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Investors in the residential rental market

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- This presentation refers to ongoing research and early findings of interest to the focus of this seminar. Those findings/comments should be treated as draft and not used without consent of the researchers.

a key part of the equation

- The private rented sector is crucial to the Australian housing system
- More low-income Australians in need live in the private sector than in public sector housing
- Concern and debate over affordability
- Concern and debate over the geographies of provision



But why be concerned about investors?

why do we need to know about investors?

- Housing policy relies on provision of affordable housing in the private sector for low-income households
- Its role and relative health influences the wider housing system: pressures on the social housing sector; implications for entry into owner occupied markets, and the flows of those markets
- 7% of Australia's adult population are investors in residential property – key to wider investment choices and asset building strategies of many households
- Housing is a major part of the economy, and the investment market is a significant driver/barometer of activity



Knowing what current and future intentions given experiences central to understanding on-going role of the private rented sector

the investor context

- Approximately 7% of Australian 'income-units' own residential investment property. RBA research based on HILDA survey suggests this figure is a little higher at 10.3% (Seeling et al, 2006; Parlett & Rossiter RBA, 2004)
- Individual/household investor accounts for 60-70% of private rental units. Most own 1 property, and those with 1 or 2 properties account for 90%+ (ABS, 1994; 1998; NSWDoH, 1990)
- Most owning an investment property owe debt on that property; higher proportion of younger investors and renter-investors do so (ABS, 1998)
- 'Standard profile': older couple, empty nesters, higher income groups: however investors **far** from homogeneous (ABS, 1998)
- Range of investor typologies/categorisations have been suggested, distinguishing factors such as scale of investment/portfolio; unintentional/intentional; primary motivations/considerations for investing (e.g Paris, 1987; NSWDoH, 1990; Seelig 2001)
- Also important to consider how motivations/behaviours change over time

investors in low-income rental housing

A distinct type of investor?

- More likely to own only one dwelling than rental investors generally
- More likely to be self employed and have generally lower levels of income than other investors
- More likely to manage their own properties
- More likely to own older dwellings
- Are more likely to want to get out of the market but cannot sell
- Less likely to be interested in long term investment

(Seelig et al, 2006)



Distinction in motivations/behaviour of interest when considering the economics of investing

the economics of investing

- Residential investment integral to thousands of Australians' financial planning
- Conditions favourable for household/small investor
- A tangible but illiquid asset



- Tax incentives (negative gearing, depreciation and deductions)
- Capital growth and rental returns
- Favourable taxation (capital gains)



- Costs of purchasing/mortgage
- Costs of managing property (agent fee, strata levies, services responsibilities)
- Costs of maintaining property
- Stamp duty/exit taxes



Wider economics, financial circumstances of investor and institutional context all subject to change, affecting attraction/viability of investment

the economics of investing

In terms of rental returns ...

- Of those reporting in FY 96/97, 34.3% made a profit, 12.8% broke even, 41.8% reported a loss (ABS, 1998, Seelig et al, 2006)
- 74% of rental income earners deducted interest payment on tax returns in 2000/01.
50% of investors aged 25-44 received zero net income from letting property
(Parlett & Rossiter RBA, 2004)
- For FY 2002/03 1.3 million taxpayers declared rental income of \$13.7bn and claimed rental deductions of \$14.9bn. The following year saw rental deductions reach \$18bn (ATO)
- Yields are currently reported at just 2-4% in the Sydney market



When yields low, rational behaviour will balance this with assessment of capital growth

the economics of investing

- Ability to draw upon equity in a rising market and negatively gear has been key to the surge in investor activity post 2000 (until recently)
- Strong re-emergence of private residential investment from mid 1990s; by 2003, investors accounted for about half the value of total housing loans in NSW
- Overall increase in rental stock, but economics of investing has meant that increases largely provided at the upper end of the market – and indeed a loss at the lower end
(Wood, 2001; Yates et al, 2004)

But economics change ...

- When capital growth is high, investors need not be as rigorous in their investment decisions as they might otherwise be. In a stagnant/declining market unsophisticated investment behaviour becomes all too apparent
- As does the fact that provision of housing to low-income groups is neither profitable nor attractive in the absence of robust capital growth

interesting times?

- Stagnant capital growth/declines, diminishing rental yields = unattractive prospect
- Competition from other market sectors: the stock market has outperformed housing (certainly in Sydney) over the last few years
- Policy uncertainty: the rise and fall of the Vendor Tax, land tax issues
 - Housing market 12-15% off 2003/4 peak values
 - Median prices: \$425,000 (-5.3% year to Dec 2005)
 - Median weekly rents (3brm houses): \$260 (Dec 2005)
 - Vacancy rates: 2.6% (Dec 2005)
- Into 2006, push to 'encourage' recovery along: coverage of declining vacancy rates, a shortage of supply, upward pressure on rents, tenants 'chasing' properties
- Price falls in parts of inner ring greater than central and outer areas; indications of price recovery in inner suburbs early 2006, continued declines elsewhere



From boom through decline to glimmer of recovery: what implications for investor motivations?

motivations of investors in the private rental market

- AHURI-funded collaborative research across 5 States, led by the AHURI Queensland Research Centre. City Futures research team are conducting the NSW research
- In the context of recent trends, an in-depth, qualitative study of investors:
 - to gain a better understanding of investors experiences, motives and actions
 - to understand how these factors vary according to the type of investor, the markets in which they operate, and the length and timing of investment
 - to consider the implications of investor actions on future supply dynamics
- Research outcomes will:
 - Provide a clearer understanding of current and future potential investment in the sector
 - Inform policy debate on mechanisms to secure current/facilitate additional supply

we're talking to ...

- Key stakeholders and informants in the property rental industry, including REIs, Property Owners Associations (POAs) and research groups across the 5 States and national bodies
- Real estate agents and property rental managers in Metropolitan and regional markets in selected case study areas
- Individual investors themselves, accessed through estate agent contacts, use of group networks and mailing lists
- While providing an up-to-date overview of residential rental investment market, focus is on the individual/small rather than institutional investor

Important to stress that the research is on-going and at relatively early stages: any observations at this time reflect initial thoughts emerging from the NSW context

research underway in NSW

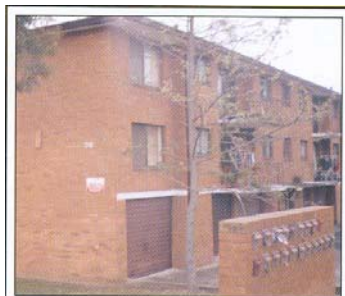
- NSW research focuses on Sydney and Coffs Harbour
- Metro Sydney identified as a series of sub-markets, and selection of real estate agents/property managers aims to reflect the geographies of these markets
 - Inner north shore/city centre/eastern suburbs
 - Central west
 - Outer/suburban



Distinctive characteristics of these markets, types of property, market segmentation, and types of investor

- Agents in Coffs cover breadth of property types in town/surrounding coastal area
- In both Sydney/Coffs, selection of agents also aims to provide spectrum of national, major chains as well as local independents
- (To date) investors spoken to mainly in Sydney central west/outer suburban markets.

investing in the rental market: Sydney's outer west



MOUNT DRUITT \$165,000
LOCATION
Neat and tidy two bedroom unit. Spacious lounge and dining, internal laundry. Just an easy stroll to all amenities. For the investor we have an excellent tenant paying \$155 per week.

1888w22.05



BLACKTOWN \$284,950

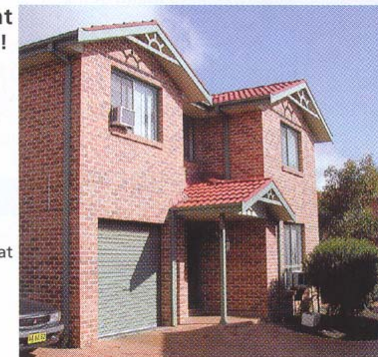
Investment / First Home
Spacious 3 bedroom fibro/tile home on level 611m² block. Offers lounge/dining, modern kitchen, generous bedrooms, large external rumpus with shower and toilet, covered BBQ area, shed, big yard. Great way to get into the market.

St Marys



Great Investment - Make It Quick!!!

- 3 good size bedrooms, walk in robe and ensuite to main
- Modern bathroom and kitchen, large lounge and dining areas
- Currently tenanted at \$200 per week
- Single lock up garage, close to schools and M4



Price: **\$239,950**

SHALVEY \$249,950



Invest Now For The Future!

Been looking for that ideal investment? well look no further then this wonderful three bedroom brick veneer home situated in a private street featuring separate lounge and dining area, air conditioner in the lounge room, large separate garage. Currently rented for \$210.00 per week. Ideal for any home buyer.

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EMERTON \$229,950



1ST HOME BUYERS & INVESTORS

Here it is! A 3 bedroom brick veneer home on a great sized block just under 600 sqm. Consists of 2 built-ins, cypress pine floors throughout, great sized lounge, separate dining, very neat bathroom and kitchen. Split system air conditioning in the lounge and main bedroom. Fully fenced property with single garage, all just a short walk to schools, shops and bus stop. Call now.

0625w22.02



St Marys



Investors Delight - Rent Guaranteed

- This modern brick veneer villa has 3 bedrooms with built ins to all
- Currently leased to a government department to end of 2007 at \$249 pw
- Lounge, dining, spacious kitchen, 2x toilets
- Lock up garage under the main roof

Price: **\$249,950**

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how are investors responding to recent trends?

- Recent experience and response in large part determined by entry into market
 - Seasoned investors are likely to have retained their portfolio or reduced their exposure, but are holding onto their properties in the main
 - Most investors purchasing <2002 will still have seen some asset growth and are sitting it out. Those purchasing at the peak of the cycle in 2003/4 may be over-exposed and in negative equity
 - ‘Mum and Dad’ investors with 1-2 properties, bought drawing upon equity of their home and entering the market towards the height of the cycle are likely to be suffering
- Evidence of pressure on small investors: rising number of mortgagee sales, forced sales, sales at a loss to the vendor
- More recently, decreased house prices and tightening rental market: early signs of seasoned investors coming back? Agents seeing only a few ‘new’ faces.
- In the absence of rising values, investors are more exposed to the costs of owning a rental property. While gearing provides some shield, monthly shortfalls in absence of capital growth become all too apparent.

have investors talked with their feet?

- Mixed perceptions amongst agents/stakeholders regarding the flight of investment activity out of NSW over the past 2 years
- Previous research has emphasised the local geography of investment decisions: 60-70% within local government area, 80-90% within State
- Appears to have been some chasing of perceived higher returns/capital growth, first Queensland and more recently on the back of the resources boom in WA and NT
- Amongst respondents, some interest in Queensland. Driven by perceived returns rather than necessarily as a long-term investment
- Research tools: the internet has played an important role in providing confidence for investors to look further a field



Residential investment has become increasingly mobile, although inter-State/international activity should be kept in perspective

the local geography of investment

“We found our local marketplace initially establishes itself in the cheaper older areas, using their first homes as stepping-stones to then move further West into the younger, bigger properties ... once our clients are well-established in their newer homes, we actively encourage them to invest in real estate. ‘Your income is your cash-flow - how you invest it creates your wealth’, is an adage we often quote when we advise on negative gearing and the benefits of owning more than one property” (from Fairfield estate agent website)

- Investors remain largely local/sub-regional. Tangible assets should be tangible - personal experience and knowledge of the local housing market is key
- Inner Sydney investors tend not to stray too far west, but there is some cross-Metropolitan investment activity (entering into investment market, invest-to-rent, new product?)
- Coffs Harbour: some sea-change investment from Metropolitan areas. Also interest from inland areas e.g. Armidale and Tamworth

implications for forward investment activity

- Some glimmers of a return to investment market, but existing investors bruised
- With limited potential for value growth, on-going costs more apparent. Concerns regarding land tax, fire safety obligations, new regulations for strata maintenance
- Fear of uncertainty regarding institutional/policy changes undermining confidence
- Anecdotally, loss of low-value rental properties to first-home buyer market: dual marketing of properties to competing market segments
- Developer response to changing contexts: profile of purchasers has shifted from predominantly investors to a more balanced, or indeed predominant occupier market
 - Seeking to prop up investment market through rental guarantees
 - Altering product and marketing focus
 - Concern that small/family/local builder-developers have suffered, impacting on local economies, even moving elsewhere to follow investor dollar
 - Potential implications for supply at lower-end of the market?
- Look for less risky options. Implications of SUPER/institutional investor mechanisms? Different type of investor, a different type of product?

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