especially those who were recent purchasers, would be disappointed with their investments, mostly on the basis of annualised yield.³

Appendix 3 to this report provides a small selection of housing market and rental investment activity indicators to illustrate what has taken place in the housing sector during the time of this study, and subsequently (up to the time of writing in early 2008).

² Of course, these sorts of analyses emphasise the factors that might impact on the most economically-driven (and professional) of property investors, but as subsequent chapters in this report suggest, this does not capture many of the householders who become investors in the rental market.

³ Again, subsequent chapters in this report suggest that this over simplifies how investors regard success.

3.2 Housing policies and interventions

3.2.1 Broad policy considerations

The first feature that requires highlighting concerns the significance of the private rental sector within the broader Australian housing system. Although it declined substantially during the immediate post-1945 era, private rental has always been a key tenure in Australia, and never took on the marginal status that the private rental sector did in much of Europe, particularly the UK. Indeed, the private rental sector has remained above 20 per cent of all housing stock in the post-war years (Yates 1996, Beer 1999, Berry 2000). For much of this period it was both a tenure of transition – a holding point for households waiting to move into ownership – and a tenure of last resort, housing the poor who could not get into the public housing sector (Jones 1973; Yates 1996;). Over the last two decades it has also become a long-term tenure for households unable or unwilling to access home ownership.

Today, the private rental market is a critical part of the Australian housing system. It is where the bulk of non-aged low to moderate income households reside, and is the largest single (and majority) source of households entering public housing. Its nature and role has changed over time, and a more complex array of 'housing pathways' (Clapham 2002) are now evident, involving transitions into and out of private rental housing, with significant proportions of tenants renting for extended periods. An increasing proportion of renters in the private rental market now see renting as their only option (Seelig 2007a).

Federal and state housing policy in Australia rely heavily on many low-income households being able to access affordable rental housing in the private sector. This policy direction is being driven by a number of factors, including funding constraints for social housing, and also by assumptions about the capacity of the private rental sector. The private rental sector has become especially significant in view of the virtual halt in the expansion of social housing provision. The supply of housing at rents affordable for people on low incomes receiving Commonwealth Rent Assistance (CRA) is critical to reducing what might otherwise be higher demand for social housing. However, while the supply of rental stock per se appears quite healthy, there is evidence of widespread market failure in the private rental sector, particularly around the supply of lower cost housing (Wulff et al 2001; Yates et al 2004; Morris et al 2005).

3.2.2 Taxes and charges

Commonwealth investment taxation measures

There are three elements of taxation that impact directly on the rental investment environment: the ability to claim losses, including interest on mortgage payments against income (negative gearing); capital gains tax; and depreciation on construction and improvements to a property. It should be noted that the two key income tax benefits, namely the concessional treatment of capital gains and negative gearing that are available to rental housing investors are not housing investment specific. They are also available, to varying degrees, to investors in equities and other forms of property.

The general income tax concessions provide an opportunity for investors in rental property to 'reduce tax', albeit in a way that may distort investment allocation and relativities. Whether such access to the available tax benefits is a significant motivating factor for an individual to invest in rental residential property becomes an issue that has important policy implications for the provision of an adequate and affordable supply of housing.

State and local investment taxation measures

Several state transaction and land ownership taxes or charges apply to investment properties. In some cases, these are standardised costs that apply to all residential housing, such as property transfer duty/tax (formally known as 'stamp duty') and mortgage contract duty; in others they apply more to investment properties by virtue of exemptions to 'principal places of residence', namely owner-occupied housing. The main example here is Land Tax.

There are also local taxes and charges – such as council rates and body corporate fees – which apply to all residential property, but may not include discounts available to owner-occupies.

3.2.3 Residential Tenancy Legislation

The states and territories are responsible for regulating landlord (investor) and tenant (occupant) relations and, in most cases these are prescribed under 'Residential Tenancies Acts'. Australian residential tenancy law has invariably sought to 'balance the interests of tenants and landlords' rather than to provide strong rental consumer protection (Kennedy et al 1995; Seelig 1996). Tenancy protection in Australia today is based on principles of basic health-related housing standards, minimum notice periods for 'no cause' eviction, and limits on the frequency of rent increases (Kennedy et al 1995). In general, Australian tenancy legislation does not regulate the value of rent levels (as it does in many of the largest US cities experiencing housing stress) nor rent increases. It also does not provide security of tenure to periodic tenants. Arguments about broader legal protections have been limited, and arguably contemporary residential tenancy law is still weighted in the landlord's favour.

Research into the nexus between tenancy law and investment in the private rental market suggests that overall investment in the private rental sector is not necessarily affected by tenancy legislation (Paris et al 1991; Kennedy et al 1995). The vast majority of investors do not consider tenants' rights as something that impacts on their investment, because in the main, the scope and extent of legislation is such that landlords' economic interests are not affected (Seelig 2007b). Despite this, there is a heavy reliance on tenancy law to provide equity in landlord-tenant relations in Australia (Seelig 1997; 2001).

3.3 Previous analyses of investors

Despite renewed interest in the private rental investors elsewhere (see for example, CMHC 1999; Rhodes and Bevan 2003; Saville-Smith and Fraser 2004), much of the Australian literature discussing investor motivations and landlord typologies dates back to the 1980s and early 1990s. This research project provides an opportunity to conduct a contemporary analysis of the motivations, intentions and behaviours of rental investors, and to consider the implications for the future supply and management of private rental housing.

Allen and McDowell (1989: 45) have argued that: "Knowing what kinds of landlords there are in the market and how they are likely to act is a necessary prerequisite to an understanding of what is happening to the private rented housing market". There has been increasing interest in private rental market issues from the mid-1990s onwards. Research by Berry, Beer, Yates and Wulff, and others have documented changes in supply, demand and prices in the private rental market. The Australian Bureau of Statistics has conducted two specific surveys of rental investors (ABS 1994 8711.0; ABS 1998a 8711.0), each being part of wider population surveys. Other past research which has discussed investor motivations or characteristics includes work by Allen and McDowell (1989), Kleinman, and Whitehead in Britain (1988), and Core

Consultants (1983), Paris (1984, 1985), the NSW Department of Housing (1990), Brian Elton and Associates (1991), Mowbray (1996), and Seelig (2001) in Australia.

The Positioning Paper (Seelig et al 2006) provides an in-depth analysis of much of this past research, and how it has improved awareness of some of the reasons why people invest in rental property, as well as and how such investors may be classified. Overall, the corpus of previous research in Australia has tended to emphasise that investors are:

- small-scale, with many investors owning just one property, and most no more than two
- household-based, in the sense of being 'mum-and-dad' investors rather than being larger institutions and companies
- 'amateur' rather than professional investors, reliant on employment derived earnings as the principal source of income, and not the income stream from their investment properties
- those who might generally be regarded as having both the financial means and the investment opportunities to invest in rental properties, namely people who are by-and-large middle aged, middle income⁴, couples, who are home owners (either outright or mortgagors)
- seeking in the main long-term gains from property investment, although there are some investor types who are more dependent on or seeking greater returns from rental income.

Seelig (2001) had previously identified that, by contrast, 'low-cost investors', those who own investment properties at the bottom end of the rental scale, tended to be older, with lower incomes, being more reliant on rental income as a principal form of earning, and also much more likely to be seeking to exit the rental sector.

More recent research for AHURI has suggested shifts in the supply of low cost and other rental housing, but has not sought to provide a detailed explanation of why such changes in supply might be occurring. In the context of the recent housing boom and surges in mortgage lending for residential property investment, understanding investment behaviour is crucial to estimating future supply trends, particularly at the lower cost end of the sector.

Despite the above research, it is widely recognised that our knowledge of the rental housing system remains limited, and that more research is needed to inform policy and understanding (Berry 1998:14). One such research and knowledge gap relates to the motivations, expectations and experiences of rental property investors, and how these impact on investment in the supply of rental housing generally, and lower rent housing in particular.

3.4 Research into investment behaviours

Academic studies of investment behaviour pay very little attention to property investment and, in some cases, provide no mention of it at all (Sharpe, Alexander and Bailey 2001; Bodie et al 2002). The specialist academic publications which are focused on property investment are largely concerned with property market outcomes, including price movements and differentials, and coming up with better trend forecasting models, commonly based on rational market behaviour. This usually sees

⁴ In 1997 (ABS 1998b 8711.030.001), it was found that 70 per cent of investors nationally earned more than \$44,876 per annum (nominal dollars).

decisions as a set of logical sequential stages, based heavily on financial motivations alone, and access to necessary information to allow for objective analysis.

In market theory, perfect information is a key assumption yet information provision for residential housing is quite poor. Moreover, many residential property investors may be conditioned by social norms and values, for example “bricks and mortar is the best investment”, herding behaviour (the fashion of following the crowd), market sentiment, or cognitive constraints, simply because of the complexity and diversity of housing markets. Bounded rationality theory seeks to accommodate these issues, by recognising that there are practical limitations and real world variations to the idealised market. Bounded rationality does not mean that residential property investors do not follow some broad decision-making process as outlined above, but that the specific decisions at each stage require a more intuitive and perhaps simpler process than might be predicted by the utility maximising formal models of the economist’s ideal world

The dearth of academic texts on property investment is in sharp contrast to the vast range of ‘how to get rich’ popular, non-academic books and resources. These vary greatly in their level of sophistication and detail, but all essentially carry the common message that residential property is the best investment, and many gloss over problems in the sector.

However, there is an emerging literature on behavioural economics, including a small but developing branch into ‘behavioural property research’ (Diaz 1999). This area holds much promise in the context of seeking to understand the behaviour of investors via an inductive approach, rather than an economically-based deductive one. The present study has not sought to apply pre-conceived assumptions about how rental markets work, nor by how rental investors ought to behave according to standard investment models. Rather, this study has aimed to understand and interpret behavioural responses according to how investors themselves have described their decision-making processes and key issues and considerations.

3.5 Summary of policy and research contexts

While the private rental sector is important in housing policy terms, there is little in the way of direct formal housing policy, other than through housing assistance to tenants (CRA). However, rental investment is clearly impacted by other, more ‘housing-related’ (Paris 1993) economic policy, such as taxation, property and planning laws, and the provision of finance. Taxation in particular is traditionally seen as having a major impact on investors, both in terms of being a key driver for investment, and also as an influence on investment outcomes. At the same time, changes to the regulation of the financial sector, and the expansion in lending products has made it easier than ever to secure funds for rental investment.

In summary, it could be fairly said that the institutional environment for rental housing investment is a very positive one in the sense that there are few legal or policy barriers for investors, particularly household-based investors. Over the last few years, Australia has seen a significant boom in such investment, particularly in the inner urban areas of the capital cities, driven seemingly by both increased demand for rental housing, but also high demand for rental investment opportunities.

While it is thus somewhat of a cliché to claim that the private rental market is under-researched and little understood, “the tenure still exudes a somewhat neglected air” (Berry 2000: 661), and some aspects do remain relatively neglected. One of these areas concerns the people who invest in residential property and thus own the rental housing – the landlords – and, in particular, why they invest in property, what their

experiences have been, and how this affects their investment behaviour. Hence this study!

4 THE MOTIVATIONS FOR RENTAL INVESTMENT

Chapter 4 commences the process of reporting on the main findings of this research. The focus here is on the motivations for initial investment. Chapter 5 considers the expectations of investors, while Chapter 6 looks at their experiences. Chapter 7 analyses the future investment intentions of rental investors.

4.1 Overview of chapter

The analysis in this chapter commences with the findings relating to the original motivations among private rental investors. Issues discussed include what attracted them to invest in the first place in property generally and more specifically the dwellings they have purchased, but this chapter also tries to identify the circumstances in which, and processes through which, people become rental investors. However, before examining these issues, it begins with a synopsis of the participants in the present study.

4.2 Characteristics of investors in the study

In many ways, the participants in the present study appear to be fairly typical of investors from past studies. The 'traditional' profile of household-based investors in most areas has been repeated here, a statement supported both by the profiles of participants in the study, but also in the view of large-scale managing agencies, who suggested that the recent housing booms had not changed the nature of investors.

Accordingly, the investors in this study were mostly either 'mum-and-dad' investors (one half were couples with children at/away from home) or couples (another quarter), middle-aged (half were between 35 and 54 years old) middle income, wage-earning workers (ie, 'amateur investors'), and owner-occupiers. The vast majority were Australian born, with one in ten from the UK. A third of investors were 'sole investors'; and a further half were 'joint investors' with their spouse/partner. One in ten used a company (trust or business) as an ownership vehicle.

There were also some points of (minor) variation from previous analyses. Investors here were still relatively small-scale, although the average size of property holdings was slightly larger.⁵ As this study was qualitative in design, it is impossible to know whether this outcome is an artefact of selection and recruitment processes, or whether it may be indicative of a shift to a growth in average number of investment properties owned in the wider sector. However, the interviews with large-scale property managing agencies supported a view that there has been an increase in average holdings, with erstwhile single property owning investors increasingly acquiring a second property, double property owners acquiring a third, and so on. Some agents also reported a sense that younger professionals on higher salaries were increasingly getting into property investment.

Investors in the study were also of higher average incomes⁶ than might have been anticipated from the earlier analyses indicated in Chapter 3 of this report. Again, this suggests that wider changes have taken place in the profile of investors, which would need to be tested more quantitatively in subsequent research. Again, some of the agents reported that there were some signs of younger professionals on high salaries getting into rental investment, which may explain this outcome.

⁵ About one-third owned just one property; a further quarter owned two. The next category only asked about a range (3-5 properties), and a further quarter fell into this category. However, from other responses, it appears that most in this 3-5 properties range tended to own 3.

⁶ The average household income for investors here was in the range of \$75,000-\$99,999.

The range of years when people first became investors spanned almost forty years, with the earliest investor becoming so in 1968, and the most recent in 2005. However, just over half of all investors had only become an investor since 1999, and this was also when most investors had started acquiring their most recent property. Most investors expected to be investing over the medium to long-term (for more than five years). This issue will be revisited in Chapter 7 in the context of investment intentions.

4.3 Why invest in property?

4.3.1 Motivators for property investing decisions

Rental investors were asked about the reasons for having invested in rental property. The main drivers concerned financial factors, market conditions, and personal goals, and family circumstances.

Investors identified a number of financial incentives that had underscored their decision to invest in property. For some, this was about embarking on a plan of wealth creation, developing long-term financial security and building an asset base through capital gains or rental return, and securing future retirement income. For others, the decision to invest in property was connected to the need to diversify investments, to spread financial risks, to establish an alternative to superannuation, and to build a balanced portfolio. Proximity to retirement emerged as a critical factor about why to invest, why to retain or dispose of property, and also senses of how well property investments had performed. For example, investors approaching retirement consider investments with the aim of financing their retirement, while investors in their retirement are motivated to be self-funding retirees and not dependent on a government pension. Investors who do not have access to superannuation benefits think in terms of investing in lieu of superannuation.

I've now retired, I have a pension fund that I've got most of my own funds in and I just felt that a property within that pension fund ... to get a balanced portfolio of my investments to try and protect my security in the future that a rental property to get capital gain, as well as a rental income, was the way to go. (Vic investor 4)

And for us it was the case of having a superannuation policy. My wife and I have spent time ... working overseas ... we do not have sizeable superannuation, and this is a way of being able to get ourselves quite a lot of money over a short space of time, although I'm now 52 so I'm looking for another 13 years. ... so we're over a twenty-year period looking at quite a large increase in the prices of property to give us some money when we retire. (NSW investor 10)

It's basically a pension... I don't believe there'll be any pensions around. That's why I invested, so I can support myself. (NSW investor 11)

I purchased them for a consideration of a net asset for me. I was thinking ahead to retirement income and just as a way to build my asset base. (NSW investor 15)

... we're in the age group where working jobs we had limited superannuation. So, we got to a stage, about five or six years ago, where between us, we had a little bit of money – enough to put a deposit down on a unit between us. Our idea is this will be our super. (NSW investor 9)

For a small group, there was an imperative around implementing a tax minimisation strategy.

We had 100 per cent equity in this house. We were both on good incomes. I got a whopping superannuation tax bill one year and we thought, you know, ... we've got to do something about our taxation situation and also we were thinking sort of further ahead the possibility of getting some extra income on retirement. (NSW investor 18)

It was just the right time when we thought I would like to invest. We had a couple of kids, one in 2001 and another one last year, so my wife stopped working, so I was the sole income earner. Because I am getting kind of higher in the tax bracket one of the reasons why I wanted to buy investment houses was for the reducing factor, so negative gearing – that was one of the things. (Qld investor 19)

For most investors, there was a sense of wanting to enhance their experience of previous financial gain made through a range of sources (employment, the wealth in their own home, and other sources), and to apply those resources into (additional) property. However, for others, it was all much less planned than this.

A second area of influence was related to the achievement of personal or family goals and outcomes, which affected decisions about timing and broad location. Some investors identified that property had been an attractive investment because it could subsequently be used as a future home for them (some time down the track or in retirement) or for family members such as parents in retirement, home for children while studying at university, or others with particular needs (including relatives with a disability or even a previous housekeeper of 25 years!). Other investors saw the benefits of second property ownership as a potential holiday destination at some point.

I guess it was about planning for that longer-term future. It was about being conscious of the need or the potential need for accommodation for kids for university. Conscious that professionally I could end up coming back to Brisbane at some point later in my career. (Qld investor 6)

... two of the properties I've lived in or intend to live in, so they're like this, one of them was slightly accidental, the other one is a future prospect for a residential property ... one was a place that I bought when I could first afford to invest any money, ... (NSW investor 5)

I bought because I'd said to my youngest son and his wife, they were up in Albury, they'd been students up there and they decided they were going to move down to Bendigo. They've both actually got jobs down here. So I said if you want somewhere to live, I'll buy another property and you can have it to rent. (Vic investor 19)

Another, more outward looking consideration for people concerned the prevailing conditions of the housing market. As will be discussed later on in this report, some prospective investors were highly mindful of where in the property market cycle they were at any time, and this was a critical factor in investment decisions, which impacted on where they purchased as much as when.

Income tax advantage by negatively gearing property and also the potential gain in the value of the property, because at that stage back in 1998 there was substantial increases in the prices of housing in Sydney and it was only considered to be going up. And there was at that stage quite a sharp increase every year in the cost of houses in Sydney. That was the reason why we took out the investment. (NSW investor 10)

For others, awareness of the cycle led to reflections about whether they had in fact bought at a 'good' or 'bad' time, but the conditions of the housing market had not in fact been that important. The reason for this is that market timing issues are, for many investors, countered by the greater significance of their personal circumstances, and most importantly timing connected to their capacity to invest.

Indeed, the role that prevailing personal circumstances and opportunity plays in dictating both general decisions about whether to invest in property and when to do so was quite clear from the investor respondents in this study. Financial capability or opportunity is critical, and for some was linked to having accrued enough savings, having access to funds after the sale of property, or having gained equity (usually in property) over time. Capacity to invest was also linked to having come into assets or funds via inheritance, or changes in personal circumstances such as re-partnering or geographic relocation.⁷ Finally, there were a mix of other motivators for having entered the property investment sector, including direct encouragement by family or others such as estate agents or developers; observing the success of others (ranging from siblings, parents, children to accountants, friends, and employers); or having read investment books or attended seminars associated with wealth creation specialists or 'gurus'.

A significant driver was my boss at the time [who] was very active in the property market, and had a lot of insight and good knowledge on investment property and from a lot of encouragement and discussions with him, [I] knew that the market was really moving, and seemed like a great investment to put our money into, and a really good time to do it. (Qld investor 13)

I was influenced by books, 'Extra Property' I went to a couple of seminars – the one who made millions and millions of dollars was an ex-math teacher. I also had friends who had property, so logically if you hang on to a property, eventually you will make a fair bit of money and that will give you an income. (NSW investor 17)

Perhaps partly due to these sorts of influences, the estate agents also described the almost 'magnetic qualities' of property investment in that people find it hard not to be attracted, and worry about missing out if they do not get into the property market. They also highlighted how such a draw might sometimes blind investors to potential downsides.

4.3.2 Property versus other investments

A related issue to the question of what motivated people to consider investing in property is 'why choose property over other areas of investment?' In fact, this binary is a little misleading, because there were a reasonable number of property investors who were in fact currently investing in other areas, mainly shares, as well as in property. For a handful of property investors, shares represented a significant portion of their equity (50 per cent or more), and as such was an important aspect of a diversified investment strategy. However, most people appeared to have a much smaller and less significant share portfolio.

While concurrent investment in property and shares was therefore common, people still faced decisions about where to invest further funds or where to expand their investments. In this context, there were a number of reasons behind investors' choice to invest their money in property over other forms of investment. First, there were a

⁷ In a few cases, this meant using property previously used as a principle place of residence as a rental property, but this form of 'accidental' or 'unintended' landlordism is distinct from more purposeful investment, with the latter being the main focus of this study.

number who had previously invested in shares and lost money. These people were not keen to repeat the experience, and none indicated that they would reinvest in the share market.

Previously, we did buy a little bit of stocks and shares, but we have been let down so many times so that is why... and furthermore I have never been interested in sort of listening to the news to see what is the more likely thing for the share to go up and down... I just don't have any desire to do this...I would rather buy a rental property and let it out The thing is that we always know that wherever we live the population is going to increase in size, and therefore there will be a need, there is no doubt at all, it's only a matter of time. (Qld investor 3)

Second, and most commonly, there was an association of property investment with low risk. Property investment was considered "safe" and "stable" and investors reported feeling "comfortable" with property. The low risk was evidenced through returns which most considered inevitable in the long term even if they fluctuated in the medium term. Investors felt that they were not subject to fluctuating markets as exist in share market investment for example. This reasoning was supported by suggestions that there would always be demand for rental housing: population growth was a constant, and increasing values was regarded as a known 'function' of the property market. Even though most investors acknowledged the greater returns that may be gained from stocks and shares, many opted for safety and stability, and the guaranteed returns available through property investment.

I suppose I'm more a bricks and mortar-type person. I know it doesn't have the returns, but it also offers the stability and long term... you can see your investment. (NSW investor 4)

Bricks and mortar is something that is there and as a whole it increases in value or at least keeps its value, you don't tend to lose the capital. (Vic investor 10)

Well, probably it's a personal interest ... rather than going for shares which have a lot of fluctuations I felt this would be a sort of, a steady growth in terms of percentages. (Vic investor 16)

The timing of the interviews (end 2006 early 2007) is significant as there were few signs of market downturn (other than certain submarkets) in housing. It is interesting to speculate whether awareness of the US subprime problem and the weakening of much of the Australian market in early 2008 would have created a context eliciting a different response.

Of those who did not have shares or other investments, a number had considered investing in other areas such as shares, and commercial property. An assessment was made at the time and risk, circumstance, or overall reason for investing prevented such alternatives being selected. Residential property investment was similarly chosen as a low-risk option, and allowed for other potential benefits (such as having a future home) in the future.

The reason why we chose investment properties was that I thought that managed funds and shares were a bit high risk and I would have preferred something where you just bought and sat on it and let it go by itself. So the experience we had with the managed funds and what I read up on with shares was that they were high risk, and I didn't want to have that risk, I just wanted something secure. There was a bigger price to pay and a bigger loan, but long-term capital growth will probably outweigh that. (Qld investor 39)

Another common rationale for selecting property over other investments was the level of control investors experienced and felt about property investment in comparison to stocks and shares. Investors felt a sense of control with property investment whereas they didn't with share market investment when they were dependent on a third party if going through a broker.

I'm more comfortable with property that is quite true, even though I thought that shares had a bigger potential at that stage. And the reason is because we had good control of it. We didn't have to know the company directors or CEOs or what the core business offering the company was just in terms of shares, and we knew that we controlled the house and that made us more comfortable I think. (Qld investor 35)

Related to this, "bricks and mortar" was often used to describe property investment reflecting its 'concreteness'; a tangible product; one that could be seen and, for some 'worked' on.

Over the years we've had nearly 10,000 [dollars] tied up in shares at any one time. We own one share at the moment, could be down to four cents or something, and \$500 worth. We haven't touched shares in years. We've got control. We can't do a darnn thing to improve the value with a company. We're just going to have to sit there and wait until someone has a board meeting and decides what to do. But a house we buy or a unit we buy, if it's not performing or not renting, then we'll go down there and I'll paint. (Qld investor 24)

Investors also highlighted their sense of familiarity with the property market; a family history of investing in property; an interest in the property market, or a general "liking" or "trusting" of property investment.

... the share market ... just doesn't excite me. I'm a kind of property kind of person. I like houses and I like things I can go and see, drive past and have a look at. And for the same reason I didn't get off on putting into funds, managed funds in property and that. I like to be able to feel like I own that... and I can control it. (Qld investor 34)

The issue of shares has come up, but no ... I mean I understand the basic principles of shares, but I don't trust them and property I trust. I'm not talking quick turnover, I'm talking in terms of long term. I trust property. I believe in the property market. So that suits me. I like to sort of know what I'm buying. I like to have the control. I like to take the responsibility. (Vic investor 1)

Most investors reported that they were relatively unfamiliar with the share market; did not understand economics well enough to meaningfully participate; or did not have the time or commitment to attain the knowledge needed to work shares on a day-to-day basis it needed if taken seriously.

With shares you've got to be so on top of the market the whole time. You have to be doing full on financial analysis; you have to be getting all their annual reports, doing all your analysis. Trying to bring the differences in financial reports together to work out what's going to...And it's too much hard work. Like I've got friends who are investing \$200,000 or \$300,000 on the share market, and if a family member got sick or suddenly investments went down, there was \$100,000 gone. I can't afford that risk. Whereas property tends not to have, in Australia, that much risk associated with it. And it takes a while to get yourself informed, but once you're informed it's pretty easy. And the more you buy the more you learn. (Qld investor 19)

I've dabbled in a very, very tiny way in shares before and I've not been very successful with that and I'm too reliant on other people's information. Whereas with property, I can look at it and decide for myself, make my own decisions. I don't want to put in a lot of time sitting there and studying the market and so on with the shares so I do have to rely on other people and it hasn't been a good way to go for me. I like real estate I guess. (Vic investor 20)

A small number were attracted by the fact that someone else was paying off the investment and this outweighed the recognition that other options may attract greater returns. For others the attractions of the tax relief influenced their choice to invest in property.

Previous and current experience of property kept investors in the property investment market. Nearly all of the investors who had been in the property investment market for several years, and many more recent investors, had experienced what they regarded as 'success'. This success provided 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. At the time of being interviewed, a handful of investors were focusing their attention on changed superannuation laws and considering moving their investment from property to super. Only one investor was actually in the process of pulling out of property investment completely, having had some gains in their early property investment ventures, but had become disillusioned more recently as a result of tenancy management problems with one property, and significant delays and blown out costs associated with another speculative property venture. Others were reviewing their investment approaches, as discussed later in this report.

In general, shares were seen as being of a different scale to property, and were treated accordingly. For example, some did not see share market investment as an option in terms of risk when they were borrowing 110 per cent to invest or they simply did not trust shares. Very few investors leverage shares in the same way that property is heavily leveraged. Also, there was a clear sense that where you lose on shares, you still have security with property even in a slump as you still hold the title. Accordingly, some indicated that they would never borrow to invest in shares unless there was a 'guaranteed return'. Others took into account their age and investing in the share market at retirement age was not going to reap rewards in the timeframe they wanted. More 'professional' property investors indicated that they had been urged to diversify by their bank, although at least one investor had done the opposite, and moved from investment in stocks to property investment to balance up a high risk investment profile with a low risk option.

4.4 Why their property/s specifically?

Having indicated the main motivators for thinking about investing in rental property generally, investors were also asked about the reasons for purchasing the specific dwelling/s they did. These factors concerned issues of location, including the particular suburb or neighbourhood selected, as well as broader options between metropolitan versus other areas; the 'economics' of the dwelling as an investment; issues about the property itself and how the investor felt emotionally and intuitively about its features; and considerations about the likely type of housing in terms of lower cost or other segment.

4.4.1 Location factors influencing investment decisions

Broadly, investors indicated that location is a very important consideration in investing, although it is often only one of many drivers influencing investment decisions. The

critical factors related to location are varied. At the macro-geographical level, there was a common view that inner-city areas were regarded as offering guaranteed occupancy.

I bought in St Lucia and Auchenflower because those are good suburbs. They're stable. They have good capital appreciation. They have very, very high occupancy rates. I think I've had, over the four properties which are good for the rental market, I've had a total of about eight weeks vacancy over the last five years. It's a very small rate. Most of them are not even vacant for a week between tenants. (Qld investor 14)

There was also a related view that property prices in the inner city will always increase due to the demand for inner-city living. A number of investors indicated that they felt that the inner city provides better value for money, and that the higher rental income counterbalances other costs. For others, meanwhile, location was driven by factors such as affordability both to themselves and to prospective tenants.

What I looked for was obviously what the real estate agents tell you, position. Apart, [from that] affordability ... I extended myself as much as I could ... and really the best that I could get for my money and the position was really important. (Vic investor 1)

Sometimes this was a forced choice, where investors described themselves as having found their local or preferred locations out of reach due to price (and sometimes related poor yield), and instead investing in a different capital city (such as Brisbane from Sydney) or in regional areas (eg, Bendigo from Melbourne).

... where to next is what your budget or what you think your budget is [and] can handle at the time, as in repayments. I had a decent deposit, but you still got to have repayments. Bendigo was in the price-range and where I wanted in Melbourne was out of my price range and I'm very conservative when it comes to money so I wasn't willing to take the risk of investing in the area I wanted to in Melbourne. (Vic investor 11)

We just went to Brisbane The motivation was that we were up there visiting. We went round and had a look at a few investment possibilities and the prices were still within our range for borrowing, whereas Sydney is not. (Qld investor 10)

Market awareness was also an important decision-making factor. Investors tended to invest in markets in which they were familiar – where they lived, visited, or which had media exposure, such as the inner-city. Regional investment in particular was localised with agents saying they had only small but increasing interest from out of town investors. This may be one of the reasons for the relative lack of rental stock in many regional areas – there is simply not enough local investors to build the market.

Bendigo is my home town and I knew it, so I was comfortable with that, and in fact it means that I am the sort of investor that, even though I am looking to build it now, I am looking to develop a whole bunch of properties, I still like being hands on and that has worked brilliantly for me. So for Bendigo it was just because it was my home town and I was familiar with it. (Vic investor 3)

Investors, particularly investors who intended to self-manage, purchased in close proximity to their own home.

I decided that having had properties away from where I lived, it's very difficult to do anything. The distance is a bit of a problem so I decided that I wanted, whatever property I have, I wanted it near to where I'm actually living and working. (Vic investor 20)

Investors highlighted how they often have competing priorities in terms of location – for example, a desire to be in close proximity to the property for self-management purposes coupled with a desire for the dwelling to be close to transport and services.

I was very comfortable with Herston because of its proximity to the Royal Brisbane Hospital, the city, and Kelvin Grove Campus. I thought that's a pretty solid market to be in. (Qld investor 22)

Indeed, rather than involving serious market analysis of rental trends and occupancy rates, properties were far more commonly selected on the basis of where other family were located, or in an area familiar to the investor.

The first one we wanted something around the area that we knew close to the city. The second one we were looking for something close to my parents' place, very different properties. (NSW investor 1)

Investors also indicated the more personal role of location in motivating investment choices. Here, location may be the primary consideration in the context of the property being a future retirement home at the beach or regional centre, or prospective housing for their children. In these cases, the future intent helped drive the investment decision, with other desired features following on from that.

I intend retiring and I have for a few years looked on Bendigo as a good place to retire and of course my wife is quite happy with that too. (Vic investor 11)

In terms of more localised geographic factors, investors spoke about several important features. These included selecting a convenient location, close to the CBD, close to schools, transport, shops, entertainment, and so on.

This process involved some 'second guessing' of renter needs and desires. There was also a sense of choosing a 'well positioned' property, in a 'reputable' or secure area, and somewhere with 'street appeal'. In some cases, a location where risk of natural disaster (flood) was reduced was mentioned.

We wanted to avoid main roads. It had to have the basis for a decent street appeal. (Qld investor 35)

The specific things we were looking for was a good size block of land, off-street parking, three bedrooms, close to public transport and schools and a nice reputable area. (Qld investor 13)

The issue of location also appeared in the context of lower cost markets, but mostly in responses to whether investors sought to target low-cost parts of the market. While this was intended to be focused on cost submarkets, discussion invariably was about location and how certain areas were regarded as low-cost rental places. In that context, such locations were usually seen as unattractive (and also unfamiliar, which reinforces some of the points above about other drivers for choosing locations).

4.4.2 Property features and investor sentiment

Following considerations about the location of a potential investment, people then turned their attention to specific properties. The processes associated with property selection generally concerned the physical features of a dwelling, the economics of it as an investment, and how they 'felt' about the place. This latter factor was less tangible than the first two, but was of no less importance.

The sorts of property features investors discussed focused on quite practical considerations: for example the dwelling had to be good structurally; with adequate light; a good size block of land, and preferably be on the ground floor. Low

maintenance was commonly a critical issue, but how this translated into decisions about houses versus apartments was less straightforward.

Something that would be re-sellable, so something looking in good condition that I didn't have to consider doing a lot of maintenance work on the property. (Vic investor 13)

Personal preferences appeared to be the main driver for decisions about the type of property.

When we were looking for it [the property], it was more of a layout thing. Something that would be suitable for someone else or ourselves down the track, and it can be reconfigured if needed quite easily. (NSW investor 4)

New properties were seen as advantageous so as to make the most of depreciation benefits, but this was more of an issue with apartments than houses.

I realised a bit more about taxation benefits and I also realised that you could get a better taxation benefit through buying something new So the whole depreciation aspect of taxation I hadn't factored in. So that's why this time we decided to go for apartments. (NSW investor 18)

Sometimes, the form of dwelling desired was selected in consideration of the potential market being pursued, such as the need for an adequate living area for the student market.

As many rooms and living spaces as I could get in. I have a fairly high standard, and I think living space is really important. If you've got quite a few people in a house, they need lots of different places to disappear. If they've got friends over, they don't want just one living room. Lots of bathrooms. (Qld investor 15)

A final factor about property features that arose from the interviews was consideration of the value adding opportunities for a dwelling, such as conversion (eg, to student housing), sub-division, redevelopment or renovation potential, and the resale value.

I was looking for something that I could work up. I looked at another block of flats at St Lucia that I couldn't quite get the money for, but I wanted something that I could do something with. When I bought the ones at Herston, I had the idea of putting a townhouse down the back of the block of flats. I haven't done that yet though I have engaged a town planner. I have converted it from three flats to four flats though. (Qld investor 20)

We wanted something that we could subdivide because that's been very profitable for us in the past and that we were able to rent it out anyway. We didn't want to just passively sit and wait for capital gain. We wanted to try and create some capital gain. (Qld investor 40)

Another important factor in considering the features of a property was the financial merits of any given dwelling as an investment. Financial considerations included whether the property had potential for secure returns, for example "good capital appreciation", and whether it represented value for money ("price and return").

I bought in Toowong and Auchenflower because those are good suburbs. They're stable, they have good capital appreciation, they have very, very high occupancy rates. (Qld investor 14)

An important question was whether the property was within the planned purchase budget, and the extent to which the investor would need to cover mortgage costs

because rents alone would not. As mentioned already, new properties with no maintenance were seen as attractive, both as a cost saving, and as a tax deduction.

Other financial considerations were more specific to the individual investor and their particular circumstances. For some, negative gearing was an issue, but for others the property had to be neutral or positively geared. Some were very 'formula driven', where the number of rents at x per cent interest would be needed to obtain \$Y returns, while others were less fixed in their assessments.

Yeah, we work on a formula that we found quite a number of years ago where for an interest rate of 8 per cent, you need to get approximately \$17/week per \$10,000 you spend. So. for a \$100,000 property, you need to achieve \$170 a week rent. So we work as close to that formula as we can... The bottom of that range is \$13/week up to \$17/week. So we look in that band. ... We particularly look at the bottom end of the market. But we look for something that's a quality property at the bottom end of the market. We don't particularly focus on the 1985 depreciation situation because we don't believe that you should be buying property for taxation deduction. You should be buying it for its worth. So we look at the land content, then we look at the building, and then we look at what the return can be. (Qld investor 18)

Overall, properties which offer some combination of consistent and ongoing tenanting opportunities ("let-ability" and "very high occupancy rates") and guaranteed returns were seen as the most attractive. However, as will be discussed later on in more detail, the simplicity of such statements masks the variability around how such features are recognised and measured. There were no clear market preferences in terms of whether low, medium or high end properties were necessarily better or worse investments, although a few were really aiming to acquire higher end dwellings. Indeed, some spread their investments across different markets, lower and higher end, as they felt there were financial risks and uncertainties at either end.

Yes, I guess it's best not to have all your eggs in one basket I suppose, spread them around a little bit...we've also got an industrial unit that we're bought. So it's just spread investment around, and as a say in 25 years it will be paying you income. The stand alone house is obviously geared towards families – it's a four-bedroom home in the suburbs. We've got a unit as well, which is close to transport and it's probably towards the lower end of the market. And, thirdly, the villa is close to a hospital and so that's generally taken up by doctors, nurses or students. (NSW investor 12)

Those saying they targeted the middle to high end property market were interested in purchasing a quality product. More commonly, investors did not specify which end of the market they targeted, and instead talked in terms of what they could afford and getting value for money.

Nevertheless, there were investors who targeted the low or bottom end of the market.

I invested in the lower end of the market which is basically 90 per cent of your rental market. It may even be a tad higher. The area that I know ... where 90 per cent of the rental property basically is a safe bet. Somebody goes out, somebody goes in. The further out you go, the less chance you have of finding a tenant. (NSW investor 11)

Often, the investors who did this were looking for a positively geared or evenly geared property and believed this to be possible with low-cost properties.

Location comes down to affordability more than anything else, that's why I stayed in the Eagleby area because you can buy and the repayments are roughly evenly geared, and it's much more affordable. (Qld investor 32)

I bought very cheap houses with relatively good rent, so they were positively geared from day dot, and I didn't have to worry about them at all. (Vic investor 3)

Some investors very specifically targeted low-cost properties in high demand areas to guarantee return through minimal vacancy periods. Some were attracted to the low end through renovation or development potential. Other investors were simply governed by price so could only invest in the lower end of the market. Interestingly, low-cost properties were frequently perceived as being easier to rent out.

One of the reasons why there was considerable divergence and individualism in property selection was because personal, intuitive and emotional factors were also evident in the process for dwelling selection. Most critically, it was clear that many investors used their own preferences as a measure of quality of a property, even if they were not going to be living in it.

While some were buying their future home/lifestyle (beach/waterfront) and so considered their own desires and needs foremost, others also applied their personal standards as a benchmark to ensure buying an attractive and liveable property. The rationale was that this would attract a "better class of tenant", but the process was about personal attraction and gut feeling. Some investors commented that the place "had a good feeling".

I'm not real fussy as long as I can live in the house then that's how I gauge. If I can live there ... then it must be reasonable enough and someone else is going to want to live there. (Qld investor 32)

... essentially the property itself was not let's call it the lower end of the market. We chose one that we would be happy living in as well There are two reasons – one is that it's a little bit more attractive for rental and the other is that you get a better class of tenant. (Qld investor 10)

One final point to note about the selection of properties, and the amount of thinking and research investors make, is about the impacts of a rapid boom in the housing market, when sales take place at a rapid rate. Some agents in NSW reported that at peak sales times, investors may have to throw caution to the wind, and buy places at short notice, sometimes sight unseen. Agents in Queensland reported some of the same, particularly now that the internet is used extensively as a substitute for onsite inspection, and where auction is the dominant selling instrument.

4.5 Factors involved in making investment decisions

4.5.1 Reasons for investing and factors considered

Three-quarters of investors indicated that long-term gains were the main reason for investing (whether described as 'capital gains' per se or 'long-term investment' which will invariably result in capital gain as well). Rental income, by contrast, was rated only by a handful of investors as the main reason for investing. Negative gearing was proposed as the main reason by just one investor! A future possible home was nominated by one-in-ten. However, rental income and negative gearing both became relatively more important with an increasing portfolio size, but neither became the dominant factor.

Three-quarters of investors indicated that the capacity to negatively gear had been an influential tax policy. Capital gains tax was the next most important influence (more

than one third, followed by depreciation (just under a third). Stamp duties, transfer taxes, and other charges were also cited, but much less significantly so. Only a very small number of investors indicated that taxation policies had not had an influence on their investment decision.

Property values ('capital gain trends') was the largest single other factor considered by investors when deciding to invest. The next most common response was about interest rates, followed by negative gearing and rent trends. The latter two rose in significance with increased size of portfolio. Other taxes and charges also gained some prominence with larger numbers of properties (presumably because this is when cumulative land values and land taxes come into play). Tenancy law simply did not rate a mention as the main influence on investment decisions, and only appeared as an issue with larger portfolios, perhaps when larger scale landlords became more aware of such legislative issues.

4.5.2 The altruistic side of property investors

During the interviews, there were a number of instances when investors indicated a reluctance to increase rents when they had a stable long-term tenant; even to the point of considering the impact of rent increases on the particular tenant.

... the same tenant when I bought it, they're still there ...I don't get market rent ... she's a pensioner ... it's not market rent for that, but that kind of suits us because I'm not interested and \$20 or \$40 a week to me is nothing to what it would be to her... (NSW investor 5)

There are, of course, benefits to investors in supporting stability around a reliable tenant. Tenant stability was commonly seen as more cost-effective than increasing the rent, as investors were fearful of vacant properties or losing a quality tenant who presented few problems to the owner. However, in some cases, such a response might also be regarded as displaying some level of altruism as well. Indeed, occasionally investors found satisfaction in supporting their tenant's experience. In several instances investors had sold properties to their tenants, sometimes for less than the market price. In another instance, an investor reported keeping rent at a "reasonable" rate enabling the tenant to save for their own home.

4.5.3 Sources of information

Personal experience and intuition were reported as the dominant sources of information for investors in making property investment decisions.

I just know from my experience of having lived around these areas all my life. (Qld investor 20)

When I bought in West End I had been looking at property and had helped my son buy one in Highgate Hill, and we had recently sold some property here in Yeronga. So we were in the market. We knew what was going on, and I knew as soon as I got that phone call, it was described to me, I thought, oh this is a good buy. (Qld investor 21)

This is one reason why market awareness was so important and is clearly linked to investors' sentimental feelings about properties and location. Accountants, estate agents and specialist advisors were much less commonly used (if at all) for the first property, and while their use did seem to increase with larger portfolios, they remained very much a minority source of information. In some cases an expert was not someone investors felt they could put their trust in.

I would never trust my investment portfolio to anybody, including banks. I mean you have to use banks to make your investments, but no, I wouldn't rely on investment managers I prefer to make my own decisions. (NSW investor 3)

Overall, the reliance on personal experience and intuition suggests that the residential property market is not like other investment sectors where advice is more readily accepted and indeed decision-making is often handed over to the experts, investment managers. And, of course, a long boom of increasing prices virtually every where and for any property confirms faith in personal judgment.

It is worth noting that housing market information is now much more readily accessible via the internet and newspapers, and this perhaps helps to explain that people no longer feel they have to rely on property or investment professionals. One quarter of investors indicated that they had attended an investment seminar. The influence of advice from friends and books was seemingly also important.

To some extent we were influenced by books from ... an Hawaiian American who made his money in the US through property, in fact property initially in Hawaii. But some of the stuff that he said made a lot of sense, if you read it carefully. (Qld investor 12)

Only one-third of investors reported reading an investment magazine or the financial section of a newspaper more than once a week. A quarter reported they did so very infrequently or not at all.

Once again, the agents interviewed for this study concurred with the impression that much more 'information' is available about investments, but they questioned how reliable much of the material actually was. One source of information the agents commonly spoke of, but which investors themselves referred to much less, was the mass media and the role that its advertising played in attracting investors.

4.5.4 Other forms of investment

The vast majority of property investors were also currently investing in other areas, mainly shares (two thirds), followed by 'voluntary superannuation', much of which is also presumably invested in shares! However, shares were seen as being of a different order and scale to property, and were treated accordingly. Many investors reported that they had previously lost money in shares, and were not keen to repeat the experience.

5 INVESTOR EXPECTATIONS

The previous chapter explored the motivations for rental investment: What brought them to become a rental investor? Rental investors also expressed a range of expectations regarding what they believed they would experience and achieve through the rental property market. Throughout the interviews with investors, it was obvious that their motivations were linked, to a degree, with their expectations, and that, for some; this was also connected to past and present experiences as an investor. This chapter considers what expectations people have about their investments, how motivations and expectations might be linked, and how they can change over time.

5.1 Returns

5.1.1 *Returns in general*

Investors generally appeared to accept the possibility that positive returns were not going to be made until a number of years down the track from the initial time of investment, and that, in most cases, costs were in practice going to outweigh returns at the commencement at least.

I do think it [the rate of return] will go up. Ultimately you can't lose on a property. (NSW investor 17)

We expected good capital gain and that has happened. We expected to negatively gear, we didn't expect our rent to cover the repayments because we just budgeted for that and it hasn't. We're still negatively gearing after five years. We expected no problems in terms of building and there have been no problems. (NSW investor 3)

Overall, expectations matched investor motivations and perceptions that property investment for the long term is a very sound investment. However, some had not even thought as far ahead as expectations – at the time of buying it was just a purchase made as a “good investment”. Investors were conscious of the net return not just the gross return (the latter being “what everybody spruiks at you”). A small number of investors had done a detailed analysis of returns over costs, but more commonly, investors broadly expected a bit of both capital gain and rental return or capital gain and tax relief.

Initially it's rent return I need to pay the bills. Long-term I'm expecting a capital gain. (Qld investor 32)

... the Currimundi property probably doubled within the first three years ... and we did buy that before the boom. The Cinnamon Park property is slowly getting there, but relatively happy with the capital gain. The other reason that is also good is for tax purposes so I am able to look at depreciation and so on to get a little bit back from my tax. (Qld investor 39)

Some expected all three – capital gain, rental return and tax relief. Sometimes, different expectations were related to different properties: one was expected to bring in a good capital gain while subsequent properties were about minimising tax.

I was going to get some benefit of the capital gains, thinking about that as part of my super. The subsequent properties are really about minimising my tax ... (NSW investor 5)

Similarly, the benefits of positive returns are connected to generating wealth, providing a recurrent income stream, or sometimes both. While profits were in practice

used for a range of purposes, including the development of a larger property investment strategy; improved lifestyles; the financing of overseas holidays or renovations, paying off the home mortgage, and so on, there was a very common view that the future sale of properties would finance retirement, and that such gains provided an alternative to superannuation.

We were looking for an increase in capital value that over a period of five years would return us a reasonable or give us a reasonable rate of return with even the possibility of being able to maintain ownership in retirement and continue sort of independently of superannuation. The expectation was a long-term one. (Qld investor 10)

... we're in the age group where working jobs we had limited superannuation. So, we got to a stage, about five or six years ago, where, between us, we had a little bit of money enough to put a deposit down on a unit between us. Our idea is this will be our super. (NSW investor 9)

Some also expressed a desire to 'have control over their finances' into their retirement and to remain independent of government pensions. Perhaps reflective of the age profiles of investors, many people indicated that they either didn't have enough money in super, or felt that couldn't rely on it alone. Ultimately, the expectation is that properties will have paid themselves off somehow by the time one comes to retire.

5.1.2 Capital Gain

A large number of investors who participated in this study stated that capital gain was their primary expectation when it came to returns. In the majority of cases this was a long-term expectation and usually associated with financing their retirement. Investors recognised that there were some potential short-term benefits from rental property ownership, but the main expectations were for capital gain over the long term. Indeed, capital gain was still held to be the greatest motivator even if the intent was to live off the rent in the meantime. Interpretations of long-term began at five years; some were expecting to have their properties for 10, 15, 20, 30, even 40 years. These often reflected the time from now to when they anticipated retiring. The common aim was to maintain a similar quality of life into retirement to the one currently living. For others, the expectation is wealth creation even if future investment activity or how the increasing value will be used was unclear. The expectation of long-term capital gain cut across a range of differing investment strategies – pay off the property rapidly: negative gear, or positive gear. Indeed, capital gain was still the expectation in the long term even if in the short term the investor expected to break even due to the costs of renovations to improve the property.

Long-term capital gains over a period of probably 15 years. Basically, I'm just waiting for one property cycle, then the plan is I'll probably start selling them one a year, and start putting the money into my super. (NSW investor 6)

It was more slow growth in general. Didn't really have a plan on when we would sell either property, but expected to get, given what the market was doing, expected to get fairly good growth fairly swiftly, and at that time the market was really, it had taken off and it was in the middle of its rise. So expected to get swift growth and not so much rental return or revenue – [that] wasn't the main driver at all. (Qld investor 13)

We were looking for an increase in capital value that over a period of five years would return us a reasonable or give us a reasonable rate of return with even the possibility of being able to maintain ownership in retirement and continue sort of independently of superannuation. The expectation was a long-

term one. I didn't have any illusions about making a fortune overnight, because I already knew that it had gone up very quickly since the previous two years. We'd seen that happen with our Jindabyne property and it mirrored that in Queensland actually. (Qld investor 10)

Although there was some sentiment that selecting the "right area" and buying for the "right price" would fulfil expectations, in general, expected capital gain was based on assumptions about the rental and broader property market: if you hang onto the investment for long enough, a capital gain will eventuate. In some cases, it was evident that investors had struggled to maintain the investment, but had done so in anticipation of the expected capital gain benefit.

Expectations of capital gain were tempered by market conditions. At the time of being interviewed, many of the people believed that the peak of the property boom had passed, and sensed that increases in values were going to take longer to manifest. Meanwhile, others who had purchased in the earlier parts of the property cycle expected reasonable rapid capital gain in the short term.

I bought ... to sell. I didn't buy them to keep long-term because they were both too old and they were both quite saleable because they were cheaper properties and you could still make a reasonable amount out of those and I did make a nice profit out of both those. (Qld investor 36)

An expectation that capital gain would double every ten years was a fairly common expectation; in a few instances, expectations of capital gain were based on financial modelling, conducted by investors themselves or espoused by a spruiker. Some investors got much more than they were expecting. They had not read the market but purchased just prior to the boom, and had not immediately anticipated the potential returns.

On capital growth I expect at least doubling of value every ten years. ... because that is why we purchased. They're all worth, well some of them it hasn't come to ten years. The one here and the one I purchased recently, the block of flats, that's almost come to double. (Qld investor 17)

Overall, investors indicated they expected greater return through capital gain than through alternatives such as fixed term interest bearing accounts.

I think precisely it was capital gains that I expected over the long term would probably be greater than the rate of interest on fixed investments, like interest-bearing on just deposits. I think from my primitive calculations, was that if I included rent and the tax offset and the capital gain, that this would probably give me a better rate of return than the alternatives. That's really what I expected to get. (NSW investor 15)

Curiously, at least one investor was strongly not in favour of the focus on capital gains, commenting that it made it harder for him "to keep coming back into the market". This may indeed be an issue for some investors who are more interested in other forms of return, and who purchase types of property that are less likely to increase in value.

5.1.3 Rental Return

One of the other main forms of return to investors is rental income. Many investors planned for capital gain when considering their retirement, but others were very specific that rental income would be financing their retirement and capital gain did not figure in the investment strategy at all.

We anticipated we would be independent from government pensions in retirement. We've never looked for capital gain. Capital gain happens or doesn't. It goes up and down like the shares do. It's more the rental income that we look for. And we focus on that. (Qld investor 18)

The three most recent ones were bought for the rental return side of it. I see that as being more stable than capital gain in terms of return, or I saw it as being more stable, but obviously capital gain is an important part of the return from the investing of property. (NSW investor 9)

As soon as you sell to capitalise you get hit with all these taxes and charges that are just gobbling up your profit whereas the way I structure things I'm looking for income. Every time you buy and sell a house it's effectively 50 grand down the drain, that's a hell of a lot of income I can have. (Vic investor 14)

In some senses, rental return was overlooked in that it was an obvious or unspoken expectation and not given the value it deserves given its contribution to financing the mortgage.

I suppose, you need the rental income to pay the loan and everything else. The maintenance ... you need that income to maintain the property and then hopefully there'll be a little bit of capital growth along the way. (Qld investor 25)

For some, rental return was intrinsic to the investment strategy as in the case of purchasing positively geared property. The rental income had to cover or come very close to covering the costs. Often rental return was an expectant short-term gain and a necessary and important factor in the whole investment strategy as it contributed to financing the mortgage. In the case of short-term investment, rental return was used to "defray some expenses" prior to the investor making improvements to the property and capitalising on those by selling the property.

Yes, because I needed the rent. I would never buy anything if the rent wasn't going to pretty well cover it. So that was important to me and I needed to know that it was always going to be full and that I was going to make enough rent to pretty well cover the mortgage. (NSW investor 14)

I guess initially its rent return I need to pay the bills. Long-term I'm expecting a capital gain, but rent return is probably far more important because if you can't get rent return then you're not going to get capital gain either because you're going to go bust, so it needs to play out the same way. (Qld investor 32)

While expecting capital gain as an important return on the property, some investors considered rental return as "more stable" than capital gain in terms of returns. The general assumption was that there will always be a demand for rental housing. Rental return was also commonly seen as a necessity for affordability reasons. One investor was rethinking their strategy since repayments had increased due to increasing interest rates; they were initially paying \$40-\$50 a fortnight to top up repayments which had increased to \$80 a fortnight. Having a property too negatively geared was too great a risk.

5.1.4 Tax Relief

A third fundamental area of return concerns tax relief, although the significance of this was much lower than capital gains and rental income. In general, tax relief was an initial and early expectation followed by capital gain in the longer term. The main form of tax relief concerned negative gearing and, although capital gains tax is also a factor

impacting on investors, it was barely discussed. A few investors highlighted a strategy to purchase new properties to make use of depreciation benefits.

Negative gearing was an important consideration for some investors moving into the property market as it contributed to the 'affordability' factor. In some cases it assisted investors in first accessing the market, for others it was commented as greatly assisting investors acquiring their second investment property.

We knew that for the first one we wouldn't have been able to afford it if it wasn't for negative gearing. We actually investigated that through the relationships' manager at the bank. He talked about that. Tax relief is basically the negative gearing. I mean if it wasn't for that we wouldn't have been able to afford it when we originally bought, so it was part of the equation that the bank took into account when lending the money. (NSW investor 1)

High income investors commented on the benefit of negative gearing, and generally, expectations reflected changing motivations, eg, tax relief became a priority as salary increased; tax relief was not a priority for inexperienced investors.

I was paying a huge amount of taxation on my salary, and so I was obviously planning to negative gear and thinking that the gap would be very minimal. It was not a big factor, but it was part of the affordability. (NSW investor 17)

The subsequent properties are really about minimising my tax, because now I'm earning much more money, I'm much more interested in minimising my tax than I was. So I'm happy if I well, the negative gearing is worth quite a lot for me and it helps me not pay extra tax in terms of my tax situation. (NSW investor 5)

Because I am getting kind of higher in the tax bracket, one of the reasons why I wanted to buy investment houses was for the reducing factor, so negative gearing that was one of the things. (Qld investor 39)

Lower income earners noted that negative gearing provided little benefit in decreasing taxable income.

I have only made a loss of about two grand maximum a year over the whole time I've had it in which case that two grand brings my taxable income down [which] isn't really that significant. But I have been telling myself that the negative gearing is important, but now I think about it, it doesn't sound as if it is that important. And probably if I understand it properly I would have to say, yes, I would continue to [buy property] even without negative gearing. (NSW investor 14)

Some investors included negative gearing and tax benefits as a deliberate strategy by ensuring their investments were running with debt, eg, purchasing on a regular basis to remain negatively geared, and ensuring that a small debt always existed. For some, it was a targeted strategy to cover costs such as insurance and rates. For others, meanwhile, negative gearing was neither a crucial factor in investment decisions nor a part of a deliberate investment strategy – it may have provided a small benefit, but the long-term capital gain was the primary motivation.

... tax advantages, knowing what is tax-deductible, was an advantage and a consideration. [Negative gearing] wasn't the main driver, but it was certainly something that I knew was going to be a by-product and going to be a good thing, so that was going to help. (Qld investor 13)

Several stated that tax benefits and relief were not considered at all. One investor referred to it as "the biggest con" by which to sell properties. For many though, at the

very least it was seen as a “useful” tool or added bonus to the whole investment strategy. In light of not being able to purchase a property outright, investors made “the most of what the government has to offer” viewing negative gearing as a “generous” government offering.

Negative gearing is not the essential. It is a bonus if I get it, but it’s relative to my situation. ... the choice of buying is not motivated by negative gearing. So the tax exemptions, I don’t have interest in that either. I find that a lovely bonus and a lovely sweetness of the deal, but not the essential characteristics I seek. (Qld investor 17)

Several investors seemed to be making a value statement – “...do not believe in negative gearing”, and making a specific statement implying rejection of the concept of negative gearing, but at the same time using it because it’s there.

... we actually don’t believe in negative gearing so it wasn’t we’ve got to go and find something we can negatively gear for tax deductions. It was just coincidentally that obviously it did, but we knew that that was only short term because we’d make money on the improvement value. (Qld investor 40)

Another, while not rejecting the concept, was perplexed by the government’s generosity: “I think it’s crazy, but I’m in it if it’s there”. Others were opportunistic in the way they viewed the tax benefit provided by negative gearing – “let the other buggers pay it off”, a secondary factor where one can “sit back and rub your ears and say goody”. One investor reflected on the risk of counting on negative gearing benefits, identifying that it may not always be available. A small number of investors said they would sell up if these incentives did not exist.

The only time that the more ‘strategic use’ of negative gearing became apparent was when larger scale investment (beyond two or three dwellings) was taking place. The small number of investors who were engaged at this level indicated that tax relief became more of a priority, and that negative gearing was highly valued when initial investment properties started to become positively geared. These investors – invariably high-income earners – were partly driven to invest further to minimise tax costs. However, even at this scale, the use of negative gearing was not unanimously considered an advantage. A couple of the large investors interviewed preferred to own positively geared properties, or to avoid borrowings at all and enjoy both income stream in the short term, and potential capital gain over time.

5.1.5 Investor measures of success

Investors viewed ‘success’ in different ways, but most commonly, capital gains over the longer term were what they expected, and for most this is how success or otherwise in property investment was assessed.

... long term we were looking at making a decent profit to if not pay off our mortgage, at least take a big chunk out of it when it came time to sell the property. (NSW investor 13)

I think precisely it was capital gains that I expected over the long term (NSW investor 15)

The expectation was a long term one. I didn’t have any illusions about making a fortune overnight. (Qld investor 10)

There were some investors who measured their success in the short term through rental return and the ability to cover recurrent costs; and a few others who mentioned rental return over the long term as an income stream in the future. However, these were very much in the minority, with many more investors regarding capital gain

particularly over the longer term (in a few cases, short term) as being how they would eventually regard their rental investment performance.

Capital gains were seen as producing the best form of return, regardless of whether investors were able to receive positive rental returns in the short to medium term. Thus, the expectation of making a reasonable profit at the end of the investment was a means to off-set losses or poor rates of rental return. Indeed, while investors expected to see good capital gain over the long term, most quite clearly expected to lose in the initial stages of an investment.

One broad observation about returns (necessarily a generalisation, but worthy of note) is that investors who entered the property market in earlier (pre-2000) periods indicated that they had done so with the thought that they would one day own the property. Today, investors seem to be more interested in using accumulated equity, but they do not necessarily or always think in terms of paying off mortgages in full or achieving outright ownership. More recent investors are more likely to view the property market as a vehicle for wealth creation; once they get going they have the expectation that it will “snowball” into subsequent property purchases, utilising asset growth on paper, or trading dwellings and using the profits in further investments.

I guess the luck came into it in that when we bought the boom happened pretty much straight away after that, which gave us the opportunity to buy further because we had even more equity in our places. (Qld investor 27)

5.2 Other expectations and unexpected outcomes

As the previous section indicates, investors invariably had some sense of expectations about returns – be they short-term or longer-term; rent-related or capital-growth derived. In nearly all cases in fact, financial expectations were the only form of anticipated outcomes. While not all investors are driven into property investment by the economics of it, it appears that all investors will consider what their investments will deliver financially, but will have little sense of other expectations or outcomes, other than long-term plans for alternative uses of the dwelling (own or family occupation for example).

Critically, as the next chapter on their experiences demonstrates, this means investors rarely develop expectations on what it will be like as a landlord, having to deal with managing agents and/or tenants, and being aware of their obligations under residential tenancies legislation, or meeting requirements concerning repairs and maintenance (and potentially tenants’ privacy and quiet enjoyment).

With the absence of clear expectations beyond returns, it is hard to describe what transpires subsequently as ‘the unexpected’, and consequently, such outcomes are analysed in Chapter 6 in the context of investors’ experiences.

5.3 Expectations and ongoing motivations

Perhaps the real significance of the way investors view success is that their unrealised expectations form one of the critical motivations for investing and remaining in property. It may in practice matter little whether, or the extent to which, such expectations are met, the investor believes that gains will be made, and this both attracts them to property in the first place, and also sustains them through periods of loss making or poor levels of rental income.

There is also the issue of how motivations and expectations may change over time in line with changes in investors’ circumstances, and how these affect decisions to remain in property. For some investors, their original motivation, such as sourcing retirement income, reaping long-term capital gain, or acquiring a future family home.

remained their primary motivations for being a rental investor. More recent investors also tended not to indicate that there had been any change in their motivations, as they had only been in the market for a shorter time.

For others, however, a change in emphasis was highlighted. This was commonly related to shifts between various wealth creation objectives; shifts from wealth creation objectives to social concerns; shifts as a result of experience and increased level of knowledge; and shifts resulting from changes in personal circumstances or objectives.

... hadn't invested much in super at that point ... the Bondi property ... was part of my superannuation, I was going to get some benefit of the capital gains, thinking about that as part of my super. The subsequent properties are really about minimising my tax, because now I'm earning much more money, I'm much more interested in minimising my tax than I was. (NSW investor 5)

Some investors did not have strong motivations in early investments, they had moved into the market because they had the financial capability. Over time, however, their interests shifted to forward planning and consideration of how their investments could meet future needs, particularly in relation to financing retirement and/or benefits for children.

When we first invested, it just seemed like a good investment. I'm concentrating far more as we've got older and semi-retired, or retired for superannuation purposes. I'm looking more for income because we have to fund our retirement totally ourselves. (Qld investor 21)

When I first [invested], I was looking at just the security of being able to retire with a little bit more comfort. Since then, I guess my expectations have grown a little bit and I would like to be able to replace my normal salary income with other money from investments, like property. (Qld investor 22)

Similarly, several people described their transition from an 'inexperienced investor' to an 'experienced investor', where their early purchase was without knowledge of the full extent of the investment outcomes (commonly focusing at the outset on rental return). Experience brought new insights, particularly around the benefits of capital gain. Others highlighted how their first purchase was an emotional buy, but they then became aware of wealth creation possibilities and their own financial capabilities.

These comments are quite interesting in the context of many investors seemingly being motivated in part by an emotional attraction to property, and the sense that most are arguably naive about investing and its likely outcomes. At the same time, as the previous section suggested, most investors come to property with an expectation of capital gains. However, the interviews have also shown how some others, who had thought less about such gains at the outset, become more focused on them, and less on rental returns, over time. This very clearly underlines the perceived importance of rising property values to investors and the related capacities for satisfaction and feelings of success when the market delivers real capital gains, and disappointment when it does not.

For some, the rationale and objectives of being a rental investor became more nuanced or considered more broadly. Commonly, these shifts occurred as investors approached retirement and/or started thinking about financing their retirement. For example, a few investors described how they moved from purely personal objectives (eg, holiday home and rental income) to wealth creation (capital gain). Some talked in terms of a shift from wealth creation alone to a mix of wealth creation and personal objectives as new priorities presented themselves, for example, purchasing

somewhere with a new partner as a means of strengthening commitment; purchasing in consideration of a future retirement home; and meeting children's needs. Investor behaviour also changed as personal circumstances changed, such as no longer working. In this case investors moved from purchasing negatively geared properties to positively or neutrally geared properties.

However, expectations also changed purely on the basis of experience. One investor explained how less than satisfactory experience of purchasing a new unit off the plan drove them to purchase a detached, older property with renovation potential. Another investor explained how twenty years ago he had been looking for long-term purchases and capital gain to be realised in the long term; ten years ago, he was looking for long-term gain, but also faster capital appreciation; five years ago, he was looking for immediate capital appreciation.

6 RENTAL INVESTMENT EXPERIENCES

6.1 Overview of chapter

The last section of Chapter 5 introduced the notion that rental investors' motivations and expectations can change over time due to experiences in the property market. However, what their experiences have actually been has not, as yet, been considered in detail. The purpose of this chapter is to do this, examining several critical issues which investors will invariably come across during the process of becoming, remaining and potentially ceasing to be a rental property investor. These issues include the various costs of buying, owning and selling a property, as well as the experience of being a landlord, managing tenancies, or using the services of an estate agent or other manager, and responding to problems with the dwelling or tenants. The chapter begins with the characteristics of investment properties, and these indicate how many of the investment decisions that investors make, actually work in practice.

6.2 Features and costs of purchased investment properties

6.2.1 *Dwelling type and location of purchase*

A useful piece of background information to discussing investor experiences relates to what investors purchased. Most bought existing dwellings rather than new ones. This might seem a minor point, but in a context of housing supply shortages it is an important one. Investors preferring to buy established properties, if it was not already a rental property, simply converted an owner-occupied dwelling into a rental one. This does not contribute to alleviating overall demand pressures and raises questions about what mechanisms are required to encourage investment in new stock.

In terms of dwelling type, most investors were split fairly evenly on whether they had bought houses or apartments. Overall, there was no clear sense of dwelling type preference among investors. Some had a strong preference for units over houses; while others preferred houses in comparison to units.

The gardens are very rarely looked after by a tenant, very, very rarely. Only by a long-term tenant if at all and they are an important part of the property and you're therefore better off with a unit. It's far easier maintenance for yourself and the tenant. (Vic investor 12)

It was size and maintenance and the fact that in a block of units you are not worrying about maintenance... a second floor unit in a block is much more manageable and much easier to control and much easier to preserve value. (Qld investor 6)

Mainly because it [a house] gives more options. It's more saleable. It doesn't have massive costs associated with units, because units are treated by a business in terms of rates and in terms of services and in terms of repairs. [It's] better value than a unit. (Qld investor 7)

A small number of investors were quite precise in what they sought out, such as 'one bedroom flats, close to the city'; while one or two regarded the decision as being driven by other considerations: "it's the land you buy, not the house".

I do think that a two-bedroom unit is probably the better way to go. Just because of the quality of the person that I can attract to that. Chances that it'll be looked after better. (Vic investor 12)

I bought [a] one-bedroom, reasonably high up. I don't like to buy ground floors, because they lack security. A lot of women prefer higher level ... I also always

make sure that I buy with a car space, preferably a balcony. ... the last one I bought is a two-bedroom. But all the rest are one-bedrooms, because that's basically the demographic [an] expanding group of people – singles, divorcees... (NSW investor 6)

In some cases it was a constrained decision. Regional and outer-urban investors had little choice but to opt for a detached dwelling as the stock of multi-unit housing is limited.

Nearly all investors purchased property/ies in the same city or state as they were resident in, with inner or middle city areas being the most popular. Greater locational diversity became apparent with larger portfolios and, to a smaller degree, larger scale investors were also more likely to invest interstate or overseas.

I've got four in Bendigo, two in Geelong. And I had a couple in New Zealand, but I sold those. (Vic investor3)

Some agents interviewed in this study indicated that interstate investment did occur, citing NSW-based investors purchasing properties in Brisbane as an example.

What can be taken from this is that there was no single, uniform approach as to what might constitute a 'good investment' or the 'best dwelling for tenants'. Indeed, as will be discussed later on, what dwelling to purchase was in practice based on a range of factors, including opportunities, personal sentiments, practical considerations, and financial capacities, as much as any sense of what represented the most astute form and location of investment property acquisition.

We always look and keep an eye out for a bargain, but this proved to be an opportunity that was just a bit too good to pass up. The regional market is a bit slower than the Sydney market, so it was still coming to its peak in some respects, but because it was a unique property, we thought that it had a load of potential. (NSW investor 16)

We were looking at it from a rental market point of view. At the time, I was working in the city in well, ***** was working in the city and I was working just around the corner in Oxford Street, and the apartment in Surry Hills came with a double car space, plus an extra big storage area that could be a third car space. So, at the time, and I was working long hours and so was she, so we'd often drive in and pay commercial parking, whereas this extra car space actually allowed me to have a parking space. (NSW investor 18)

6.2.2 Purchase price

The range of prices paid for investment properties was very wide, from \$15,000 (some considerable time ago), to \$1.25 million. The average fell in the \$180-250,000 range, although the average price paid broadly increased with the number of dwellings owned (presumably as the later additions to the portfolio had been acquired more recently, with the likelihood that house prices generally would have increased).

6.2.3 How purchases were financed

Most of the investors interviewed used a specific loan from a bank to finance the investment purchase and a mix of interest only and interest-and-principal type loans were used. The majority indicated that they had put in less than 20 per cent equity, suggesting high levels of gearing (supported by other responses in the survey). Three-quarters of investors had made use of negative gearing provisions, although as discussed later on in this report, this does not equate to negative gearing being a key motivator for investing per se.

6.2.4 *Value of rental income*

Most investors indicated that their properties were let out in the \$200-220 per week price range, but one quarter of rents were in the order of \$300 per week or more. The lowest recorded rent was \$90 (two properties), and only four were in the \$100 or less bracket. The highest rent recorded was \$1,140 per week, and six properties were being let at \$700 or more per week. Most investors said they aimed towards the 'middle of the market', with not many targeting low cost, but high cost also not seen as attractive either to most investors.

I invested in the lower end of the market which is basically 90 per cent of your rental market. It may even be a tad higher. The area that I know, being Penrith, in central Penrith where 90 per cent of the rental property basically is a safe bet. (NSW investor 11)

Based on the rent potential, we knew we'd always have a tenant with that sort of property. It's a medium end, low to medium area of the rental market. Once you start renting places out for over \$240-\$250 a week you're not going to keep people long because they can't sustain that. The demographic of the sort of work they're doing wouldn't pay for that. (NSW investor 8)

6.3 **Other costs of buying, owning and selling**

Many investors saw themselves as 'being realistic' in terms of costs associated with property investment. Some noted their preparedness and prior research, and so believed they were not hit with anything that they had failed to foresee. However, there were several instances where investors indicated that costs had turned out to be much higher than they had expected or been led to believe would apply. In most cases, these concerned management fees, renovation costs, upkeep costs of an older property, or capital gains tax on sale of a property. It was not uncommon for such investors to comment that while they did experience some unexpected costs or higher than expected costs, they looked at these in the broader context of the long-term capital gain they were 'earning'. This appeared, in most cases, to compensate for costs.

6.3.1 *Maintenance costs*

In the main, investors expected and were accepting of, most of the minor maintenance costs or at least the inevitability of having to undertake minor maintenance, such as electrical and plumbing repairs. They were recognised as part and parcel of property investment. However, in terms of budgeting for maintenance costs and how they were planned, there were a variety of approaches.

First, there were investors who anticipated maintenance costs, and who did some budgeting. Then, there were those who did not necessarily budget for them in any formal sense, but made some in-principle allowance for their potential. They simply responded to them at the time repairs were needed. Finally, there were those who did not factor maintenance costs into their financial planning at all, and consequently either did not spend much on repairs because they did not have the resources to do so, or were hit with unexpected costs.

Overall, less than half of all investors spent more than \$500 per annum on maintenance (2006 dollars). However, the amount of money spent varied significantly, potentially reflective of the age and type of property purchased. Examples included a new property starting with nothing spent in the first few years and building up to \$350-\$500 a year; a 10-year old property requiring \$1,000 per year. In one case, the \$2,700 per year in body corporate fees, included rates and maintenance.

Where they were considered at all, maintenance costs were generally taken into account at the time of purchase. Some investors chose to invest in new or newish properties to not only capitalise on the depreciation benefits, but also as a means of keeping maintenance costs down. Some also chose units over detached houses to keep garden maintenance costs down.

A few investors commented on entering their early investments with very little experience and accumulating experience and increased awareness over time.

... the first house I bought, I didn't really know, because I was only 20 when I bought it. So I didn't really know what was involved in maintaining a house structurally. So I guess I didn't really think about accounting for say, you know, the house is on a bit of a slope, so yeah, drainage issues and things like that. (Qld investor 25)

One investor commented that his earlier experience of purchasing a property with reasonably high maintenance influenced his decision to later purchase something that would involve "less maintenance".

The last one ... I put a bit into that, but I didn't mind, because the rent was okay in comparison to the loan. I put a new roof on it and painted it regularly, new hot water, I can go on and on, and a new fence ... maybe in hindsight that might have been the thing when I saw the opportunity to make a good amount of money, the maintenance bit probably said well, go and get something with less maintenance. (Vic investor 5)

Some investors walked out of properties that they could see required significant work to bring them up to a condition they considered rentable.

We let out one house, and we didn't even know that the family [had] even let out some of the rooms in the house, and after some time the agent told us that the place was so badly kept, so we went over there and we had to refurnish the whole house again. So, we eventually decided to sell that house. (Qld investor3)

It was evident with other investors that they had purchased a property requiring repairs before it could be rented. A couple of investors had negotiated with their tenants an agreement whereby, in one case, the owner would not raise the rent for five years if the tenant organised and paid for repairs themselves. Some reluctant and begrudging owners only repaired as it was required and perceived tenants to be useless in terms of basic maintenance.

Investors were keen to maintain the property to their standard as an owner-occupier. One investor was so routine in their maintenance that they undertook a complete repaint and recarpet on their one-bedroom unit each time a tenancy changed. This was part and parcel to their strategy to retain tenants for longer tenancies and not increase the rent which they believed may influence tenants to leave.

...this is what I weigh up – the longevity of tenants, as opposed to people moving in and out, it actually costs you more having people move in and out, invariably because of some of the damage. You've got to always repaint. I like to have it clean, so recarpet, repaint. (Vic investor 1)

Significant costs associated with improving the property were seen as "preserving the investment" and a way of attracting the 'better' tenant.

...we spent [a lot] last year on maintaining this place. But we saw that as part of preserving the investment. Same thing with painting. If you let it deteriorate

too much your property runs down. It changes the types of tenants that you're likely to attract. (Qld investor 12)

Some investors seemed to go out of their way to maintain properties as a way of keeping "good" tenants.

It's seven years old. The tenant said I want a new carpet ... a new person who's going to be paying top dollar will expect new carpet. Because he's a good tenant I instantly went, 'Right, you want new carpet, you got it'.. (Old investor 19)

A number of investors experienced costs blowing out on work or renovations they were undertaking. Some did not mind because they considered the benefit of the outlay in terms of capital improvement on the property in the long term. Some commented that they were interested in having a presentable property so any outlays were seen as worthwhile.

Investors who managed their own properties acknowledged their need to call on qualified tradespeople to carry out specific repairs such as electrical and plumbing repairs, but otherwise undertook a whole range of minor and some major repairs themselves. Out of town investors, particularly those that were self-managing owners, commented on their lack of control on the maintenance outcomes or costs where they were dependent on tradespeople to undertake repairs that they would do themselves if they were closer. Some investors were cognizant of maintenance that needed to be done in the future. This was generally undertaken between tenancies.

6.3.2 *Land Tax*

Most investors did not incur any land tax. The thresholds needed to be passed for land tax to kick in were quite high in most states, and the levels of investment generally associated with rental property ownership (ie, small number of properties) meant that exposure to land tax liability was limited. Of those who did incur land tax, some were expecting and had adequately prepared for the charge, but others didn't expect such a high cost when it did come and one or two were not expecting it at all.

... we knew land tax would be there, and again, because of the nature of running the accountancy practice, that didn't come as a surprise. I remember one of our clients, it was a big surprise too, she'd got to having two or three properties... she rang and said when did this new tax come in, and we said actually it's not a new tax, it's been there forever. It's only that you've now tripped over the boundary. So they hadn't experienced it before. (Qld investor 12)

We got caught with land tax for one year. Again when we bought that wasn't the case and then they made changes and we got caught. Now they've made changes again, but we're not caught up in it... all these unexpected things that happen. (NSW investor 1)

I knew about the strata fees and they're not key, and I kind of knew about agents' commissions and other expenditure, but I didn't realise how much the land tax was going to be. It's huge so it's a real drain on the income, and sure you can claim it as a tax deduction against rent, but it's still very high. (NSW investor 3)

While some accepted land tax, others begrudged having to pay it, saw it as a "terrible imposition", or government "greed" or a "concern" and "onerous" cost, or a bit "scary".

It's a terrible imposition...it's just an extraordinary thing to be taxed because you've purchased something, and you're providing a service too. (Qld investor 15)

It's drawn down our ability to probably accumulate and invest in more property. I mean land tax is a very wicked sort of tax really. In the time of overabundance of GST revenue, I find it just sheer greed that they're still holding up a land tax. (Qld investor 17)

The potential for land tax was managed in several ways, often with a view to avoiding it. Some spread their investments across a number of states to avoid a concentration in one state as land tax is usually calculated on the accumulated values of land owned. Others simply stopped purchasing further dwellings before they were exposed to land tax. Others managed their portfolio through a trust arrangement so that property ownership was spread out.

I now use an accountant from Sydney that I got onto through another family member and I take advice from them how to structure things in terms of trusts and things like that. So I am obviously trying to minimise or avoid that, and have things structured right for the future. (Vic investor 3)

In addition to the cost issue, the impact of land tax concerned the type of property purchased. Some investors suggested they had selected a unit to minimise land tax, while in one case investments were spread across two states to prevent land tax kicking in.

Given the evidence in Section 4.2 that investors appear to be moving toward multiple holding more so than in the past, the land tax issue is likely to become more of an issue (read political problem) than in the past.

6.3.3 *Capital gains tax*

There were surprisingly very few comments about capital gains tax. There are perhaps three main reasons for this. First, not all investors being interviewed had disposed of rental properties, and all were presently still in ownership of acquisitions.

I don't know what's going to happen in the future. Possibly I'm going to get caught with capital gains with selling the units, but you've got to face these things head on and I have with buying and selling. If you're making a profit, well you're paying capital gains. You've just got to face up to those things. (Qld investor 2)

It is possible that their exposure to capital gains tax was thus limited. Second, capital gains tax arrangements had been changed in 2000⁸ and, for most investors, this reduced the net effect of capital gains taxation. It is thus possible that the tax is now seen in more generous (and forgiving) terms. Finally, and perhaps most significantly, the relative impact on investors' gains will have been smaller in recent years, as housing values (and thus capital gains) have been on average rising much faster than inflation. For any investor who has actually disposed of property and been exposed to capital gains tax, the financial impact may have been smaller than it might have been. For related reasons, the psychological impacts of this tax as a potential impost may be reduced, because investors anticipate making significant gains even with a capital gains tax applying.

⁸ Comment that previously capital gains tax was apportioned over a five-year period and not all in one year as is currently the case. Shares spread over a number of years?

6.3.4 *Other costs*

A range of other costs were mentioned by investors. There were several comments relating to Body Corporate fees. One investor had calculated that 14 per cent of their return went on body corporate fees. Others indicated that fees can oscillate, and are often adjusted depending who is on the committee and deems what is required for the sinking fund. This makes financial planning for these costs somewhat difficult.

Body corporate fees weren't too bad initially; body corporate fees have oscillated over time. Being an absentee landlord, you tend to be the recipient. You are a taker of what's available. So for a while there were a number of people who were resident in the complex who got on the committee who had ideas about where it should be and the sinking fund became bloody enormous and body corporate fees went through the roof. (Qld investor 6)

Some mentioned difficulty meeting the costs of repayments. Some talked of undisclosed costs associated with a developer leading to a manager-type venture (Unilodge).

Those sorts of things that are in the original contract, nobody who signs up sees that contract. They just see their own rental contract. So nobody is aware of what is behind the scene and how much it disadvantages the owners. To change it, it's either a court case or it's really difficult. (NSW investor 17)

One larger investor begrudged the costs associated with purchasing searches etc, but also acknowledged the importance of purchasing based on good research.

Some investors indicated that property management fees had turned out to be much higher than they were expecting. Rates varied, but some reported paying 8.5 per cent of rents, and one 9.5 per cent.

Another investor begrudged council rates where the charge was greater for an investment property than an owner-occupied property. One or two investors indicated that they felt stamp duty to be onerous, but this was not a widely expressed concern.

One investor described how they had spent considerable time convincing the taxation office that work on the property constituted repairs as opposed to an upgrade or part of a renovation, particularly when large amounts of repairs were undertaken, eg, repainting or replacing of carpet.

Although quite a few of the estate agents in NSW spoke of the state Vendor Tax which had been introduced and then (prior to this study) removed (see Seelig et al 2006 for an outline of this NSW tax), the investors themselves made almost no reference to it.

6.3.5 *Unexpected costs*

Investors provided examples of unexpected costs associated with buying, owning and selling property. At the point of purchasing, a small number of investors were unaware of the details of various costs including mortgage insurance, and stamp duty costs. While owning property, some investors were not prepared for land tax costs when they applied while others had not expected such high body corporate fees.

The body corporate is a bit higher than I thought with the extra costs. By the time you add it up, electricity, gas, management fees, water and all of this, it ends up being more than you think. (NSW investor 17)

The other unexpected costs associated with owning property were maintenance costs.

There have been some unexpected costs in the way of strata. Investing in strata management, one would think that you'd have reasonable ... for a few years anyway. But sometimes you'll find that you might need to dip your hand in the pocket. There'll be something that's totally unexpected, or there's a structural problem. Whether it be some form of refurbishment with building, guttering, nature boards. (NSW investor 11)

Some had under-budgeted for general maintenance, others were left with maintenance costs associated with tenant damage, while still others had run across costs associated with structural damage not existing or identified at the time of purchase.

What we didn't expect with the first property was the problems that we had with the original faults that were found in the property, and that the builder had gone bankrupt apparently. So we had to go through building insurance to get these faults fixed. (NSW investor 1)

The only unexpected cost identified associated with selling the property was the costs of renovating property in order to sell.

There were a number of unexpected costs associated with property management such as unpaid rent, needing to drop the rent to attract tenants, covering periods of tenant vacancy, undisclosed management fees, and higher than expected agent management fees.

I asked them half a dozen times and even when I went back for the second and third time, I said are you sure that's all there is, yes, positive. I should have got it in writing, and as soon as I signed they sent me a letter and said that I had to pay the maintenance fee, the cleaning fee, I had to pay for advertising, I had to pay \$6 for statements; there was a whole list of various expenses... (Vic investor 9)

6.3.6 How costs are managed

Investors discussed a range of approaches to managing investment costs. Most simply indicated that they budgeted what they believed to be the correct amount, and dealt with additional costs on an as-needed basis. One explained how they budgeted and then added another 25 per cent to cover for the unexpected. Another, meanwhile, indicated that he was aware of costs but still didn't budget in a planned sense. Others said that they had taken out a 'line of credit' type loan specifically so that funds could be drawn on if unexpected costs arose.

I did work it out when I was looking – there's rates, water, body corporate fees, you know, there's often repairs and maintenance. I worked out a yearly cost for that, but I also got a loan that would accommodate an unexpected situation where you know, so you have a loan where you can draw on it at any time. (Vic investor 01)

A different approach was articulated by several as being prepared, well-researched, and over time gaining more experience about what to buy. Often this involved considering potential maintenance needs at the time of purchase; buying relatively new property, or accepting the costs of repairs and maintenance, but realising they will be compensated by capital gain over the long term.

We had done our homework pretty strongly. We budget at \$2700 per year total costs. That's body corporate fees, maintenance and council rates... and we come in pretty well on target with that each year. So, for example, in a stand-alone property we put money aside for future maintenance. But in a body

corporate or a community title scheme, you put money into a sinking fund.
(Qld investor 18)

One investor suggested that tenant selection was the critical issue: good selection will decrease the incidence of maintenance problems, and thus contain costs.

Overall, investors did not expect to incur significant costs, and as a result certainly did not appear to effectively budget for them.

6.4 Body Corporate

Complaints about body corporate issues are not just related to cost but included issues associated with personality clashes; one or two individuals carrying the load; or the hassle of having to take everything to the body corporate; and a lack of awareness about bodies corporate, or mismanagement.

6.5 Tenancy management

6.5.1 Property manager experience

Three-quarters of investors in this study had their rental dwelling/s managed professionally by an estate agent or other property manager⁹. Investors were reluctant to take on tenancy management responsibilities mainly because they did not have the time to manage the property themselves.

I've always felt that because I work fulltime, because I'm a single parent, I really don't have the time to manage these properties myself, and I don't mind paying the fee so that the real estate agent takes on those responsibilities.
(NSW investor 7)

Others opted for the professionalism or the security that real estate property management could offer after a negative self-management experience despite property management fees adding to the investment costs.

... it's a professional job, and so we've done that and in fact, it's been very good. I mean they've got everything – it's all cut and dried, above board, everything's there. They deal with things if there's a problem. (NSW investor 20)

We tried to do that one ourselves, even though we had a standard 5A lease in place and it was legal and we lodged the bond with the Bond Board, all of that sort of stuff. We didn't use a managing agent – we tried to do it ourselves. Ever since then we've learnt our lesson. We always go through a managing agent these days, regardless of the fact that it costs more. (NSW investor 16)

A number of investors were keen to work closely with property managers and developed and enjoyed a trusting, cooperative relationship with them.

We just leave it to them. I mean they're people we trust. (Qld investor 8)

I would say ***** is the best rental manager, best agent. We went with the people we bought it from, and the woman there has been exceptional. She has just developed a relationship with me. When the tenants weren't up to scratch, she'd ring and say look, they've only paid a week's rent and I'm going round. And I just thought she was doing everything she could do, but she'd do it personally. (Vic investor 6)

⁹ This may largely reflect recruitment processes for this study, although it was also the case that some of the investors who were recruited outside of estate agency referrals were also using agents to manage their properties.

Some investors had been using the same property management agency for years and once a good property manager was found, further investments would be managed by that same agency. It was evident that those who had experienced few tenancy management problems were invariably satisfied with their property manager and attributed it to good property management and “luck”.

I consider that we've been fairly lucky.. You hear stories and it doesn't make much difference – city or the town or where the agents are, I suppose. Although people ... who've got a long history of real estate and managing rentals ... they've been excellent. (Qld investor 5)

Investors identified various qualities or characteristics about property managers. Qualities and characteristics seen as enhancing the experience included 'personability'; responding quickly to tenancy issues; and keeping investors informed of what was going on. I

In terms of the agent, we've been with the same agent since the beginning. The value of the agent is very much the actual individual. When we first started with that particular firm the person that was handling rental was absolutely top drawer, couldn't speak highly enough of her. As a landlord, she provided excellent service to us, excellent advice, particularly to someone who knew bugger-all about the business. (Qld investor 6)

Investors had had different experiences, depending on whether the property manager was experienced or inexperienced, and a small number commented that the quality of property management was much better with older managing agents than younger property managers.

I actually have more confidence with the ... older managing agent and I would say our values are more aligned ... (Vic investor 3)

In other instances, investors, despite a less than satisfactory experience with a property manager, were still inclined to remain with a particular agency rather than change, as overall they had been satisfied with the property management agency.

In a number of instances more than one property management agency was used by investors to service properties that were in different locations or states from the investor. Sometimes this occurred when the investor, for convenience sake, chose to remain with the current property management agency at the time of purchasing the property.

Some investors chose to engage a property management agency as a leasing agent only, whereby an investor paid one weeks' rent to an agent who was responsible for selecting tenants. In these instances, property management agencies had the advantage of accessing national and state tenancy data bases and were better placed to undertake reference checks of potential applicants.

Investors changed property managers as a result of perceived poor management where investors had a negative experience associated with loss of rent; damage; or high maintenance costs.

The tenant's money was late. You didn't know until three weeks after ... and there was just no follow up, or you'd get a letter that was nowhere near as personal. I've actually moved from one agent to another ... I got so fed up with them in the end that I just thought they were very average and not following through, not doing the right thing. (Vic investor 6)

Another reason for changing property management agencies for a small number of investors was when property agents merged and investors found the process of going about this unsatisfactory or “deceptive”.

The agent we had merged with another agent. When they merged we chose another agent because we weren't happy with what happened with the merger. So we chose another agent (Vic investor 10)

A small number of investors had moved through a number of property management agencies due to dissatisfaction with the way the property had been managed and commented that possibly their main “hassle” in property investment was “the incompetence of real estate agents”.

I'm with a few agents and with one of my properties I've been through about five agents and I'm looking at moving again. ... I guess you don't account for incompetence of the real estate agents. That's probably my biggest hassle. Like ***** that I'm with at the moment, they're just totally incompetent. Totally! Like, you know, fixing up a smoke detector when you ask. That's pretty much illegal [with] insurance requirements ... (Qld investor 25)

Another investor also commented that finding a good property agent was the “biggest issue” and that there was a level of uncertainty in knowing that the property manager was doing all that was needed, for example, sourcing several quotes, rather than one, on maintenance work.

Certainly investors had experienced dissatisfaction with property managers. One investor challenged a property manager as to their apparent lack of action on rent arrears by “pulling the agent into line”. Comments such as “most real estate agents ... need the whip cracked every now and then”, or kept a “close eye” on, or were “not up to scratch”, “appalling” “shocking”; “slack” reflect investor dissatisfaction with property management and property managers.

I use agents and I'm a passive owner who keeps a very close eye on the agents. (Qld investor 21)

One investor claimed to have “fir[ed]” the agent after their property remained vacant for three weeks between tenants, while another spoke of doing a fairly thorough assessment of property managers before selecting an agency.

By and large they're not too bad. We've used the same person ... for both properties. They've been pretty good, but like most real estate agents they need the whip cracked every now and then. The place – when we purchased it, it was being managed by one agent, and they were just a disgrace, so in the end we had to sack them and get a new agent. (NSW investor 6)

The relationship between one investor and a property management agency had soured to such a degree that criminal proceedings were currently in place. One investor had complained to consumer affairs and had been told court proceedings would occur while another had lodged a complaint with an agency for poor management.

There were a small number of investors who would not even contemplate contracting a property manager to manage the property. Reasons for choosing not to contract a property management agency included objection to the costs of property management, particularly for what is involved; a perceived lack of trust of property management processes; or past negative experience of property management.

... they get too much money to manage a property for doing nothing and that experience is coming from what I'm seeing with my neighbour's properties.

Both each side of me have been empty, as I said, one has filled, but no one in the owner's absence has looked after it or managed those properties. I believe they get too much money, way more than what they're worth on a monthly basis just to collect the rent. They don't actually manage it as such. (Vic investor 5)

6.5.2 *Experience of self-management*

Investors chose to self-manage or moved to self-management for a range of reasons associated with cost; better tenant-landlord relations, better control over the investment, and encouraging a better maintained property.

Where investors chose to self-manage, they did so because they valued developing a relationship with tenants. Some viewed the closer relations contributed to tenants better care and respect of the property. One investor who was both self-managing and in a contractual arrangement with an agent viewed the properties they were self managing as a "much, much better arrangement" in terms of the positive relationship they have with the tenant and their responsiveness to addressing maintenance problems when they arise.

The ones I'm managing myself are a much, much better arrangement. We get along well with the tenants and they get everything fixed the next day, if not before. There's no dispute, there's no dispute between who said what down the line. (Qld investor 29)

The direct relationship contributed to increased trust and, in one instance, the owner gave tenants responsibility to manage minor repairs up to several thousand dollars without consulting the owner as a means of encouraging the tenant to treat the property like their home. It was also a way for the owner to manage and limit their level of intrusiveness into the lives of the tenants.

I don't want an agent in there, because if the tenant has a problem I want to speak to them, it's easier if they ring me, because I'll respond instantly. And I also work on trust, I've told the tenants that if any repairs need to be done, to do it, nothing over you know, if it's two or three grand let me know, but generally it's treated like their home. I don't want to be intrusive. So that's what I do. So plumbing or electrical, just fix it and send me the bill and they've got my address and that works really well. And nobody has ever taken advantage ... (Vic investor 1)

The cost of property management was a contributing factor to decisions by investors to self-manage. Some saw it as a cost saving, others saw it as better value, and that the management fee charged by real estate agents was simply "fleecing" people. One investor of interstate properties who self-managed, and which could entail a five-day interstate trip to re-let a property, even considered it much more cost effective than employing an agent in that location.

Other investors who chose to self-manage did so because they preferred to trust their own instincts rather than an agent working for a fee, and to have more control over the property. Self-managing investors reflected on their relative inexperience of tenancy management when new to property investment and that many lessons were learnt through hard experience.

... it's cheaper for us because we don't have to pay the 7per cent ... it means that you've got more control ... when I first bought, the worst experience that we had was tenants in the back flat who were four weeks behind in the rent and the agent didn't tell us. Then they skipped out and we lost a lot of rent, and that was a salutary experience and I've never used an agent since

because, I mean figuratively they work for you, but ultimately you're just that part of their business. Some people think it's difficult, but it's not actually, and I think that because the tenants are dealing directly with you as the owner, I think they have more respect for the property. (NSW investor 18)

Investors commented that they gained confidence over time to successfully property manage, including in areas of screening tenants and gaining an increased awareness of tenancy legislation. However, some self-managing investors chose to contract property managers as leasing agents to undertake the tenant assessment and selection, as they felt this was not an area they had expertise in and this was viewed as a very economical option.

With properties that are vacant we'd give it to a real estate agent, they give us a casual let. They find a tenant and we give them one week's rent. I find it's an economically viable option. Because at least with one week's rent you get a tenant from a place that's open seven days a week, that's great. We only open Monday to Friday... And for that, I look at what it would cost for me running an office on Saturday and Sunday compared to the one week's commission. The one week's commission is more economical. (Qld investor 17)

Other investors were quite comfortable, had well developed practices, and had become quite skilled in undertaking this responsibility.

6.5.3 Property management and self-management

A number of investors interviewed indicated that they may place some property in the hands of agents while they themselves self-managed other property, depending on the circumstances. Mostly, properties that were managed by agents in these situations were those that were not in close proximity to the owner. Distance was a barrier to self-managing which meant that investors in a regional town were more likely to be self-managers than metropolitan investors. This was not only an issue of accessibility. There was a greater likelihood that potential tenants would be known to the investor. In one instance, an investor who preferred to place his properties with agents to manage did self-manage his other property in which family were living, as well as a property next door. In this instance, the investor regarded these properties as safe to self-manage because they either knew the tenants or were in close enough proximity to keep an eye on the property and therefore viewed the property management as a relatively problem-free responsibility.

A number of investors who had both self-managed and contracted an agent to property manage were able to compare between contracting a manager and self-managing. Some commented that the cost of property management outweighed the responsibilities and this was emphasised when an investor had a prior poor experience of property management.

6.5.4 Moving from self-managing to property management

In a number of cases, investors shifted from self-management to enlisting a property manager. This was done for a range of reasons. For example, investors, in some cases were keen to hand over the responsibility of tenancy and property management to an external party; or investors valued property management screening processes; or the location of their property meant it was no longer feasible to self-manage; or as a result of other circumstances, such as when family were no longer tenanted in the property.

... the first few years ... I used to advertise myself in the paper ... I then found that really it wasn't such a good idea because I couldn't check up on the people, their references and everything else, as well as an agent ... all our

properties are actually done through ***** since then. We found they're excellent managers, they really are. (Qld investor 4)

There were also a small number of investors who chose to property manage initially, but due to negative experiences they had of self-anagement, shifted pretty quickly to property management and did not look back.

6.5.5 *Moving from property management to self-managing*

On the other hand, some investors moved from property management to self-management mostly instigated as a result of their experience of property management. Some questioned the value they received for the cost of property management and that they (investors) could do a better job; others considered property management practices as generally poor; while yet others believed that property managers were not working in the investor's best interest. As one investor commented, "we've started to manage more because of the inefficiency of agents".

We used to have our properties managed by an agent. But we gave them away because we felt that we weren't getting our money's worth. (NSW investor 9)

Self-manage the local ones [and] some of the others that are not local ...you get to the stage where they have been managed and not necessarily satisfied with what they're doing as managers, what you're getting with the 6 per cent or 7 per cent. Sometimes you think, well they should have been in touch with the tenant a long time ago. The rent's starting to get behind and that should have been tended to and you're not hearing about it. So you think, well, stuff it, I'll do it myself and the tenants can deal with me (Qld investor 27)

6.6 Tenancy relations

6.6.1 *Relations between investor and tenant*

Self-managing investors, by virtue of their independence had, in some instances, developed a successful 'working' relationship with their tenants. Some investors were happy to negotiate rent of a new rental, rent increases, and the management of minor maintenance with tenants. In one instance, an investor saw benefit in offering their tenant the option to develop a 'wish list' as a means of ensuring tenant satisfaction which the landlord viewed as of significant benefit to themselves, both in terms of maintaining the tenancy over the long-term and ensuring that the property remained well maintained and respected.

It was not uncommon for investors in general to opt to maintain "good tenants" rather than increase the rent, particularly if they had had problematic tenancies in the past. The value placed on maintaining problem-free tenancies and tenanted properties was stronger than any need to ensure that the property was attracting market rent.

I've had the same family in there for about three years. Again, I could probably charge more rent than I do, but you know, there's pros and cons with all of that. She does improvements to it and plants at the back... (NSW investor 5)

If your tenant moves out you immediately lose a week's rent ... Even if they get someone straight in, you've lost a week's rent immediately in re-renting fees. I tell you what, \$200 is a lot of five dollars a week. It takes you quite a while to get it back if your tenant decides to pull the pin, and so while you're not raising the rent the tenant generally feels they're on a good wicket. So, whenever you raise the rent that immediately puts them on a decision point. So I don't tend to raise the rent. (Qld investor 14)

... when I look around I think I could probably get more for it, but I'm actually keen to just keep the good tenants once I've got them. I think it's much more important to keep it coming in regularly and know that you've got people who are not going to wreck your place. (NSW investor 14)

On one occasion a tenant, possibly wanting to ensure tenancy security, approached the landlord and suggested a rent increase.

There's a lady ... who is a sole parent with five kids and she fell over herself to rent the place ... she's still only paying \$230 and she rang me up two weeks ago and said it's about time you put the rent up. And she's the tenant, asking to put the rent up. I nearly fell... I nearly drove off the road. (Qld investor 36)

6.6.2 *General investor attitudes to tenants*

Tenants were variously described as "good", "bad", "fussy", as the "tenants from hell", or "problem tenants". Some investors defined their preferred tenant types and were quite blatant in their preferences, while others "found that sometimes the people that look the worst are the best". Still another investor was adamant in stressing to the property manager the need for non-discriminatory practice. In contrast, some investors gave the property management agency a "pretty wide brief" in terms of tenant selection.

In some instances, investors responded to tenants with empathy, and care and "work[ed] in" with tenants in difficult circumstances.

We rented to a friend ... and during that time his business went bust and he didn't pay his rent for eight or nine months. We actually carried him, which in retrospect seems really silly now, however, the fact that we did give him that chance to do the right thing, he came through for us in the end and everything was paid up in full once he got a job and could manage. (NSW investor 16)

On occasions, investors were flexible in their dealing with tenants, for example, tenants were given some leeway in terms of rent arrears, especially when those tenants were long-term and where they were, on the whole, 'good'.

I think everyone who rents has that problem. That's one of the reasons why we don't have a real estate agent manage ours. Because if we had a real estate agent do it they would either evict him, and in essence he's a good tenant. Or they just let it slip and we wouldn't know about it for a minimum of six weeks. And we don't want anyone six weeks in arrears with rent. (Qld investor 18)

One investor described themselves as a "soft sort of landlord". Others did make some mention of their role in providing housing which they regarded as being more or less affordable to a range of people. While this was not positioned in any sense of being charitable or philanthropic, or in terms of providing a social good, a few investors were cognisant of who they were likely to be providing housing to, and that renters benefited from a range of housing options in the market, with the investors contributing to the choices available.

... all the properties that I've bought – because I'm a single parent, I'm just a sole worker and the only source of our income, so I haven't had the money available to buy high end properties – they have always been at the lower end of the market. However, my rule is, even though real estate agents tell me that this is not a good rule – but my rule has always been, never to buy something that I wouldn't live in myself. So even though they've been at the lower end of the market, they've always been in good condition, and therefore, they do attract the more low-income or young people. (NSW investor 7)

While there was little sign of investors interviewed in this study providing extended (long-term) tenancy agreements with their tenants, a number of them indicated they were not necessarily adverse to such leases.

6.6.3 Specific 'renter submarkets' targeted or avoided

Investors were asked about their theoretical or actual preferences for specific groups of renters as target submarkets for their housing, and whether they would say they aimed towards or away from certain groups, or alternatively, whether they would say 'neither for nor against'. This revealed that overall, investors are pretty sanguine about who rents their properties. Generally, investors were not as keen on 'students' or 'group households', and were also less attracted to Centrelink clients, sole parents, and families with children.

I do want them to be employed, the tenants to be employed ... that's about the only condition, and they have good references. (NSW investor 7)

I probably wouldn't take anyone unemployed; I think they'd have to have a job. I prefer a couple. (Qld investor 23)

I've found people on Centrelink benefits like single mothers and that sort of thing, can be good or bad. However, sometimes you find that in most cases it's worked out pretty good, but in some cases you might have the single mothers and then they have their ex-partners come along and you get complaints from tenants next door or people next door saying there was domestic violence or arguments. It doesn't make me avoid them because I can empathise with the situation; I'm quite sympathetic with all sorts of groups. I'm more wary and more vigilant when I do the interviewing process of getting tenants in. Not ruling them out, but trying to get a group of three or four tenants who have applied for a property so I've got a bigger choice. (Old investor 27)

They were much more comfortable with 'young people' and single people alike, although 'working families', couples without children, and older renters were clearly the most popular groups.

6.6.4 Tenancy problems

There were a number of investors, whether self-managing or not, who did not experience any significant problems; or experienced problems from time to time or with the occasional tenancy, but not with all tenancies. However, for those who did experience tenant-related problems, issues included stolen property; property damage including fire; sub-letting; lack of garden maintenance; failure to clean the property at the end of a tenancy; failure to inform the agent or investor of minor maintenance needs; the giving of false information; pet-related issues; high maintenance due to high turnover and unexpected vacancies, or lengthy periods of vacancy. Rent-related issues were a common problem and included irregular rent paying leading to rent arrears; severe rent arrears leading to eviction; rent decreases during periods of high vacancy; and loss of rent during periods when the property was being re-let with vacancies of up to three months.

For those who did experience problems, these were seen as an "irritation" or stressful. Investors who had contracted a property manager did not always attribute problems that arose in a tenancy to poor property management. In many cases, investors took the problems in their stride.

A tenant on one of the previous properties certainly treated the property as her own dwelling and, for argument's sake, there was a weatherboard garage on the property and she took a saw to the side of it to open it up because it was

easier car access ... but as far as maintaining the house and paying the rent on time, yes, she was no problem. (Vic investor 4)

I've just had some tenants moved out of that property who have left one hell of a mess really ... obviously you take out the insurance policy against this sort of stuff happening as well, but there's always problems with that sort of thing when it does happen and I guess unexpected costs as well. Whatever way that goes, there's no doubt I'm going to be out of pocket as far as that goes. (Vic investor 8)

Some situations highlighted the relative inexperience of investors, particularly when they were self-managing.

We had one lot of tenants that basically moved out and didn't pay the rent for about four months. We then had trouble getting the money back and then found out that the Tenancy Act basically gives them a lot of leeway, and we had to actually forfeit half the money that they were owing to us in order to settle it through the tribunal. (NSW investor 1)

For the odd investor, continuing tenancy management issues had influenced their decision to sell up and, for a small number of investors, negative tenancy management experiences had led to their decision not to reinvest in low socio-economic areas.

... we certainly didn't intend to be landlords for long term in that sort of area. We've had much better success at being landlords in a little bit better socio-economic area. We actually don't like being landlords in that area because there are so many hassles. We may be landlords again in the future ... but it would never be in that sort of area. (Qld investor 40)

One investor had experienced tenancy management problems associated with a low-income area and had made a decision not to reinvest in lower socio-economic areas. However, at the same time, this particular investor also recognised limitations in their ability to manage lower income tenancies.

... we have basically pulled out of those [low] socio-economic [areas] and wouldn't go in again because of very, very high maintenance costs. You are forever in those cases going to a tribunal.

You can't just say people in low socio-economic areas are bad tenants, they're not. It just requires a higher level of management. And I think it also needs careful selection so you try to avoid problem tenants. (Qld investor 31)

A number of investors had settled rent arrears; damage and cleaning-related issues through legal proceedings. Investors had gone through various avenues to lodge complaints. Some investors, or the agent representing them, had been through the Small Claims Tribunal to settle tenancy issues. There were differing perceptions of legislative frameworks such as the tenancy tribunal across investors. One investor considered that the Tribunal was property-owner friendly in Queensland and "tenants are victimised", while another held an opposing view that the Tribunal was biased to the tenant. This was based on their experience of the tribunal process taking three months to obtain an eviction. Another NSW investor claimed that tenants had "too much in their favour", including the Tribunal.

There was very little mention of Landlord Insurance. Where it was mentioned, the basic cover was described as "pretty useless" and the comprehensive cover was considered expensive, particularly for the low-income investor.

Finally, there was also virtually no mention of tenancy legislation in terms of it being a consideration in investment decisions, and limited indications that it was something investors were particularly familiar with. Indeed, during the interviews, it proved extremely difficult to engage investors on tenancy law as an issue, let alone an important factor connected to investment decisions.

6.7 The overall profitability and success of rental investment

For most investors, the average current estimated values of their rental properties were higher than the original prices paid, indicating the anticipation at least of capital gains. In terms of actual experiences of profitability and success, there were many examples presented of significant capital gains (some, for example, spoke of values doubling in just a few years and others of this occurring over a decade or so).

We initially bought the property including on-costs of near \$216,000. Now the property seven years later is considered to be worth in the area of \$320,000. That is a significant increase in capital gain. And therefore if I was to sell the property successfully in the near future for that amount I would consider that to be a successful investment. (NSW investor 10)

I bought it for \$60,000 [and] sold it for \$180,000. (Vic investor 5)

It was stressed that these gains invariably vastly outshone the sorts of net gains achieved through negative gearing tax offsets ('just a thousand or so dollars a year'). When examined in terms of yields (annualised rents as a percentage of property value), a number of investors aimed for, or indicated rates of return in the order of six to ten percent.

We generally start our properties off at around about a 5 per cent yield. We simply don't buy below a 5 per cent yield, and over a period of time through I guess natural rental increase, or because of improvements we make, we look to move them up to about a 10 per cent yield, but that's not a 12-month process. That's a three to five-year process. (Qld investor 12)

Among those who have previously sold properties, investors in the main reported that their expectations of capital gain had indeed been met. Although such claims were not objectively verified, there were indications of high gains where a profit of 100 per cent or more was made over the purchasing price. In some cases, this was over a very long period of time; in other cases in very short periods during the recent boom.

With property, especially with the one that I bought in '87, I paid about \$65,000 then for that house, and I sold it two years ago for \$189,000, so I made a profit on it, but I kept it for lots of years. (Vic investor 9)

... I knew I could sell it any old time and it went up... in the 12 months it went up 50,000 and Eagleby went up 25,000. So that wasn't a bad return for the 12 months. (Qld investor 36)

Investors also discussed their measures and indicators of disappointment. Sometimes, these related to poor financial outcomes, principally low rates of rental return and having misread the property market and missed out on sufficient capital gain.

I have bought property, even this latest one, with a tenant in, showing a fabulous rate of return, but could we ever get that rate again? No. (Qld investor 21)

The capital return's been pathetic because this is the first time that we've speculated rather than investing. We took a gamble on the market. Our

philosophy has always been that real estate is very forgiving if you've got a long-term perspective, but if you're trying to get in and get out you are gambling. (Qld investor 40)

For others, the financial issues related to costs and charges, including rates, management or body corporate fees, and maintenance costs. In a smaller set of cases, the factors that led to dissatisfaction were less about the economics per se, and more about management issues, including relationships with estate agents and more commonly problems dealing with bodies corporate. There were also just three instances of investors owning 'student-targeted accommodation', but two of these expressed disappointment in their investment.

In a couple of instances, the sense of success and disappointment were rolled into one: in one case, the investor had described how the estimated returns of the property had fluctuated from "terrific" to "abysmal", but the investor was nonetheless attaching success to the long-term capital gain.

The return has been abysmal. The first few [years] was a guaranteed high return and it was terrific and then it just plunged. The returns were very, very low ... and the occupancy rate was very low. It has since gone up to 100 per cent because ... there is a rental shortage at the moment. Returns are still not terribly high. (NSW investor 17)

In another instance, however, an investor had experienced a rapid and very satisfying initial increase in the value of the property; it had doubled in worth over five years, but had since depreciated and, after eight years, was worth less than what it had been worth after five.

I'm aware that the prices have really dropped in the last year or two, I'm really conscious of that. If I stick to my original plan of keeping this forever, then it wouldn't matter to me because the fact that that place has dropped in value probably by 30 grand in the last two years, and so if I'd sold it at five years I would have been better off than if I'd held on to it for eight, which I have now. But the fact that that's happened wouldn't normally matter because I bought it to hold on to until retirement, but now I have had a big life change and I'm trying to sell. So, because of that, I'm in a bit of a spot, because now is a really bad time to sell. (NSW investor 14)

The disappointment here was perhaps as much about how, in hindsight, a better outcome could have been secured, particularly now that changing circumstances meant that they had to sell.

7 FUTURE INVESTMENT INTENTIONS

7.1 Overview of chapter

The final part of the interviews with rental investors concerned their intentions and plans for the future vis-à-vis their investments in the rental property market. In a sense, future investment choices are effectively whether to retain existing holdings, to expand into further investments, or to reduce their investment, and potentially to cease being a rental investor. Accordingly, in this last of the 'main findings' chapters, these issues are analysed.

7.2 Grouping investors in terms of broad intentions

The investors who participated in this study could be grouped into six categories in terms of future intentions about their current rental portfolio or holdings. First, there were those who had recently sold a property (or more than one). Second, there were those who were either clearly considering or intending in the immediate future to sell. In fact, very few investors had either actually sold in the recent past, or were currently in the process of selling properties, or were intending to do so in the near future. Reasons for selling included changed life circumstances; to eliminate debt; to realise some capital growth and to offload a potentially difficult to sell property; as per the plan (to sell after five years); short-term speculative venture in train; to realise the gain and establish self and children; set in train retirement income process of selling assets and depositing into super; and sell to repurchase.

Third, there were those who were not intending to sell in the immediate or near future, but who none the less had considered the medium-term factors or circumstances that might lead them to selling property. This did not equate to formal planning, but indicated some potential preparedness to dispose of their property at some stage.

For these latter two groups, there were a number of interrelated factors investors took into consideration, including age (in particular retirement age); income (low, high, none, and some); and costs (buying and selling). Investors also indicated that they often had different plans for different properties, weighing up the costs and benefits of each when considering a range of factors. This indicates that a decision to sell one property does not necessarily represent an intention to divest completely (unless the investor only owns one property, and even here, there may be a parallel decision to reinvest, as will be discussed later).

Fourth, there were investors who intended to sell in the longer term, as part of a planned long-term strategy. An example of this is where investment is associated with working, and divestment with retirement. Interestingly, some of these investors indicated that they would not be distracted by shorter term market movements, even if that was a shift to boom conditions. In other words, the temptation to change long term plans and seek to realise significant capital gain more immediately would be resisted.

A fifth group was made up of those who had no intention to sell a property at this stage: disposal was simply not on the decision-making radar at all. Finally, there were those who had plans to expand their rental portfolio.

Overall, regardless of which category an investor might fall into, the overwhelming impression from this study is that while investors are initially motivated by a variety of factors, and display varying levels of knowledge and sophistication towards investment, greater experience and increased knowledge developed over time means investors often make more informed and considered decisions when it comes to future

options. At the same time, future investment 'strategies' are also likely to be shaped significantly by what has happened to their past investments.

7.3 Perspectives of prevailing investment conditions (at time of interview)

Investors were torn between what they have experienced themselves, and how they perceive their own investment outcomes to have been, on the one hand, and what they sense about the broader market and their own capacity and desire to invest further on the other.¹⁰

7.3.1 General sentiments towards investment outcomes

Nearly all who had been in the property investment market for several years, and many more recent investors had experienced what they regarded as 'success'.

The expectation was for an increase in capital. And that has certainly been met. (NSW investor 10)

I don't think we could have got a better return elsewhere for what we've put into it, we couldn't have got that return elsewhere. (NSW investor 13)

When asked specifically to estimate whether they had made or lost money from their present investments in terms of returns received, almost a quarter responded with 'significant profit' and just under a third more said 'small profit'. Less than one quarter indicated that they had made a 'loss', although when eventual capital gains are factored in, this could be expected to be redressed. This overall sense of success provided investors with an ongoing incentive to remain in the property market, to increase their portfolio, to consolidate, or to start realising their assets as part of their investment strategy.

Based on the reasonable success that I've had so far, I'm always interested in buying more properties, but there are financial considerations in how much money I've got and how much money I could actually borrow, so I guess at this stage I'm at a bit of a standstill. I'm still keeping an active eye on the market. I'm seeing if my circumstances change, getting an idea of where I'd like to go, but my intention is to add to the portfolio. (Qld investor 22)

Indeed, investors, new and seasoned alike, reported very high rates of satisfaction with various aspects of their property investment: yield, capital gain, property and tenancy management.

When asked about their current thinking on their rental investment/s, the clear majority saw capital gains as more important than rental income over the next five years. An even greater majority saw capital gains as more important than rental income over the next ten years. Nearly all regarded property as the 'best investment', and a number said they would still invest in property even if returns were clearly higher in other areas (eg, shares). However, investors were evenly split on whether they would have invested if negative gearing had not been available.

¹⁰ Property managing estate agents were also asked for their analyses of their respective property markets, and where they thought these might be going. At the time (mid-late 2006), most markets were seen as being flat, with little prospect for significant capital gain in the near future. This was especially so in Sydney where price falls were already apparent, while the Brisbane market was seen as a mixed picture, with some agents saying that returns were still to be gained in Queensland, while others considering there to be slim chances of capital gain in the next ten years!

7.3.2 Impact of higher costs on investment

There is no doubt that, for some current investors, an increase in the costs of property acquisition had “slowed” down potential investment activity. Post-boom, housing now costs more than it did a few years previously, and incremental increases to interest rates raise the costs of borrowing. These higher costs don’t necessarily have any impact on the current holdings of investors – they affect the ability to invest in more property – and may have mixed impacts on potential new investors, many of whom, like current investors, will be motivated by a range of factors including but not limited to purely economics-related considerations.

Another way in which further investment can be curtailed is the cumulative effect of land tax in most states, where land value thresholds may not become effective with one or two dwellings, but larger holdings may make an investor liable. Several investors in this study indicated clearly that they had not continued investing in more dwellings because of land tax.

7.4 Intentions to reduce investment

Investors could be distinguished between those who had recently sold, were intending to sell in the very near future, and those who were intending to sell some time in the future (and for the investors interviewed this spanned between the next two and twenty years).

Over our whole history we’ve only sold two of our rental properties. There was the one 25 years ago that we sold to buy the house that we spent most of our married life in, and interestingly enough we sold that to the tenant who was in it. And then there was one about two or three years ago, that we sold. And again we actually sold it to the tenant. (Qld investor 12)

Despite this categorisation, there was very little difference in the responses between these three sets of investors in terms of the drivers for selling.

Reasons for selling included a range of personal and financial factors. There were a number of standalone personal factors that influenced investor decisions to sell, including changes in personal circumstances; health reasons; tenancy problems that required a high level of management; and a desire to assist children or provide an early inheritance to children.

Financial drivers for leaving the market included poor returns; the need to alleviate financial pressures and increase income; opportunity to capitalise on market changes and realise capital gain; and in order to invest in alternative and better investment choices such as the share market.

When I started and over a two-year period, I suppose I had a bit of a spurt and I set myself a criterion that I would only buy places if I thought they would yield me a gross 9 per cent on the capital invested. Part of the reason why I’m starting to sell down now is the fact that that’s impossible to achieve these days. Prices of properties have gone up and rents just haven’t kept pace, understandably I suppose. (Vic investor 19)

The first two years were fantastic, but the last six months our tenant left and he was fantastic. And since then we’ve had to drop the rent \$25. We’ve had two bad tenants in there, so basically come tax time we’re going to speak to our accountant and see what he suggested. See whether it’s worth keeping it. If it’s not... we would look at selling the property and invest it in shares. (NSW investor 13)

... we've renovated the house, but we haven't sold the properties yet because we're waiting till the market goes up a bit. (NSW investor 18)

I bought to sell. I didn't buy them to keep long-term because they were both too old and they were both quite saleable because they were cheaper properties and you could still make a reasonable amount out of those and I did make a nice profit out of both those. (Qld investor 36)

In some cases buying and selling was a reason in itself as some investors had only ever operated this way and opportunities arose to consolidate existing investments and/or reinvest. Some investors had a planned strategy of selling – sometimes one property every several years or one a year.

I'll probably sell one in the next financial year because I will receive superannuation, and who knows what taxes are going to be in when I retire. So I'll probably do [it over] four years. I hope one unit will be kept for a heart transplant and any other medical problems that will pop up, regardless But they'll be disposed of in individual financial years. (NSW investor 11)

Personal and financial factors were intertwined in some cases. For example, investors coming up to retirement were selling in order to finance their retirement.

I'll make a decision, but at the moment I believe that if I should sell it and put it into my superannuation – I'm with Health Super and the return's about 13 per cent which it has been for the last couple of years. If the property gain was to be about 5 per cent that would be on a par with the expenses I no longer have and what I would gain with putting it into my superannuation. (Vic investor 13)

I'm just waiting for one property cycle, then the plan is I'll probably start selling them one a year, and start putting the money into my super. (NSW investor 6)

I've got six. I'm going to sell them off over the next two to three years. I'll probably work on my four days a week for another two and a bit years until I reach 70 and then, according to our financial advisor, [with] the money that we get from the properties, we [will] invest that into superannuation... (Vic investor 19)

7.5 Intentions to remain investing (but not to grow portfolio)

7.5.1 Responses from those who were not intending to sell but considered factors hypothetically

Lastly, there were those investors who had no specific intention to sell, but who, nevertheless, were able to hypothesise about the sorts of conditions in which they could conceivably sell, and the factors that might drive such decisions. While not representing anything concrete or formal, these responses do illustrate the areas in which investors feel vulnerable and the pressures that underlie investment retention choices.

Some of these factors were financial, related either to the costs of investment, such as rising interest rates or poor returns, or to personal circumstances, for example, reduction in or loss of other income, or the need to access finance to meet one-off/unexpected costs (private schooling, holidays, children needed money).

... a huge bill like a private school bill, which at this stage we are aiming to avoid. Yes, something huge like that. (NSW investor 19)

Some investors foresaw the need to divest to avoid being ineligible for an aged pension. Some others anticipated a need to balance their investment portfolio to include shares, and disposing of property was part of that process.

Other financially-related factors were also apparent. There was the potential to be made an offer “too good to refuse”, or where a sudden increase in property prices might make selling attractive, or simply the need for cash.

I would say hypothetically say someone knocked on our door and said, say the agent said we’ve got a person who really would love to buy that property you’ve got and this is what they’re offering, well we would consider it and may be if it was really good we’d say okay. (NSW investor 8)

I’m never going to sell it. Unless of course I run short of cash, and it’s unlikely I’m going to do that because I’ve planned pretty well for my retirement income. But you never know it’s always a possibility, but it is unlikely. But if I ran short of cash and I needed the cash I would sell it, yes, and live off the proceeds, but I am not planning to do that. (NSW investor 3)

Additional related reasons included having simply reached their planned objective in terms of capital gain, coupled with a desire to divest before the market declined. For several investors, this would not necessarily result in ceasing to be a rental investor – such circumstances might mean upgrading their investment through selling and buying.

In other cases, the factors were connected to individual situations, including personal health-related reasons, the death of a spouse, (re)marriage, and capacity to respond to ongoing care and maintenance of the property (in terms of time rather than cost).

On the other side of the ledger, investors who had no specific intention to sell, but who could see this as a possible event continued to acknowledge many reasons for not selling. Factors included the ongoing attraction of capital gains (and the avoidance of capital gain tax), particularly when the dwelling had already performed well, and there was a perceived risk of not getting the same returns with a replacement. Other reasons were as varied as the attraction of capital gains to retaining the property for their own use.

I think capital gain would be one reason. The other reason would be just the fact that it’s a nice property and we might use it at some stage. I mean we always thought it was a possibility that we would use it ourselves. (NSW investor 2)

In some cases, investors saw many benefits in achieving outright ownership or to at least positively gear properties, giving investors and their families “greater choices”.

But really the goal is now not to sell and cash up. The understanding is that they will all, that as rental income increases over time they will become more and more positively geared, so I won’t have to. So it really is now long term, to hold property, and just to give myself and my family choices. (Vic investor 3)

Again, family factors were also present – the desire to pass ownership onto their children or to retain for their own use, for example – and were seen as significant counter-balances to selling up.

7.5.2 Intention to retain, for the short term at least

Some investors indicated a clear intention, for the short term at least, to retain their rental properties. In most cases, this was because the dwelling/s had performed well, and there was no reason to consider selling it in the foreseeable future.

I’m keeping them for the long term because I want to stay invested in property and the costs of changing to another one are a lot more than it’s worth. There are a couple of them I think the returns aren’t as good as the others and will be the first to go if I make a change, but there’s no reason to make a change. I

guess until something changes in my situation I will stay invested in property. I don't think it will be actually worth my while to actually sell any of them. (Qld investor 14)

In some cases, retention was due to market conditions: "to sell now would be to sell at a loss", implying the possibility of sale down the track.

Depending on how the rental market goes in terms of the value for money compared with an annuity on the capital, because annuities can be very tax beneficial whereas a property is still subject to tax as an income and so it literally may not be the best way to do it and ultimately we may have to get investment advice on that best option. But at this stage we're just holding for capital gain. In a sense we've committed ourselves to it now and to sell now would be to take a loss, there'd be no question of that. (Qld investor 10)

Because the market's gone off the boil, we would consider selling that to invest in something bigger in Sydney, but we figure we're not going to get a reasonable price for it at this stage so we're going to sit it out and wait for the next cycle. (NSW investor 16)

For others, the costs associated with selling inhibited the option to sell.

We couldn't afford to sell it today I suppose with capital gains and that sort of stuff. (Qld investor 28)

Other investors said that it was more about an emotional attachment to the dwelling, which created a psychological barrier to selling, and for others still it was about family and lifecycle issues: holding on for use as a retirement home in the near future, or imminent passing onto children.

... we've probably gotten a bit emotionally attached to the two places that we've bought, and would consider moving into the Brisbane house at some point in the future and would ideally like to have maybe the unit as a bit of a holiday getaway. So for those reasons, I would expect that we'll try and hold onto them. (Qld investor 13)

A few investors indicated that they simply had no intention to sell, largely because they had not thought about it much, and defaulted to a status quo position through a lack of clear intentions and an absence of any future planning. Obviously, this implicitly suggests some level of satisfaction or sanguinity with their investment. Its corollary is that such investors lack long-term intentions as well, and are a relatively unpredictable group when it comes to being confident of their capacity as long-term investors.

7.5.3 Intention to retain investment for the long term

There was also a group of investors, who had a clear intention to continue investing for the long term, although this did not preclude their eventual disposal of the property.

I will have the houses for 20 years. That's the plan, and whether they're still tenanted with students or I take the easier option of just throwing it to the rental market as is, and I am accelerating the payments, so we'll see. (Qld investor 15)

There were several reasons for these long-term investment intentions, including holding on to properties until investors retired, at which point they may either move into the property or realise capital gains via sale as a means of funding their retirement.

If they stop my pension, if they cut my pension, or if I needed the income to live on, to survive on. It's my survival, it's my backup it's my ... my form of superannuation. (Vic investor 12)

The length of time long-term investors intended to keep properties before selling varied depending on when they planned to retire. A number of investors intended to realise their investment at "the time of the next boom" which was commonly predicted to occur in about ten years.

There were other investors who had no intentions of selling their property and planned to pass the property onto their children as an inheritance.

It's something to put in your Will for your children. (NSW investor 19)

In some cases, they could not envisage selling under any circumstances, while several added that their plan not to sell may change if circumstances arose, but commented they would have to be significant.

There were also several investors who intended to hold onto their investment for the long term, but that was the extent of their 'plan'.

7.6 Intentions to expand investment

When asked about their intentions, a number of investors indicated that they were seriously considering plans to expand their investment holdings. In some cases, this represented a very definite intention to purchase further rental properties in the next couple of years, while in others plans were less formed or definite than this, and included the potential to acquire other (non-property) investments rather than stick with property alone. In the process of these discussions, some of the thinking and reasoning among investors became apparent, including likely barriers to investment.

7.6.1 *Definite intention to invest in the next two years*

Among the 'certain to expand' investors, there was a strong sense that the property in some places remains good value and that it continued to be a good way of accumulating wealth. This was perhaps most apparent in regional markets where there was a greater sense of 'lower prices higher rents'. Some investors were unquestioning in their growth intentions, with the uncertainty more about how many to buy into the future. Common plans involved purchasing another one, two or even three, depending on financial capacity and also intended purposes (as indicated in the motivations chapter earlier).

I would definitely do it again; I think it's a good idea. I'm not sure whether I will ever have the money to do it again, although I expect ... I will inherit Now I wouldn't think of putting that into shares, I would only think of putting that into property. (NSW investor 14)

7.6.2 *Possible investment in the property market in the future*

Among those exploring the possibilities of expansion, the most common sentiment was one of consolidating their present holdings first, and then expanding. Similarly, a few investors expressed the need to pay off the home mortgage first before they would feel comfortable with further investing, or saw expansion opportunities in the context of a personal financial situation and other personal circumstances.

Expansion was also considered in terms of cashing in on a high cost property to reinvest in several properties.

It's actually worth quite a bit of money and what we want to do, we're thinking... is dividing [and] selling the house in a few years, not now. Doing it

up a bit, selling the house and buying from that three properties. ... maybe two houses and a flat, or three flats and a house – establishing ourselves. In part that is because this is our super and also because of ***** - they're having a baby. I've got to buy them something ... (Vic investor 1)

Others in this group of investors indicated a broad sense of watching the property market, stages of the property cycle, and interest rates, and then weighing up options and opportunities in these terms.

This suggests that investors learn from their past experiences, and may become more analytical and objective (or at least less driven by the more emotional attractions of property) over time.

Having to consider land tax and its potential applicability was also mentioned.

I would be dubious about adding too many more rental properties because of land tax. The land tax bill gets so big that you really have to think about how you invest. (NSW investor 3)

7.6.3 Intention to invest, but not in the residential property market in the future

A small number of current investors indicated that they were looking at other investments, but not in residential property.

We've got plenty invested in that area at the moment so we've swung across to the share market, looked after our super fund a bit more, and invested our savings in the business... (NSW investor 12)

Alternatives included land as part of holiday home, commercial property, and shares. In some cases, investment strategies were reported to have changed as a result of the introduction of policy, for example, changed superannuation laws.

With the new taxation laws to do with people my age and in business it might be better and more suited to keep on pouring money into super ... (Vic investor 14)

Some investors considered moving investment to super and leaving the property investment market.

For all these investors, it was not necessarily the case that residential property had been a bad experience, but more of having learnt much more about investments generally through the experience of property. In some cases, it was also clearly part of a diversity strategy, to spread risks and returns in a mixed portfolio.

7.7 Interest in future low cost housing investment

A critical question from a housing policy perspective is not just whether investors are likely to hang onto their current investments, and also whether they are planning to expand their portfolios, but where in the cost segments of the market will their additional investments be. In particular, there is policy interest in whether investors will be adding new stock at the lower end of the rental market. This question was put to investors directly, although in fact it proved a difficult area to elicit much in the way of consistent and considered response. Most investors had either not thought about the issue at all, or had but were immediately dismissive or sceptical about it as an opportunity or possibility. Even getting agents to separate out concepts of low cost housing as a price submarket from locational considerations was hard, but at the same time quite instructive in how low cost housing is commonly perceived.

7.7.1 General level of interest in low cost housing

A number of investors expressed some level of interest in low cost housing, but couched it in terms of needing a stable investment; having a guaranteed income or return, and allowing flexible arrangements so that it was not necessarily a long-term commitment. A small number were attracted by the concept of assisting people and others had 'considered' the needs of low income households and people with high needs.

We didn't put the rent up exorbitantly; we've got a commitment to providing low-cost accommodation in Lismore, because we think it's a worthwhile thing to do. It just goes to show that there is a lot of demand for that kind of low cost accommodation and that it can make money. (NSW investor 16)

A small number of investors actually were already involved in, or had heard of, community housing head lease schemes¹¹.

We have one with them [community housing]. We're very interested in providing housing at a reasonable price – we keep our rents fairly low. (Qld investor 18)

If I could, well obviously if I benefited and me with my community spirit, that would be fantastic ... a partnership with the government to put in more community housing, yeah ...good idea. (Vic investor 1)

... they have schemes where you can have government tenants in there, and they actually pay part of the rent for the tenants, so definitely more of those schemes I think are great. There's a few community places that do that where they actually take on the property. They pay the rent each month and then the tenants pay the rent to them...more stability... If they could give you that guarantee that yes, you can put a government tenant in there, but we'll guarantee the rent, I think that would be the way to go and I think most investors would take that opportunity. (NSW investor 13)

Others were attracted by the concept as they had heard it offered reasonable benefits to the investor, and indicated that they would be interested if it meant they could get more tax relief. Others still said they could see themselves involved in a scheme where capital input from investors was matched by a guaranteed return for a number of years (cf, the Defence Housing Authority model).

Sometimes I look at those army ones they advertise, buy your house and then we'll rent it back off you for a certain amount. I look at those and think they're almost too good to be true. You would have to look at the fine print, but they do sound quite reasonable in that basically they build them and you buy them, but then they take the tenancy over and then guarantee that you'll get rent for so many years at market value.... (NSW investor 1)

Another drawback was the perception that investors would be attracted to the low end of the market because of lower vacancy rates and tenant turnover. A few recognised that if they were to buy cheaper property and rent it for less, they might still get comparable returns.

These largely positive responses need to be understood in the context of the fact that very few investors were currently seeking to provide lower cost housing, and many

¹¹ These investors indicated that, while they were not motivated by a sense of social good, they saw these models as quite attractive. This was because the property is managed by someone else for no cost, market rent and full occupancy is guaranteed because of subsidies provided to the community housing organisation, and minor maintenance is the responsibility of the head-lessee.

investors were clearly not interested in doing so. They saw it as a government responsibility to house the low income, not the job of the private investor.

I'm not a great believer in the public-private partnership, because I don't think it works brilliantly. I'd rather pay higher taxes than have the government do that, and I think it's a government social responsibility, not a private sector responsibility. (Vic investor 6)

There were also several references to unattractive low cost housing they were aware of, suggesting that the lower end of the market has a poor reputation among at least some investors. Media portrayal of low income renters was nominated as something that doesn't help investor perception of the low end of the market.

Location was an important consideration, with a number of investors acknowledging that the areas where they believed low cost housing is found are not the areas they would normally invest in. This is because of a perception at least that low cost housing areas would not experience the same rate of capital gains as the areas they were investing in. A number still simply had not really thought about the idea.

7.7.2 Incentives to encourage interest in low cost housing

When asked about the incentives that might encourage low cost investment, several suggestions were forthcoming. These included government assistance with the building costs leading to reduced purchase price, elimination or reduction of capital gains tax (generally but more on low cost housing), reducing stamp duty; and providing a subsidy to ensure returns met investors' need.

The government could perhaps partially fund the building so that the purchase price is relatively low and affordable, both for residents and investors. So maybe if they could assist in the actual cost of the building, then maybe the cost of purchasing would be lower. (NSW investor 17)

... capital gains tax is a significant factor which will sway people against investment in property... (NSW investor 10)

... incentives in terms of investing that property, I want to know that my income was safe, so whether it means that a pension commitment or something like that, or I know there is a rent subsidy, I don't mind being involved in that situation, but I just want to know that my investment is safe. (Vic investor 3)

At the same time, several investors said the idea raised a number of questions about roles and responsibilities, particularly for government. Some said "governments do enough" already, and it was unrealistic to think government should provide more tax relief such as negative gearing. A few pointed to the fact that government was already providing on the demand side through Commonwealth Rent Assistance, and that this was a better way to go. One investor thought this discussion was all "too much"!

Some said the solution lies more in providing people with adequate income to afford housing rather than "trying to change the marketplace". Similarly, quite a few shifted the conversation to increasing people's access to home ownership, via no interest loans, rent/buy schemes, and increased first home owners grants, as a better response. One or two suggested the promotion of social housing, but this was not a common point.

8 MAKING SENSE OF INVESTOR BEHAVIOUR: CONCLUSIONS AND POLICY IMPLICATIONS

8.1 Review of the purpose of the study

The study has sought to fill an important research gap by investigating the motivations, expectations and experiences of investors. Making sense of investor behaviour is important and useful, both in terms of better appreciating the actions of key actors in the provision of private rental housing and also because doing so links into policy debates about the drivers (and prospects) of supply in general, and whether or how government policies such as negative gearing or tenancy laws affect such supply. There are also important potential implications of investment motivations and behaviours for the future of lower rent housing, which has also been under consideration in policy and research contexts.

This study has attempted to illuminate our understanding and appreciation of rental investment behaviour through the investigation of critical questions, such as:

- Why are people investing?
- Why in property?
- What attracts them to specific dwellings?
- What are their expectations?
- What are their experiences?
- How does all of this impact on rental investor behaviour?

All of these issues have been researched directly from the viewpoints and experiences of rental property investors themselves, supplemented by the perspectives of rental property managers, and other key agents directly involved in the private rental sector. These supplementary views have very much supported the main responses of investors themselves, providing in most cases a triangulation of materials for analysis.

8.2 Summary of findings and policy implications

Although the study has interviewed investors across a variety of geographies and histories in the rental sector, and has captured a mix of very small scale and moderate holdings-based investors, one striking overall observation is that there is a high level of consistency among investors. This is not to suggest that there are single motivators or drivers for being an investor; indeed, there are a number of these, as this study has highlighted. However, the range of motivations, experiences and intentions were very similar across investor portfolio size, geography, and even across the lengths of time that interviewees had been investors.

This study shows that there are a range of motivators for people to become investors, including financial factors, personal goals, personal and family circumstances, and other influences. In some cases, motivations are strong and clear; in others they are much less so, being more speculative or exploratory. Often, there is not just a single motivating factor but a number of interrelated factors or circumstances occurring. For some investors, seeking financial gain through investing was about embarking on a clear plan of wealth creation, developing long-term financial security and building an asset base, and securing future retirement income. For others, it was connected to the need to diversify investments, to spread financial risks, to establish an alternative to superannuation, and to build a balanced portfolio. Financial capability or opportunity

was critical in both cases: having accrued enough savings or equity (usually in property) over time, or having access to funds after the sale of property, led to a sense of 'need' to invest. But for others, it appeared to be less planned. In some cases, this was because the capacity to invest was linked to having unexpectedly come into assets or funds via inheritance, or changes in personal circumstances, such as re-partnering or geographic relocation.

Overall, it would appear that personal and situational factors significantly drive investment behaviour in the first instance in terms of investors' intentions to enter into the property investment market. These are largely based around financial imperatives, but the decision about investing if, when, and how they do, is linked more to circumstances and capacity than it is to market considerations or objective analysis of investment options. However, market conditions – particularly house price movements – do then significantly influence those initial investment decisions in terms of whether or not investors remain in the sector.

Personal circumstances, investment experiences, and market conditions influence broader future investment decisions, such as when they might plan to sell, or whether they might expand their investment portfolios.

In terms of the policy implications of this situation, it seems that investors come in and out of the market all the time, driven by an array of financial incentives, situational circumstances, market conditions, personal goals and other influences. They are not driven by economics alone, and so the capacity to shape their behaviour (and investment patterns) on that basis is often limited. When the economics are paramount, investors usually have their eye on the long-term capital growth picture.

Investors are attracted to property investment because they believe it represents a good long-term investment, and associate it with notions of property being 'low risk' and offering a 'guaranteed' return in terms of capital gains. Sentimentality and informality are also important factors when it comes to making critical property investment decisions. Investors feel 'comfortable' with property. It is safe, stable, tangible and familiar, particularly when compared with shares, and is also relatively easy to invest in, and is not mysterious or complex like some other investments appear to be. The general impression is that because lots of people invest in property, it perhaps escapes the closer market scrutiny, objective analysis, and detailed planning that might otherwise be devoted to significant financial investment commitments.

Perhaps the clearest example of how rental investors are relatively relaxed about their initial investment decisions is that the dominant sources of information for investors' pre-purchase are not accountants, estate agents and specialist advisors, but 'personal experience and intuition'. Information from the internet and newspapers are relied on in preference to professional market analysis, and the direct or indirect influence of friends, family, and wealth creation 'gurus' are also influential. There may well be limited objective information available about housing markets, but in reality there is little evidence that rental investors are looking for it anyway. Property is effectively deemed to be so familiar, and within both the comfort and knowledge zones of the average person, that detailed personal research and/or professional independent advice are seen as unnecessary.

In practice, the picture of the sophisticated, well-informed and economically rational investor simply does not well-describe the norm among rental investors. Perhaps a better descriptor of how people approach the housing market as prospective rental investors is that they are trapped between the 'bounded rationality' of what they see

and hear about property, and an 'emotional opportunism' connected to their own capacity and desire to become a rental investor as a means of wealth creation.

A fair question is whether any of this matters. This study essentially proposes that it may not, in fact, matter to investors. If they feel they have been successful to date, or that success is somehow guaranteed down the track, this is what impacts on their overall sentiment. In truth, successful outcomes from property investment can only ever partially be attributed to erudite financial decisions. They are necessarily also connected to serendipity and circumstance, particularly when financially-based decisions are only part of the thinking in the first place! Indeed, while home owners and investors alike have a tendency to congratulate themselves on their astute purchasing decisions, these are invariably made in hindsight, and it is worth reflecting briefly on just how much control investors have over the outcomes from their investments.

But so what? Nearly all investors who had been in the property market for several years, and many of the more recent investors experienced what they regarded as 'success'. They reported very high rates of satisfaction with various aspects of their property investment such as the yield, rate of capital gain, asset management arrangements and the tenancy management. This sense of success in the market is the key, as it provides 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.

On the flip side, however, using longer-term capital gains as the main measure of success can also be problematic. Such gains are theoretical only at the commencement of the investment, and after that they remain profits on paper only. To be realised (and quantified), the property has to be sold and gains in value taken, or there must be some other way of accessing the wealth. Very few investors in this study were at the point of selling their rental property investment, so the 'performance measure' of capital gains was merely an anticipation or expectation, yet to be realised. It is quite possible that some investors will be wrong about the level of capital gains that will be achieved, particularly if they are not factoring in the effects of inflation and the opportunity costs of not choosing alternative options. They may also pick a bad time to sell or be forced by circumstances to dispose of a property when the market is at a low point.

Despite this reality, investors' expectations were generally very high, and hence the capacity for potential disappointment was also high. This is accentuated by the fact that nearly all regard property as the 'best investment', and some said that they would still invest in property, even if returns were clearly higher in other areas (eg, shares). It is further potentially fuelled by prevailing market conditions proving less significant than might be expected when it comes to decisions to sell. The critical deciding factors varied, but age and personal circumstances appeared to be the dominant considerations for all these groups. Again, we emphasise that investors' perceptions of the property market are to some extent backward looking – the growth of the last decade has affirmed their belief in the market. But what happens, given the importance of capital gain, if there is a sustained period of little growth – for example, five years of minimal gain? This has occurred in the past in Australia, such as in 1990-1995, and in relatively recent times in some other countries, for example, in Sweden, the Netherlands, Japan and Hong Kong where there has been sharp capital losses.

While this study contributes to our understanding of investment behaviour and the attitudes of rental property owners, it also raises important policy questions about the capacity of governments to shape investment patterns. It would appear that private

rental investors are a difficult kettle of fish when it comes to pinpointing opportunities for interventions, particularly financial ones, as economics is only part of the story.

The very 'amateurism' of many investors can be problematic policy-wise, because they are not easily susceptible to policy levers. But it can also be a positive, in that these investors are not as reactive to market fluctuations or poor short-term returns as more professional investors, when weighing up the attractions of rental housing as an investment proposition. This is perhaps true for some potential entrants to the rental property market, although others might be put off coming in. However, it is of critical importance in terms of the net effects of market trends on existing, longer term investors, who may remain in the sector despite apparent market signals not to. We may have supply problems in today's rental sector, but how much worse would it be without investors who base decisions to invest in property on a number of personal, emotional and intuitive factors, as well as their own financial considerations?

The relationship between investment and tenancy law reform continues to prove weak. Previous research has emphasised that investors simply do not consider tenancy issues when investing for the first time (see Seelig 2007b for a brief review of this research), and in this study it was almost impossible to get investors to engage on tenancy law as an issue, let alone an important factor connected to investment decisions. By contrast, the lack of budgeting for management, maintenance or other costs, and in some cases taking on management themselves, raises the potential for the amateurism of investors to create conflict with tenants.

Negative gearing is not a critical driver for becoming an investor either, but significantly, it is seen as an important component of the economics of property investment. Investors were split evenly on whether they would have invested if negative gearing had not been available so, in practice, it may be hard to remove. This strengthens the case, in the shorter term at least, to find interventions which sit on top of broad negative gearing, rather than seeking to contain or remove it.

This study has highlighted that, despite the multifarious drivers and influences on investors' behaviour and decision-making, investors are clearly not driven by any sense of moral or social imperative to provide housing as a social service. Aversion to low-cost rental housing is not necessarily by design, but is more an effect of housing markets, investor economics, location choices and possibly the broad availability of negative gearing without strings. However, investors appear reluctant to see the lower end of the market as an attractive proposition for future investment, at least not without significant government assistance.

Given that the low cost end of the rental sector is regarded with some suspicion and concern, it is unlikely to attract rental investment interest without some encouragement. Again, targeted tax incentives are clearly an option for directing more investment to the lower end of the market, although in the absence of clear evidence that capital gains can be achieved in this part of the market, or at least a strong belief among investors about the potential for this, it may still prove very difficult to attract the average 'mum and dad' investor into the low end of the market. A more judicious approach to attracting particular types of investors – either those keen to use tax minimisation instruments, or perhaps a different class of investor entirely (such as larger scale more professional investors, or corporate/institutional level investment) – will probably be required to create sufficient interest.

Overall, perhaps the critical challenge with property investment behaviour among many investors is that it is quite difficult from a policy intervention perspective to seek to shape investment activity and to steer rational inputs into a relatively irrational and complex set of actions, values and beliefs.

One final observation about policy responses which arose from the interviews with property managers, was the difficulty encountered in trying to engage with the real estate agency sector about housing policy reform. Aside from a few references to removal of stamp duty, agents themselves seemed largely detached from such discussions.

8.3 Positioning study findings back into the broader housing context

Beyond these more immediate policy concerns, this research of the motivations, behaviour and intentions of rental investors in the Australian context, is important in broader housing policy terms for several reasons.

The private rental sector represents an investment opportunity to a reasonable slice of the adult population in Australia, and attracts some overseas investment in the domestic economy. The sector delivers investment returns to individuals and others, providing a means of wealth generation and financial planning for retirement. Perceptions and realities about the desirability and profitability of rental housing investment significantly affect the levels and location of supply, and the overall propensity to invest and provide rental housing.

Ongoing monitoring of market activity and performance allow for the detection of major problems in terms of future prospects for the rental sector. While there may be short term supply constraints at specific points in time (2007-08 being an example), these can be shaped largely by demand pressures as much as by supply issues. The broad longer term picture of private rental investment however continues to be positive.

The private rental market also of course houses around one-fifth of the population nationally; with much higher proportions in specific urban locations. The sector actually accommodates a greater number of lower income households than the public housing system, including the majority of those on social welfare benefits and pensions. Events in the private sector have implications for the demand for Commonwealth Rent Assistance and state/territory- provided private rental support programs.

At a housing policy level, we thus rely on the private rental sector to provide a sufficient supply of housing across a range of cost segments, and understanding the processes through which such supply – in the form of property acquisitions and ongoing investment decisions – occurs allows us to better appreciate the strengths and weaknesses of both those processes, and perhaps our policy expectations of the sector.

The private rental market functions in a wider systems context. What happens in private rental housing in terms of costs to tenants can have effects on entry to home ownership by influencing the capacity to save deposits, the demand for public housing if conditions are not adequate or appropriate, and even the levels of homelessness if people are excluded from private rental housing, for example, via tenancy databases, without alternative options being available. While investors appeared to be fairly sanguine about the types of tenants they rent to, there were certain groups – often those who are most reliant on rental housing because of a lack of alternative options – whom investors saw as a greater risk, and were therefore more likely to steer away from.

A lack of affordable and stable housing can impact directly on tenants' well-being physically and psychologically. In a broad policy sense, the supply of lower cost private rental housing is important in the context of ongoing public housing reform

agendas. If the private rental sector is incapable of providing a reliable source of rental housing for low income households, the demand and normative need for growth in social housing to house such households will remain and potentially grow.

Finally, rental cost and supply may affect national and state social policy programs such as increased access to labour markets, spatially-specific employment generation, and reduced public expenditure on public housing. There are therefore broader social and economic policy reasons for being concerned about rental market issues.

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APPENDIX

Appendix 1: Survey and Interview Questions for individual investors

Part A: Survey (please provide relevant information or '☑' as requested)

1. Property investment background

1.1. What year did you first become a rental investor? _____

1.2. What ownership arrangement best describes your current property investment situation.

☐ *Sole investor*

☐ *Joint owner with spouse/family partner*

☐ *Joint owner with others*

☐ *Trust/business*

1.3. How many rental properties do you currently own?

☐ 1

☐ 2

☐ 3-5

☐ 6-10

☐ More than 10

1.4. What sort of rental properties have you purchased in the past five years?

	Dwelling Type (Select from list)	Location (Select from list)	Approx original price \$000s	Approx Current value \$000s	Year of purchase	Year of sale (if sold)	Current Rent charged \$pw	Main-tenance Budget \$pa
Property 1								
Property 2								
Property 3								
Property 4								
Property 5								

DWELLING TYPE:**LOCATION:**

A	NEWLY BUILT LOW RISE FLAT	W 1	INNER CITY (SAME STATE)
B	EXISTING LOW RISE FLAT	W 2	INNER CITY (INTER-STATE)
C	NEWLY BUILT HIGH RISE APARTMENT	X 1	MIDDLE SUBURB (SAME STATE)
D	EXISTING HIGH RISE APARTMENT	X 2	MIDDLE SUBURB (INTER-STATE)
E	NEWLY BUILT TOWN HOUSE	Y 1	OUTER SUBURB (SAME STATE)
F	EXISTING TOWN HOUSE	Y 2	OUTER SUBURB (INTER-STATE)
G	NEWLY BUILT DETACHED HOUSE	Z 1	NON-METRO (SAME STATE)
H	EXISTING DETACHED HOUSE	Z 2	NON-METRO (INTER-STATE)
I	OTHER	*	OVERSEAS

1.5. Do you seek to target your rental property/ies towards or away from any of the following parts of the market or types of renters? (please tick for each of the following options)			
	Towards	Away from	Neither
Low cost end of the market			
Middle cost part of the market			
High cost end of the market			
Older renters			
Young renters			
Single person households			
Couples without children			
Sole parents			
Families with children			
Students			
Group households			
Working households			
Retired households			
Households receiving government pension/benefits			
Other (please specify)			

2. Your last residential property investment
Thinking only about your last investment property

2.1.	What was the approximate original cost of the property?	\$_____
2.2.	How did you finance the property?	☐ Specific loan \$_____
		☐ Extension of own home loan \$_____
		☐ Equity contribution \$_____
		☐ Other (please specify) \$_____
2.3.	What were the sources of finance for this property?	☐ Bank
		☐ Building society
		☐ Finance Company
		☐ Mortgage manager
		☐ Vendor Finance
		☐ Solicitors or trust funds
		☐ Other
		☐ Not applicable
2.4.	What sort of loan did you use?	☐ Interest only
		☐ Interest and principal
		☐ Other
		☐ Not applicable
2.5.	What level of equity did you have when you first acquired the property?	\$_____
		As % of total value _____%
2.6.	What would you estimate to be the current value of the property?	\$_____
2.7.	Do you make use of taxation provisions such as negative gearing?	☐ Y
		☐ N
2.8.	How is the property managed?	☐ Real estate agent/professional manager
		☐ Self/partner

☐ *Other family member*

☐ *Other*

2.9. What rent is charged for the property? \$_____

2.10. Over what sort of term did you originally anticipate investing for?

☐ *short term (less than 1 year)*

☐ *medium term (1-5 years)*

☐ *long term (more than 5 years)*

2.11. What sorts of returns have you received?

☐ *Significant profit*

☐ *Small profit*

☐ *Broken even*

☐ *Loss*

☐ *Don't know*

3. Reasons for investing

3.1. Did you attend any property investment sales conferences/workshops prior to purchasing?

☐ *Y*

☐ *N*

3.2. What sources of information about residential property investment do you use, and, in terms of a ranking, how important are they to you?

	Source used (tick)	Rank on a scale of 1 to 5 (1 = most important)
Personal experience/intuition		
Property sections of newspapers		
Specialist property investment magazines		
Investment advisors		
A tax accountant		
Networking with people in the know.		
Real estate agent		
Family and friends		
Web-based information		
Other (please specify)		

3.3. Which taxation policies (if any) influenced your investment decisions?

☐ *depreciation tax concessions*

☐ *negative gearing*

- ☐ capital gains tax
- ☐ stamp duty
- ☐ property transfer tax
- ☐ vendor tax (NSW)
- ☐ other
- ☐ none

3.4. Overall, what were your main reasons for investing in residential rental property?	Reasons:	Rank:
3.5. How would you rank them in order of importance (1 = most important)?	☐ Long term investment ☐ Capital gain ☐ Rental income ☐ Negative gearing ☐ For family members ☐ Possible future home ☐ Other (please specify)	☐ ☐ ☐ ☐ ☐ ☐ ☐

3.6. Overall, what factors did you consider in deciding whether to invest in residential property?	Factors:	Rank:
3.7. How would you rank them in order of importance (1 = most important)?	☐ Interest rates ☐ Capital gain ☐ Rent trends ☐ Negative gearing ☐ Other taxes and charges ☐ housing policy ☐ tenancy law ☐ Other (please specify)	☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐

For each of the following statements, please indicate whether you agree or disagree:

3.8. Over the medium term (next five years), capital gains is more important than rental return	<i>Disagree strongly</i> 4	<i>Disagree</i> 3	<i>Agree</i> 2	<i>Agree strongly</i> 1
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3.9. Long term capital gains (over five to ten years), is more important than rental return	<i>Disagree strongly</i>	<i>Disagree</i>	<i>Agree</i>	<i>Agree strongly</i>
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4

3

2

1

3.10. I would not have invested if it was not for the capacity to negatively gear the investment

*Disagree strongly**Disagree**Agree**Agree strongly*

4

3

2

1

3.11. Property is the best long term investment

*Disagree strongly**Disagree**Agree**Agree strongly*

4

3

2

1

3.12. Even if returns were higher in other sectors (e.g. stock and shares), I would still invest in property

*Disagree strongly**Disagree**Agree**Agree strongly*

4

3

2

1

3.13. I would only invest in locations I am familiar with, even if this meant lower returns

*Disagree strongly**Disagree**Agree**Agree strongly*

4

3

2

1

4. Investor experiences

4.1. Compared to your expectations, how satisfied have you been with your rental investment in terms of:

(a) the rent yield

*Very dissatisfied**More dissatisfied than
not**More satisfied than
not**Very satisfied*

4

3

2

1

(b) the capital gain

*Very dissatisfied**More dissatisfied than
not**More satisfied than
not**Very satisfied*

4

3

2

1

(c) managing the property

*Very dissatisfied**More dissatisfied than
not**More satisfied than
not**Very satisfied*

4

3

2

1

(d) managing the tenants

<i>Very dissatisfied</i>	<i>More dissatisfied than not</i>	<i>More satisfied than not</i>	<i>Very satisfied</i>
4	3	2	1

5. Investor Profile

Home postcode (where investor lives now) _____

5.1. What family type best describes your household?

- ☐ *Single person*
☐ *Sole parent*
☐ *Couple without children*
☐ *Couple with children at home*
☐ *Couple with children away from home*
☐ *Other*

5.2. How old are you?

- ☐ *15-24 yrs*
☐ *25-34 yrs*
☐ *35-44 yrs*
☐ *45-54 yrs*
☐ *55-64 yrs*
☐ *65-74 yrs*
☐ *75 + yrs*

5.3. What was your country of birth?

- ☐ *Australia*
☐ *New Zealand*
☐ *UK*
☐ *Other European country*
☐ *Asian country*
☐ *African country*
☐ *Nth/Sth American country*
☐ *Other*

5.4. What is the main income source for the family?

	You	Partner
<i>Wage/salary</i>	☐	☐
<i>Own business/ partnership</i>	☐	☐
<i>Investments</i>	☐	☐
<i>Gov'ment pension/benefit</i>	☐	☐

Other

☐☐

5.5. What would your gross annual household income be (approximately)?

- ☐ *Less than \$10,000 pa*
- ☐ *\$10,000 - \$24,999 pa*
- ☐ *\$25,000 - \$49,999 pa*
- ☐ *\$50,000 - \$74,999 pa*
- ☐ *\$75,000 - \$99,999 pa*
- ☐ *\$100,000 - \$149,999 pa*
- ☐ *\$150,000 or more pa*

5.6. What investments do you have (excluding residential rental property)?

- ☐ *Other property*
 - ☐ *Property trusts*
 - ☐ *Shares*
 - ☐ *Bonds*
 - ☐ *Term deposits*
 - ☐ *Voluntary superannuation*
 - ☐ *Collectables*
 - ☐ *Other (please specify)*
-

5.7. How often would you read an investment magazine or the financial section in a newspaper?

- ☐ *Daily*
- ☐ *More than once a week*
- ☐ *Once a week*
- ☐ *More than once a month*
- ☐ *Once a month*
- ☐ *Very infrequently*
- ☐ *Never*

Part B: Face to face Interview questions *(More open ended questions)*

6. Past experiences and reasons for residential property investment

- 6.1. Why did you purchase your residential rental property/ies when and where you did?
- 6.2. What did you look for when you purchased your most recent investment property? How did this differ from when purchasing previous investment dwellings?
- 6.3. Why did you choose to invest in residential property over other investments (most recent purchase; earlier purchases)?
- 6.4. If you did not consider other types of investment, why not?
- 6.5. What did you originally expect to get from the investment (in terms of income, capital gain, tax relief, etc)?
- 6.6. Have there been particular operating or other costs you have encountered in owning a rental property? Were they expected?
- 6.7. Have there been particular problems you have encountered in owning a rental property? Were they expected?
- 6.8. Do you believe there are types of renters who represent a greater or lesser threat to your property investments? If so, how do you seek to manage this?
- 6.9. Have your reasons for investing in property changed over time? In what ways?

7. Future investment activity

- 7.1. How long do you intend to keep this investment property? Why?
- 7.2. What sorts of factors are likely to affect your decision to keep or dispose of the property?
- 7.3. Overall, are you happy with the rates of return achieved? Please explain why.
- 7.4. If you sold your investment property in the next month where would you invest all or most of the money? Why?
- 7.5. What factors or experiences have influenced your thoughts and intentions about future investments?
- 7.6. If you were deciding today whether to purchase the rental property you own, would you still become a rental investor? What factors would you mainly take into account?
- 7.7. Do you intend to purchase any residential investment properties over the next 5 years? If so, what sorts of property and where would you buy?

	Dwelling Type (select from dwelling list)	Location (Select from location list)	Approx dwelling price
Property 1			
Property 2			
Property 3			
Property 4			
Property 5			

DWELLING TYPE:

A NEWLY
BUILT
LOW RISE
FLAT

LOCATION:

W 1 INNER CITY (SAME
STATE)

B	EXISTING LOW RISE FLAT	W 2	INNER CITY (INTER- STATE)
C	NEWLY BUILT HIGH RISE APARTMENT	X 1	MIDDLE SUBURB.....
D	EXISTING HIGH RISE APARTMENT	X 2	MIDDLE SUBURB.....
E	NEWLY BUILT TOWN HOUSE	Y 1	OUTER SUBURB (SAME STATE)
F	EXISTING TOWN HOUSE	Y 2	OUTER SUBURB (INTER-STATE)
G	NEWLY BUILT DETACHED HOUSE	Z 1	NON-METRO(SAME STATE)
H	EXISTING DETACHED HOUSE	Z 2	NON-METRO (INTER-STATE)
I	OTHER	*	OVERSEAS

- 7.8. Under what circumstances would you consider investing in affordable housing for lower income households?
- 7.9. If government was to restructure tax relief for rental investment to create greater incentives for more affordable housing for lower income households, would this affect your investment intentions or practices?
- 7.10. What else could government do to create such incentives?

Appendix 2: Interview Questions for estate agents and other rental sector key informants

AHURI Project 20280: Motivations of investors in the private rental market

Interview Questions – Key informants

Key informant type (estate agent, housing sector body, finance provider etc)

Background

1. How important is rental investment or property management to your business?
2. What sort of markets, submarkets do you deal with, etc?
3. How would you describe recent trends in the rental market; impact on agents or investors?
4. Who are the different groups of investors you see; how would you describe the 'typical' investor? *Include follow ups re international, migrant investors etc.*
5. How do investors vary according to property type, location, segments of the market?

Investor motivations

In your opinion

6. What drives investors in their investment decisions at the current time, and have these changed over time?
7. How do investment motivations vary according to discrete groups or types of investors, scale of investment holdings, or different types of housing markets?
8. What role does location play in motivating rental investment within metropolitan areas and between metropolitan and regional areas?
9. What role do government incentives (eg, tax concessions and negative gearing) play in motivating investors to purchase properties for rental purposes compared to other potential factors?
10. Do particular groups or types of investors focus on specific cost segments of the market? Do any target their investments towards the lower cost end of the market? What are the main reasons for doing so or not doing so?
11. Has the post-2000 boom in rental investment involved existing investors expanding their property portfolios, or has it attracted groups or individuals new to property investment? If the latter, what motivated them to choose to invest in residential property?
12. Are there clear patterns or trends associating different types of investors with different points in the property cycle?

Investor expectations and experiences

In your opinion

13. What expectations do property investors have of rental returns, capital gains and other benefits? Do investors believe such expectations have been met, and how have they changed over time? Have expectations influenced their future investment intentions?
14. What expectations do rental investors have of the costs associated with tenancy management? To what extent do investors use professional managers versus more informal management arrangements? What experiences have investors had of tenancy management in terms of professional property managers and tenants? Have these experiences influenced their future investment intentions?
15. What sorts of legal and financial instruments have investors used to enter the rental market? What were their experiences of lending institutions and sales agents?

Investor behaviour

In your opinion

16. To what extent is investor behaviour influenced by initial expectations and ongoing perceptions and experiences?
17. How do investors select the area and type of housing they invest in?
18. What drives investment into or out of specific segments of the rental market?
19. How has investor behaviour been impacted on by recent property cycles? How have these impacts varied across different types or groups of investors, cost segments and housing market location?

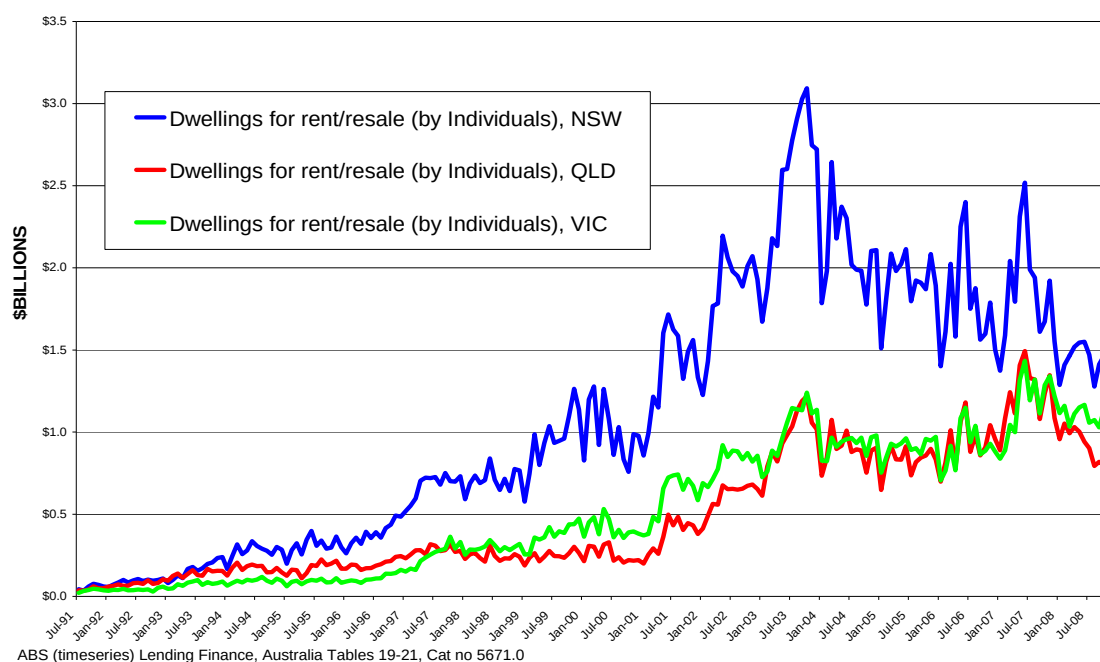
Institutional context

20. What changes in the institutional environment helped to create the recent upsurge in private rental investment?
21. What new lending products were created and how did these products work?
22. What was the role of investment brokers and spruikers in shaping attitudes to residential investment?
23. What are the future prospects for lower cost rental investment?
24. What policy options exist for government (State and Federal) to preserve existing investment and/or attract new supply at the lower cost end?

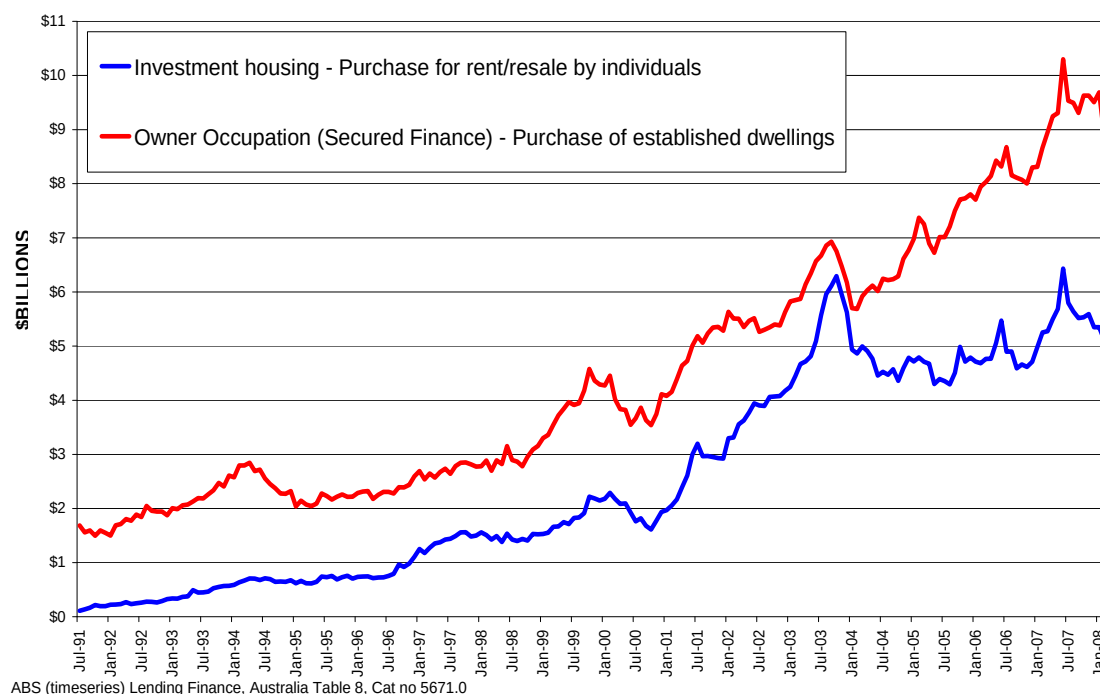
Finally... Would you be able to assist us in identifying investors who might like to participate in this study. We would like to interview 5-10 rental investors in this area.

Appendix 3: selected housing market and rental investment activity indicators

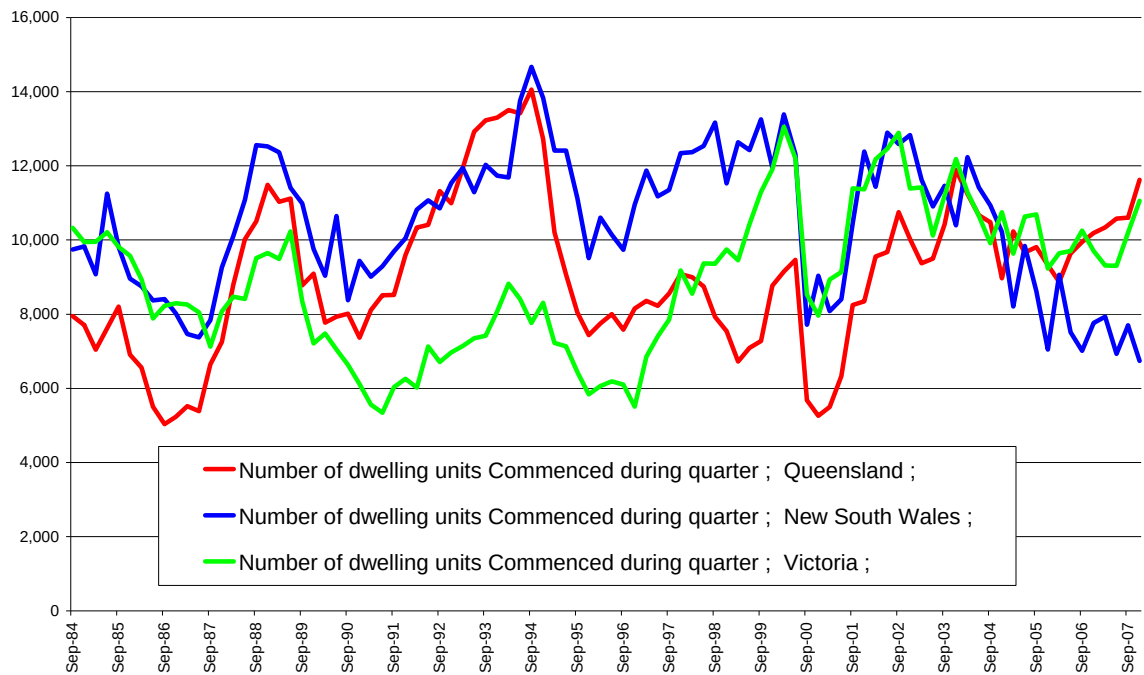
Dwellings for rent/resale (\$'000s by Individuals), 1991-2008



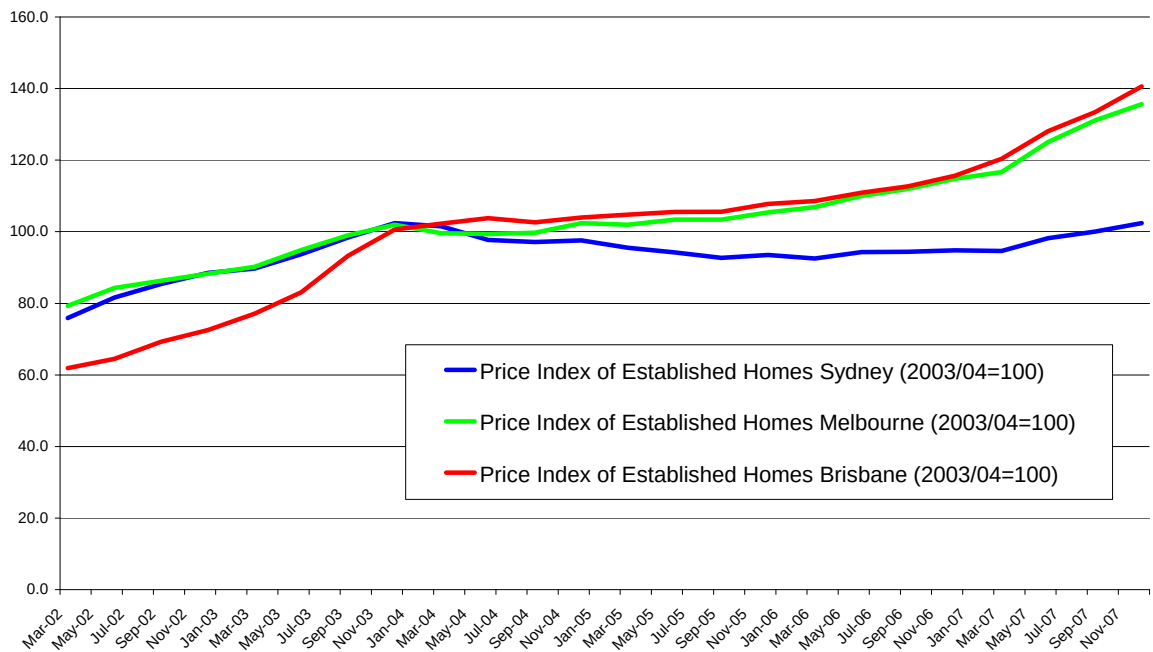
Lending for owner occupation and rental investment by individuals, (\$'000s) 1991 – 2008



Dwelling commencements, 1984 - 2007

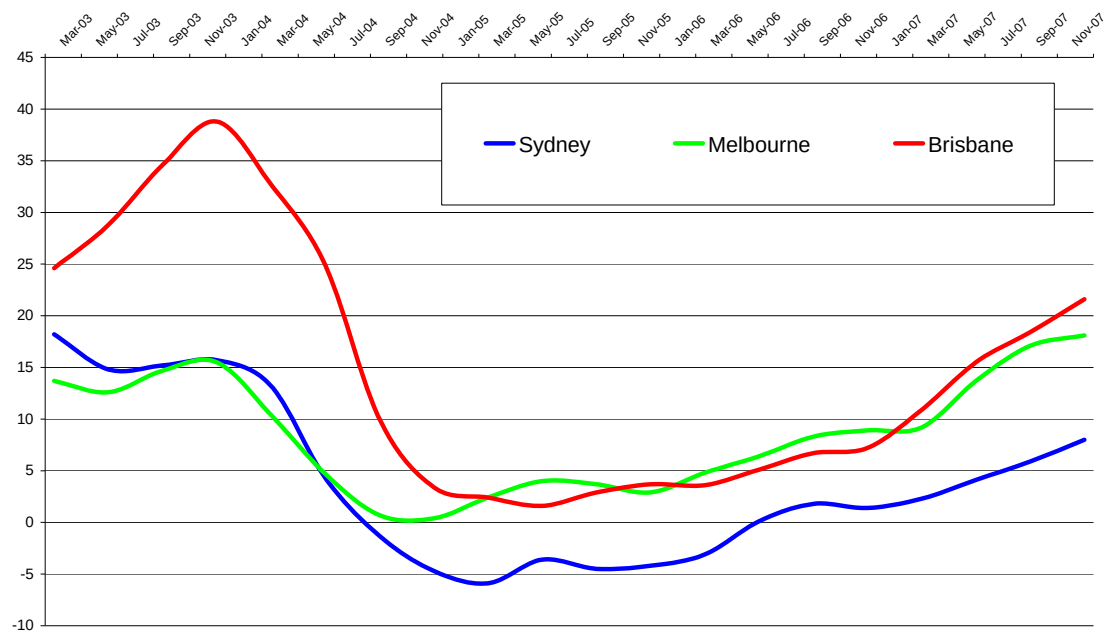


Price Index of Established houses, 2002 - 2007 (2003/04=100)



ABS (timeseries) House Price Indexes: Capital Cities, Tables 1-6, Cat. No. 6416.0

Established houses percentage change from corresponding quarter previous year (2003/04=100)



ABS (timeseries) House Price Indexes: Capital Cities, Tables 1-6, Cat. No. 6416.0

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