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INVESTING IN HOUSING MARKETS:

DIRECT INVESTMENT VERSUS HOUSING TRUSTS

– private investor's point of view

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INVESTING IN HOUSING MARKETS: DIRECT INVESTMENT VERSUS HOUSING TRUSTS

– private investor's point of view

The purpose of the thesis is to explore housing investment options offered to private investors in Finland while focusing on housing investment trusts and direct housing investments. Attention is paid to the benefits, expenses and obligations of each method to illustrate their suitability for investors.

The main research question is which of the two methods of investment is expected to yield higher revenue for a private investor with 20.000€ in capital with a 5 year investment horizon, with two sub questions being what are the most common risks of both types of investment and what are the benefits, obligations and expences offered by the methods.

Once the housing is picked correctly, the rent level is defined, the tenant is carefully selected and the contract is well prepared, direct housing investment can be a very profitable business. The research indicated that the biggest risk for direct housing investors rises from the investor itself, unlike in housing investment funds which are managed by professional investors. A financially stable investor with large income is naturally able to handle more risk but regardless, not studying the investment in detail or using too large a debt leverage is a sure way to fail on the housing investment market.

KEYWORDS:

HOUSING MARKETS, HOUSING TRUSTS, HOUSING INVESTMENT, REAL ESTATE

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SIJOITTAMINEN ASUNTOMARKKINOIHIN: SUORA- VAI RAHASTOSIJOITUS?

- yksityisen sijoittajan näkökulma

Tämän opinnäytetyön tarkoitus on tutkia yksityissijoittajan eri vaihtoehtoja sijoittaa asuntomarkkinaan joko suorana asuntosijoituksena tai sijoituksena asuntosijoitusrahastoon. Työ kiinnittää huomiota kunkin menetelmän etuihin, kuluihin ja velvollisuuksiin havainnollistaakseen niiden soveltuvuutta sijoittajille.

Tärkein tutkimuskysymys on kumman kahdesta investointitavasta odotetaan tuottavan suurempaa tuottoa yksityiselle sijoittajalle, jolla on 20.000 euron pääoma ja 5-vuotinen sijoitushorisontti, sekä kaksi alikysymystä mitkä ovat molempien investointitapojen yleisimmät riskit ja mitkä niiden tarjoamat edut, velvoitteet ja kustannukset

Kun sijoitusasunto on valittu oikein, vuokra-taso määritetty, vuokralainen on valittu huolellisesti ja vuokrasopimus on hyvin valmisteltu, suorat asuntosijoitukset voivat olla erittäin kannattavaa liiketoimintaa. Tutkimus osoitti, että suoran asuntosijoittamisen suurin riski nouseekin itse sijoittajasta, toisin kuin asuntosijoitusrahastoissa joita hallinnoivat ammattimaiset sijoittajat. Rahatilanteeltaan vakaa ja hyvätuloinen sijoittaja kykenee luonnollisesti kestämään enemmän riskejä, mutta siitä huolimatta investointien tekeminen puutteellisella tutustumisella kohteeseen tai liian suuren velkavivun käyttö ovat varmoja tapoja epäonnistua asuntosijoitusmarkkinoilla.

ASIASANAT: ASUNTOMARKKINAT, ASUNTOSIJOITUSRAHASTOT, ASUNTOSIJOITTAMINEN, KIINTEISTÖT

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1 INTRODUCTION

Investing in real estate is very popular nowadays, driven by a decade of low interest rates and rising margins in rental revenue. Housing and real estate are also seen as a relatively safe way of investing, because of their lack of sensitivity to economic fluctuations resulting in steadily growing value, especially when compared to other forms of investing. This is especially true in locations that have a positive population growth, where the demand for studio and two-roomed apartments is steadily high or on the increase. Additionally, real estate and condominium apartments tend to maintain their value in the long term (Kiinteistömaailma, 2018). Currently, about two-thirds of non-subsidized rental apartments are owned by private landlords. In Finland, there are about 220 000 private landlords. (Suomen Vuokranantajat n.d. a, 2)

Housing investment can be done either by directly investing in housing market by buying a housing investment or by investing in a housing investment trust. Direct investing, which is the act of buying a personal housing investment, is the most traditional and popular way of investing in the housing market. This will allow the investor to directly influence on the value of the investment, for example, by conducting renovations or partaking in the decision making of the condominium. The main sources of income consist of monthly received rental revenues and the possible rise in the value of the housing. (Kinnunen, 2017)

However, the direct housing investment often demands the use of leverage by loan, which means that only a proportion of money invested originates directly from the investor while the rest is loaned (Thurén, 2017). In recent years, to challenge traditional housing investment, a number of housing investment trusts have entered the scene. These trusts offers the possibility to invest to the housing markets without need for a loan. The capital requirement in these trusts could be as low as 200 euros. This enables private investors to enter investment trusts with significantly more ease than in previous years. (S-pankki, 2018)

The advantage of these trust over the more familiar private equity funds is that the investor can enter a decentralized real estate portfolio with a small amount of capital. Buying and selling is usually possible only quarterly. Nearly all housing and real estate base of housing trusts are in the Helsinki metropolitan area and growth centers (Osuuspankki, 2018; S-pankki, 2018). The differences between various funds are the different styles they use to invest in the market. In addition, the funds often include warehouse and office space in addition to apartments. (Kyynäräinen, 2016)

The situation in the Finnish housing market is exceptional because the 12 month Euribor rate has been negative since February 2016, which offers investors cheap loan and therefore, has contributed to the rising of housing prices (Terhemaa, 2017). The chief economist of the housing loan creditor Hypo verifies that the amount of housing investment loans have risen five fold over the last ten years. In 2007 the total amount of housing investment loans was 2 billion euros and the amount has now risen to 20 billion. (Brotherus, 2018b) However, during the decade a number of housing investment funds have entered the scene and have since stabilized their presence in the housing investment domain. This thesis offers an overview of the housing investment market for a private investor seeking to invest in the market. (Uusisuomi, 2018)

This thesis focuses on finding out which of the two methods of investment is more profitable for a small-scale investor. The main question is, which investment method is more profitable for an individual that has 20.000 euros in capital and a 5 year investment horizon. To compliment this question and to give the reader a perspective about the investments, the thesis will present the most common risks associated with the investment, and deal with the benefits, obligations and expenses offered by the methods. Therefore, the aim is to research which of the two options would be the most profitable for a private investor

The thesis consists of two parts. The first one examines what direct housing investing practically means for a private investor and which risks it entails. The second part opens up the operations and functions of housing trusts from the investor’s point of view and the risks associated with the funds. The conclusion summarizes which of the ways of investing is more profitable for a private investor. The aim is therefore to highlight the benefits and risks of both investment models and to compare them by expected yield of revenue for a private investor with 20.000€ in capital with a 5 year investment horizon.

1.1 Research question

The research is about which of the two methods of investment is more profitable for a small-scale investor with 20.000 euros in capital with a 5 year investment horizon. To compliment this question and to give the reader a perspective about the investments, the thesis will present the most common risks associated with the investment, and deal with the benefits, obligations and expenses offered by the methods. Therefore, the aim is to find out which of the two options would be the wisest for a private investor.

1. Which of the two methods of investment is expected to yield higher revenue for a private investor with 20.000€ in capital with a 5 year investment horizon?
    a. What are the most common risks of both types of investment
    b. What are the benefits, obligations and expenses offered by the methods

Due to the sheer amount of different trusts, there is a need to narrow the subject. Three trusts were chosen for the analysis. The chosen trusts are S-Asuntorahasto, OP-Vuokratuotto and Ålandsbanken Asuntorahasto A. The funds were chosen due to their popularity and availability for private investors. Numerous funds investing in housing and real estate exist, yet only a handful offer subscriptions for a moderate capital requirement of under 5000 euros. S-Asuntorahasto offers subscriptions for as low as 200 euros for their co-op members (S-Pankki, 2018), OP-vuokratuotto has a minimum subscription of 5000 euros (Osuuspankki, 2018) and Ålandsbanken Asuntorahasto A is in the between by having a capital requirement of 500 euros (Ålandsbanken, 2018). In addition, the funds chosen have been on the market for a relatively long time (4-6 years) and are operated by known companies that have a long history on the Finnish market. S-Asuntorahasto is operated by FIM Asset Management founded in 1987, OP-Vuokratuotto is directly operated by OP itself, founded in 1902 and Ålandsbanken Asuntorahasto A started its operations in 1919. Additionally, the thesis will discuss REIT funds and introduce Orava Asuntorahasto, which is the only REIT currently operating in Finland. (S-pankki, 2018; Ålandsbanken, 2018; Osuuspankki, 2018)

2 **DIRECT HOUSING INVESTMENT**

Direct investing (later DI), the act of buying an investment home for personal ownership is the most common way of investing in the housing market. With a direct investment the owner can personally influence the value of the investment by deciding on renovations or by partaking in the decision-making of the housing company. An advantage of a direct investment is also the ability to decide which kind of an apartment to invest in and in which neighborhood and city to buy from. If the buyer wants, or is capable to, he/she can take care of the trade from start to finish, from the acquiring of the dwelling to renting and selling it. The alternative is to use professional help, such as real estate and rental agents to help in buying and renting the real estate. It is also possible to outsource the administration of the apartment to the professionals, for example when monitoring rental income and expenses. The benefits of using such services are more easy and secure management. On the other hand, the cost of these services decrease the profit of the investment. (Kaarto 2015, 54–56; Neuvonen, n.d.)

2.1 Direct investing

Although the amount of capital needed to invest in housing is large. The investing is made easier by banks that grant loans that are worth 70 to 80% of the housings worth. This is called leveraged loan. By utilizing leverage you can invest in an apartment where your personal savings would not be sufficient. This naturally increases the profit potential. You can also make an agreement with the bank to seize paying the monthly instalments of the loan for a period of time, which enables you to save and re-invest the rental profits. (Hänninen, 2015a)

Once the housing is selected, the rent level is defined, the tenant is carefully selected and the contract is well prepared, direct housing investment can be a very profitable business. (Suomen Vuokranantajat n.d. b) Therefore, mathematics and counting are always associated with investments and the investment can or at least should not be chosen with emotion. Especially when the target is in housing, where the income and expenditure are more complicated than for example, in stock investments. Hence it is important to count the rental profit of the housing as accurately as possible even before investing in it (Väänänen, 2016). Even though counting the potential profit of a housing investment can seem obvious to some investors, it is unfortunate that often housing investors either cannot or will not count the rental revenue. This can, in turn, lead to a failed investment. (Hänninen, 2015b)

Rental revenue should be one of the key factors which the investor weighs in choosing a housing investment (Thurén, 2017). When calculating the rental revenue the investor inevitably makes an assessment about the level of rent of the apartment. Additionally, it is necessary to find out the amount of maintenance charge collected by the housing company. A large maintenance charge lowers the rental revenue, but a charge clearly lower than the market rate can be deceitful and can change unexpectedly. In addition to calculating rental revenue, the investor will also conduct valuable groundwork regarding the location of the investment, the housing company and its expenses. A revenue between 5 to 7% is considered a good and desirable rental revenue. (Hänninen, 2015b)

When calculating the revenue from the investment, one of the things that can cause trouble is assessing future costs that will affect the revenue. The total amount of loan, monthly instalments on the loan and the fund transferring tax are easily visible, but estimating the costs of renovations can prove difficult. A housing investor can easily underestimate these costs, which causes profits to be considerably lower than previously calculated. Future renovations and their costs should therefore be estimated as accurately as possible when calculating rental revenue (Väänänen, 2016). The necessary information on future renovations is available from the housing company or by asking directly from the deputy landlord. Naturally, if the investor focuses on acquiring new apartments the costs of renovations can be nonexistent. (Hänninen, 2015b)

2.2 Ownership of housing property in Finland

Finland's housing property ownership can be divided into four main types. Privately owned apartments are owned by individuals that live in their own home. Apartments owned by large scale investors is housing owned by institutions or investment companies and apartments owned by private investors are referred to as direct housing investments made by individuals that rent the housing out (KTI 2014a, 23, 28). ARA housing, on the other hand, is government subsidised housing. See (figure 1) the distribution of housing stock by the percentage of apartments. The proportion of professional, non-subsidized, housing accounts for only 6 percent of the total amount of housing. Private investors own 10 percent of the entire housing stock, which means that approximately one-third of rental housing is owned by private investors. It can be seen from the figure that about half of all rental housing are various subsidized housing, including the housing finance and development centre of Finland, so called "ARA-housing". This group also includes housing owned by other public corporations. (KTI 2014a, 21)

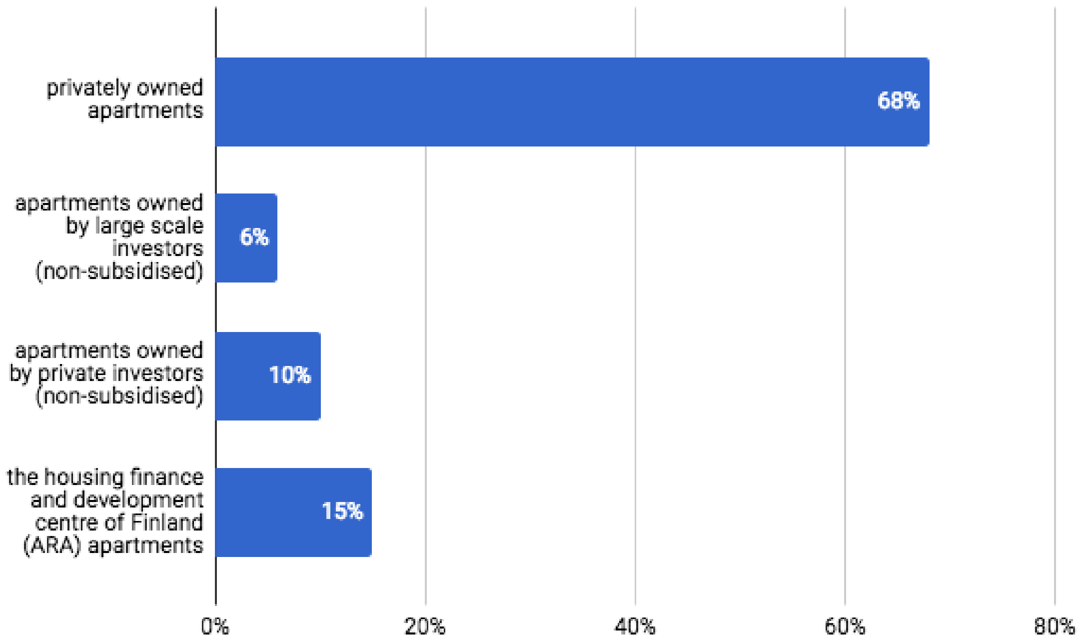

Figure 1 demonstrates the the distribution of housing stock by the percentage of apartments between various types of owners. (KTI 2014a, 20-21)

2.3 Development of rental fees

The figure 2 and 3 can be used to examine the development of rental fees and the cost of housing in the 21st century in the three largers housing markets in Finland. The graphs show the development of the rental fees market in the Helsinki Metropolitan Area compared to the market of Tampere and Turku, which have been more moderate in recent years than the development in the Helsinki Metropolitan Area. The growth in rental fee levels increased in 2007, after which the annual rental rise has been relatively steady. (Kuusenaho 2014, 22)

The increase in rental fees per square meter in the three cities between 2010 and 2017 is demonstrated in the following graph. Even though the largest cities see a lot of supply as new apartments are constructed, they still have a steady demand for apartments. (Kuussaari, 2016) The rising rental costs are a signal that the demand is growing faster than the supply (Muhonen, 2018). Last year the price of housing rose by a bit over one percent and for this year it is predicted to rise over 1,5 percent. (Hypo, 2018a, 2) Turku, as one of the growing cities, has seen a rise in rental fees by 27,8% in the last 8 years. Helsinki and Tampere grew even faster, with 33,5% increase in the metropolitan area and 28% in Tampere from 2010 to 2017. The rise in prices is partially driven by the positive population growth in these growth centers. For example, the population of the Helsinki region has been growing by 17.000 to 19.000 people yearly to reach 1.7-1.8 million by 2050. Tampere region, respectively, will grow by 11% by 2030 and Turku region by 8% in the same period. Additionally, when counting in the Oulu region, these four regions accounted for 49,9% of the total amount of jobs in Finland in 2015. Together these factors cause the rise in property prices and thus drive up the rental prices per square meter as demonstrated in the graph below. (KTI, 2018, 18-19; Suomen Vuokranantajat, 2017).

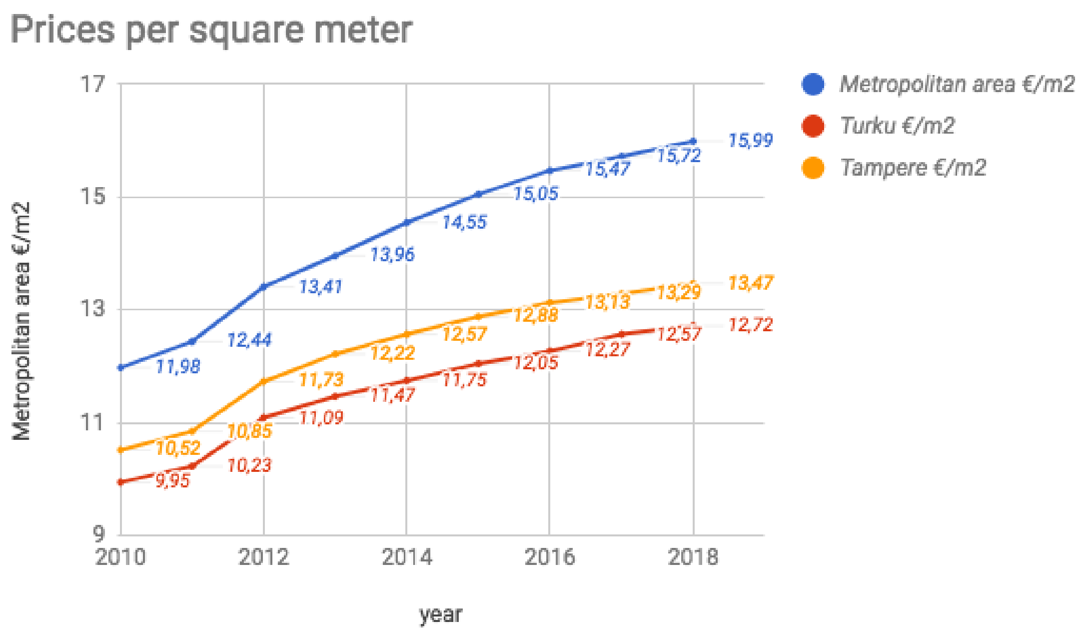

Figure 2 demonstrates the rental price trends per square meter in three biggest growth centers; Metropolitan area, Tampere and Turku (Tilastokeskus, 2018; Tilastokeskus, 2017; Tilastokeskus, 2016, Tilastokeskus, 2015; Tilastokeskus, 2014; Tilastokeskus, 2013; Tilastokeskus, 2012; Tilastokeskus, 2011; Tilastokeskus, 2010)

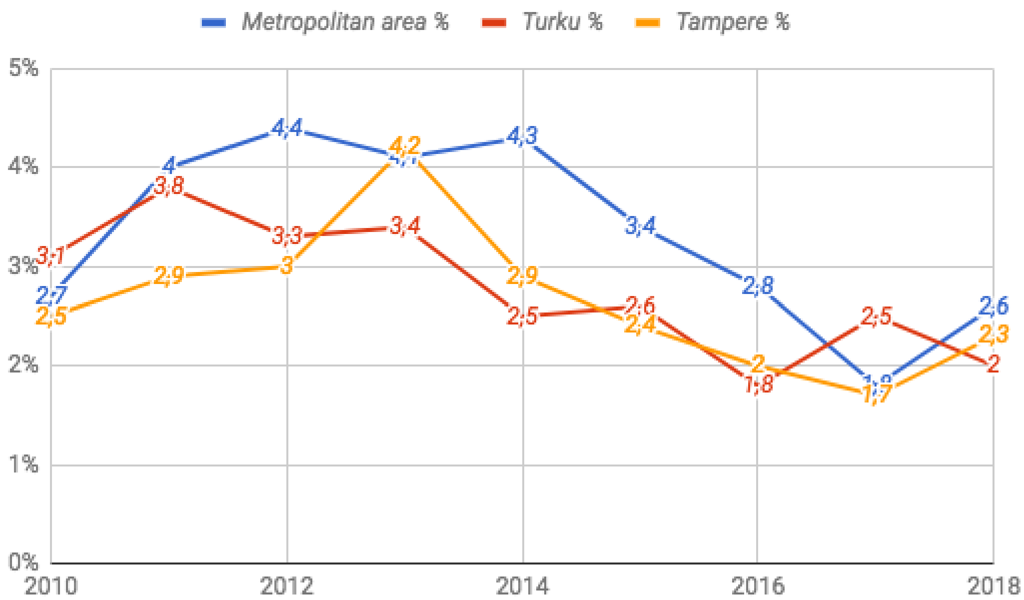

Figure 3 demonstrates the annual rental price increases in percentages during the past 8 years. (Tilastokeskus, 2018; Tilastokeskus, 2017; Tilastokeskus, 2016, Tilastokeskus, 2015; Tilastokeskus, 2014; Tilastokeskus, 2013; Tilastokeskus, 2012; Tilastokeskus, 2011; Tilastokeskus, 2010)

2.4 Taxation

According to the Finnish taxation law Income Tax Act (Tuloverolaki 1535/1992) the profit of a housing investment is always considered as capital income to the investor. Exceptions to the rule are cases where the tax authorities have considered the activity to be so extensive that it is considered as business activity, for example, as an office hotel type of rental activity. (Verohallinto, 2017a) In 2016, the tax on personal capital income was 30% up to 30 000 euros and 34% in excess (Verohallinto, 2018; Verohallinto, 2017b; Korpela, 2017, 11-12).

As a general rule, rent income is the income from a personal income source, where income tax law is applied to taxation (Häkkilä, 2015, 3). The leasing company is obliged to keep a record of the income and expenses. The notes must be based on supporting documents (Häkkilä, 2015, 19).

The income received by a natural person is divided into two categories: earned income and capital income. Capital income is the income that a property is deemed to have accrued in the form of profits or a profit in connection with the transfer of property (Verohallinto, 2017a). Earned income is, in turn, different from capital income, such as payroll, pension, and various other benefits. Thus, all taxes directed on real estate and housing investment belong to capital income. In addition to capital income and earned income, the taxpayer's incomes are divided into three sources: commercial activity, agriculture and other personal income yielding activities, to which the income tax law of each income source is applied. As this thesis deals with private housing investment activity, it focuses on the income source of personal activity and no other sources of income are dealt with. Taxation related to housing investment is regulated, for example, in fund transfer tax law, income tax law and in collection at source law. In addition, it is important to take into account, for example, the regulations regarding inheritance, gift and real estate tax on a case-by-case basis. (Tulovero 1535/1992 29§; Asuntosijoittajan verotusopas, 2016)

In accordance with section 29 of the Income Tax Act (Tuloverolaki 1535/1992) a taxpayer is entitled to deduct from his income the deduction of expenses arising from the acquisition or retention (so-called natural deductions). This provision is supplemented by section 54 of the Income Tax Act, this right of deduction therefore applies to the most common costs arising from activities intended to obtain taxable income. Such activities include rental of an apartment. Different tax deductions, from the housing investor's point of view, are an essential factor affecting the return and should be paid particular attention. Particularly interesting for a homeowner is the right to deduct the interest of loans on income tax. Reducing mortgage-backed homeowner's mortgage interest rates will add a comfortable boost to the leverage. (Tulovero 1535/1992 29§; Asuntosijoittajan verotusopas, 2016; Veronmaksajat, 2017)

According to the transfer tax law (Varainsiirtoverolaki 931/1996), the homebuyer is obligated to pay the transfer tax to the government. A trade or exchange where the buyer compensates the seller in some way is subject to the transfer tax. The compensation is generally money, but can also include or be composed of other property, such as another real estate or housing. In these cases the transfer tax is paid according to the amount of compensation. (Varainsiirtoverolaki 931/1996; Huolman-Lakari, 2011, 11–13.)

The amount of transfer tax when buying a housing-company share is 2% of the total purchase price. In real estate transactions the tax is 4% of the purchase price. The amount of transfer tax is determined by the dept-free price of the item in question, which means that any debts the housing share has are added to the purchase price, in cases where the shareholder has the right or the obligation to pay the debts to the housing company as financial costs or as other instalments. Trades made before 1. March 2013 used the amount paid as the basis for the transfer tax, not the debt-free price. Additionally, the shares of a housing company had a smaller, 1,6% transfer tax which is still used in trades other than housing company shares. (Korpela, 2017, 204-206; Verohallinto, 2017a)

If a trade is conducted independently, i.e. without a real estate agent, the payment of the transfer tax and filling the transfer tax return are under the buyers responsibility. The transfer tax has to be paid and the transfer tax return made within two months of signing the bill of purchase. If a real estate agent is used, the transfer tax is paid when the purchase if made. When using a real estate agent, the payment of the transfer tax and the transfer tax return are the real estate agent's responsibility. The real estate agent will hand over the proof of payment and confirmation of transfer tax return. (Korpela, 2017, 206; Verohallinto, 2017a) Noticeable is that the transfer tax is paid even when the share in question is bought from a compulsory auction. In the case of a new housing stock, the payment date for the transfer tax is two months after the transfer of ownership. (Huolman-Lakari, 2011, 14)

In case of acquiring a house from relatives instead of free market, it is noteworthy that even though transfer tax is paid according to the purchase price, the price has to amount to at least 75% of the valid value of the property. A comparable housing unit or a real estate agents' objective assessment is used as a market price point when estimating the value. If a house is sold under market price, the tax authorities interpret the difference between the selling price and the market price as a gift, which is treated under the gift tax law. (Asuntosijoittajan verotusopas, 2016; Verohallinto, 2016b.)

Housing company shares or other real estate received as inheritance or donation are not subject to transfer tax, but to inheritance or gift tax (Perintö- ja lahjaverolaki 378/1940). (Huolman-Lakari, 2011, 13.) Moreover, it is noteworthy to the buyer of the housing that a delay in performing the tax payment leads to additional tax, which in 2018 is 7% annually. (Verohallinto, 2016c)

However, the first-time home buyer is exempted from paying the transfer tax when certain conditions are met. Despite the exemption, the transfer tax return has to be fulfilled when purchasing the housing. When using a real estate agent the agent will deliver the transfer tax return to the tax authorities. Briefly, there are four conditions for exemption from the transfer tax law:

I. buyer has to own at least 50% of the first-time housing,
II. buyer has to be between 18 to 39 years old,
III. housing has to be bought for personal use, and
IV. buyer has not previously owned 50% or more of another housing

These four main rules apply to most first-time home buyers. (Räbinä & Myllymäki, 2016, 95-98)

There is a number of tax deductible costs that are listed in Appendix 1.

Additionally, if there are more tax deductibles than there are capital income, it is possible to do a so-called deficit crediting from the tax of earned income. Moreover, if there are still deductibles left, the tax authorities will confirm the loss which can be used to deduct capital income for the following ten years. (Kaarto, 2015, 29-31)

2.5 Costs and Risks

As with all investing activity, housing investments also hold some risks. The risks associated with housing investments include risks that are unchanging and are considered to be a part of the game, as well as changing risks arising from the surrounding society and its changes. The housing investor should be aware of the existence of risks, because being conscious of them allows the investor to minimize their own risk. However, even an experienced housing investor can not prepare oneself for everything, because some risks are independent of the investor. (Vuokranantajat, 2017c; Hänninen, 2015e)

Most common risks that can be associated with housing investment are listed below. Most of the risks can be averted by the investor by conducting a comprehensive investigation of the housing investment. Such risks are the general attractiveness and future of the area the housing is located in, which affects the long-term price of the housing as well as the level of rent. (Väänänen, 2018) Moreover, the investor can decrease interest risk by using moderate debt leverage and carefully pick the tenant to reduce the risk of unpaid rents or damage to property. However, something unexpected can happen to the tenant, such as losing a job or a serious illness, which affects the tenant's ability to pay the rent. The risk of expensive renovations can also be averted by carefully examining the situation of the housing company. However, some risks are independent of the investor, such as an unfavourable rise in capital income tax or transfer tax.

1. Price
    - It is not uncommon to hear people say that a significant drop in housing prices is one of the biggest risks affecting housing investments. The investor might have acquired housing from an area that people are migrating away form (Väänänen, 2018). The less demand an area has, the smaller are the prices. However, unlike other types of investment, housing investments are not very sensitive to economic fluctuations and housing investments tend to maintain their value in the long term. (Hänninen, 2015a)

2. Interest
    - Significant rise in interest rates, direct housing investments are usually financed by loan. The more loan an investor has, the bigger the effect of the interest rates. (Suominen, 2018)

3. No tenant
    - There is no tenant in the apartment, empty months can damage the finances of the investor as the investor still has to pay monthly maintenance fees and loan payments.

4. Risk by tenant
    - Failure to pay rent or damage to property. The tenant can neglect paying rent or damage the housing. The effect of the tenant not paying the rent is the same as having the housing vacant. Damage to property can be even more unprofitable to the investor, as renovations can be expensive.

5. General level of rent
    - Regional rental level decreases significantly. If the investor has not done enough research on the location of the housing investment a situation can arise where there is less demand for rental housing. This can happen, for example, if there are more people moving out of the area than there are people moving in.

6. Maintenance charge
    - Maintenance charges of the housing company rise significantly. The housing company can have neglected doing necessary renovations and can significantly raise the maintenance charge to collect funds for future renovations.

7. Renovation
    - The housing company will have a renovation longer or more expensive than expected. For example, during a rutine renovation an extensive water damage is found that will inevitably raise the total costs of the renovation.

8. Taxation
    - For example, a rise in capital income tax or transfer tax.

(Suomen Vuokranantajat, n.d. b; Hänninen, 2015e, Väänänen, 2018)

2.6 Advantage of leveraged loan

Taking advantage of leveraged loan is relatively easy for a housing investor. The direct housing investment often demands the use of leverage by loan, which means that only a proportion of money invested originates directly from the investor while the rest is loaned (Thurén, 2017). Typically banks prefer housing investors over stock investors when granting loans as housing markets have a lack of sensitivity to economic fluctuations. Stable housing markets and regular cash flow thus enable the investor to take advantage of leveraged loan. For the same reason a housing investor will be able to borrow money at a fairly low risk. (Hänninen, 2015a)

Leverage loan is often used if an opportunity to buy a prime investment property opens up and the investor does not have sufficient capital to finance the apartment entirely with equity, the investor may use debt leverage (Kaarto 2015, 36-37) For example, if the price of an apartment is 75,000€ and the investor decides to use 19,000€ of own capital (approximately 25%), and so needs 56,000€ of borrowed capital which the investor will loan from a bank. The interest rates are currently at a historical low, as the total interest rate is about 1%. The investor understands to also prepare for the rise in interest rates and calculates the investment at 4% total interest rate. (Kaarto 2015, 36)

An example: a purchased 30m^2 studio apartment is already rented and the rental revenue for the apartment is 4200€ per year (Rent 500€/month - maintenance charge 150€ x 12). On the basis of earnings, the investment is now yielding 5,6% profit per year off of rental revenue (4200€ / 75,000€ x 100%), which is within the pursued rate between 5 to 7% and is considered a good and desirable rental revenue. (Hänninen, 2015b). Since the investor has used borrowed capital (leverage), the interest cost will swallow 4% of the loan money. When preparing for a 4% interest rate, the default rates are 4% x

56,000€, amounting to 2240€ per year of interest expenses. However, the investor's own invested capital is not 75,000€, but the invested 19,000€. Thus, the investor's return on own equity is 10,3% (4200€, profit - 2240€, interest rate) / 19,000€).

Therefore, the investor's return on equity will increase significantly when borrowed capital is used. When looking at the above example, it should be noted that it does not take into account any possible increase in the value of the housing. If the value increase would have been 2% annually, the total return would be 13.9% (return on equity 11.9% + increase in housing value 2% = 12.3%). (Kaarto 2015, 37)

Using debt leverage can thus have a significant effect on the return on equity. The size of the debt lever must be in proportion to suit the investor's own investment plan and according to the investor's risk tolerance. For example, the following four types of investors and the effect of debt leverages:

1. Cautious investor, no leverage used
2. Investor seeking fair return, debt leverage 50%
3. Investor seeking high return, debt leverage 75%
4. Investor seeking maximum return, debt leverage 90%

The table below (table 1) uses a 25-year loan period, a fixed flat-rate loan and a loan interest rate of 4%. As shown by the following tables, the cash flow of the first two investors is positive on a monthly basis for a 25-year loan period and a 4% interest rate. The investment thus generates usable money to its owner monthly. On the other hand, the table demonstrates that for investors seeking high return and maximum return the cash flow calculations are negative, meaning that the investors have to invest their own money to keep the investments afloat. Using debt leverage will therefore increase the return on equity, but the risks will increase as well, especially if the lever is misused. Generally, it can be said that the use of a strong debt lever is justified when rental income exceeds the interest costs of the loan by at least a few percent. (Kaarto 2015, 40)

Example	1.	2.	3.	4.
Investment price	70 000 €	70 000 €	70 000 €	70 000 €
Own capital	70 000 €	35 000 €	17 500 €	7 000 €
Borrowed capital	-	35 000 €	52 500 €	63 000 €
Leverage %	-	50 %	75 %	90 %
Interest 4%	-	4 %	4 %	4 %
Interest charge	-	1 400 €	2 100 €	2 520 €
Rental revenue %	6 %	6 %	6 %	6 %
Own capital return %*	6 %	8 %	12 %	24 %

Table 1 demonstrates the different investors on a monthly basis for a 25-year loan period and a 4% interest rate. (Kaarto 2015, 39) (*before tax)

The following table demonstrates the effect of leverage on monthly cash flow.

Cash flow calculation / month				
Example	**1.**	**2.**	**3.**	**4.**
Rent	500€	500€	500€	500€
Maintenance fee	150€	150€	150€	150€
Other expenses	30€	30€	30€	30€
Interest	0€	117€	175€	210€
Taxable income	320€	203€	145€	110€
Tax amount	96€	61€	44€	33€
Instalment	0€	68€	102€	123€
Cash flow	224€	74€	−1€	−46€

Table 2 demonstrates the cash flow of different investors on a monthly basis for a 25-year loan period and a 4% interest rate. (Kaarto 2015, 39)

The investor's return on capital are significantly affected by the three issues following issues:

1. rental income
2. amount of debt leverage; and
3. interest rates

The following table demonstrates the effect of previously mentioned components to the net returns of own capital. Taxes and interests have already been taken into account and are removed from the table. The percentages are the net returns of own capital and the investment's interest rate is calculated at 4%. It can be clearly seen from the table that when the loan interest is at 4%, the use of a strong leverage is justified only the rental profit is at least 2-3% higher than the interest rate on the loan.

Rental revenue	**2,0 %**	**3,0 %**	**4,0 %**	**5,0 %**	**6,0 %**	**7,0 %**	**8,0 %**	**9,0 %**	**10,0 %**
No leverage	1,4%	2,1%	2,7%	3,4%	4,1%	4,8%	5,5%	6,2%	6,9%
Leverage 30 %	0,8%	1,8%	2,7%	3,7%	4,7%	5,6%	6,6%	7,6%	8,6%
Leverage 50 %	0,0%	1,3%	2,7%	4,0%	5,4%	6,7%	8,1%	9,4%	10,8%
Leverage 70%	−1,8%	0,4%	2,6%	4,8%	7,0%	9,2%	11,4%	13,6%	15,8%
Leverage 90%	−9,3%	−3,5%	2,3%	8,2%	14,0%	19,8%	25,7%	31,5%	37,3%

Table 3 demonstrates the change of rental revenue depending the amount of leverage used. (Kaarto 2015, 41)

As can be seen from the table above, it is not reasonable to use 90% leverage with 4% rental income and 4% interest rate, because the net return on the investor's equity after taxes is only 2.3%. However, if the rental profit is 7%, the net return on own equity when using 90% leverage is at 19.8% annually, which is an impressive return.

The next table (table 4) shows the significance of changes in interest rates and debt leverage to net return on equity when rental profit is at 6%. It can be clearly seen that strong debt leverage should be only used when the loan interest rates are low in relation to the rental income. With rental income of 6% and 2% loan interest rate combined with 90% leverage the net return of own equity is at 24.5%. Therefore, at low interest rates, it is worth taking advantage of leverage when pursuing high returns on equity. (Kaarto 2015, 42)

Loan interest %	**1,0%**	**2,0%**	**3,0%**	**4,0%**	**5,0%**	**6,0%**	**7,0%**	**8,0%**	**9,0%**
No leverage	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%
Leverage 30%	5,5%	5,3%	5,0%	4,7%	4,4%	4,1%	3,8%	3,5%	3,2%
Leverage 50%	7,4%	6,7%	6,1%	5,4%	4,7%	4,0%	3,4%	2,7%	2,0%
Leverage 70%	11,6%	10,1%	8,5%	7,0%	5,5%	3,9%	2,4%	0,9%	−0,7%
Leverage 90%	29,8%	24,5%	19,3%	14,0%	8,8%	3,5%	−1,8%	−7,0%	-12,3%

Table 4 shows the changes of the return with different interest rates depending how much leverage the investor has used. (Kaarto 2015, 42)

An example of the findings and differences in potential profit. a 35m^2 apartment is already rented and the rental revenue for the apartment is 4200€ per year (Rent 500€/month - condominium charge 150€ x 12). The investment is now yielding 5,25% profit per year off of rental revenue (4200€ / 80,000€ x 100%), which is within the pursued rate between 5 to 7%. Because the investor has used borrowed capital, the interest cost will swallow 1% of the loan money. At present the interest rate is 1%, and the default rates are 1% x 60,000€, amounting to 600€ per year of interest expenses. However, the investor’s own invested capital is not 80,000€, but the invested 20,000€. Thus, the investor’s return on own equity is 18% (4200€, profit - 600€, interest rate) / 20,000€). In this way, the investor could have gathered 18,000€ over the course of 5 years (3600€ x 5), which could be used for another direct housing investment.

3 **INVESTMENT TRUSTS**

Over the last decade, a wide variety of housing investment funds have appeared on the market, offering an alternative to owning an investment property. In addition, with the funds, it is possible to invest in housing with very little capital requirements. Housing funds are easy and, above all, a simple way to diversify investments into housing. (Kaarto, 2015, 57) Housing trusts are special investment trusts. Their advantage to the more commonly known capital trusts is that the investor can get into a decentralized real estate portfolio with a small amount of capital. Nearly all of the housing and real estate portfolio is in the capital region and in areas with positive population growth. The main differences between different trusts are the ways of investment. (Kyynäräinen, 2016)

Housing investment trusts open a pathway to housing investment for investors that might not have sufficient capital to acquire a personal housing investment, or might want to an easier and smoother way to invest in the housing market (Viita, 2018). By investing in trusts the investor outsources all the practical work to the treasurer of the trust by only acting as a financier. In addition, by investing in trusts the investor automatically benefits from decentralization of investment in more than one apartment, which can be challenging even for a professional investor and demands a significant amount of capital. When compared to investing in a single housing, investing in a trust significantly lowers the risks associated with location, housing company and the tenant. (Kuusenaho, 2014, 9) To compensate for the effortlessness of housing trust investment, the investor pays a number of fees to the company operating the trust, such as management fees and fees occuring when buying or selling. Although housing trusts are fundamentally similar, trust strategies, for example, the location, type and duration of ownership vary slightly. Therefore, an investor considering housing trusts should familiarize oneself with the different goals and principles of action of different trusts before making a decision. (Kaarto, 2015, 57-59)

Housing investment funds function with the same principles as stock funds. When investing a certain amount of capital into a housing fund, the company takes care of acquiring the housing, as well as renting and selling them for you. The company managing the housing fund thus maps out apartments or larger real estates which they buy, rent and sell. The housing fund is, in fact, a commonly used term for all funds investing in real estate, although investments may include facilities, holiday cottages, garages, storage facilities etc. (Hänninen, 2015c)

The profit of housing funds comes from two sources; rental income and selling the housing. Housing funds typically buy apartments and other real estate, for which they receive rental income. This is usually the most significant source of income. On the other hand, trusts typically buy housing in larger quantities which enables them to pay a lower price for a single unit. (Kaarto 2015, 57) When housing is first bought under the market price and then later sold at the market price, the fund will receive a significant amount of profit, which is the second major income for the funds. (Hänninen, 2015c)

Housing funds are normal investment funds, where a client buys a share in a trust. When the investor wants to sell his shares, he redeems them from the fund management company which pays the investor the current price of the shares. However, housing fund OP-Vuokratuotto portfolio manager Tenhunen points out that there are differences (Satuli, n.d.). Housing funds are more difficult to liquidate than stock shares due to the nature of the real estate market. (Ålandsbanken, n.d.) The cost structure also leads to long-term investing. Tenhunen recommends housing funds to investors that is relatively cautious. The investor can forget about rapid profits because the return on funds is based on a steady cash flow. (Satuli, n.d.)

The share of housing funds in the commercial housing investment market has grown in recent years, even though housing funds are still commonly regarded as a marginal actor in proportion to the whole housing market. (Elo, 2017) The role of housing funds in the investment market is mainly stabilizing and contributing to diversification, as housing is perceived as a safe investment instrument. The growth in the demand of housing funds has been influenced, among other things, by the good return on housing investments, low interest rates, the ease of housing fund investments and the ability of companies to use debt leverage. Currently, it can be seen that the growth in the number of housing funds is declining. The housing fund market is expected to grow over the next few years mainly in the form of fund volume and through private investors. (Kuusenaho, 2014, 59-60)

The reason for the surge of housing investment funds to the Finnish market in recent years can also be found in the low interest rates and the leverage they offer. In most cases the housing funds use 50-80% of debt leverage to support the fund's investment activity. Low interest rates and the use of debt leverage are the main reason for the lively creation of housing funds. The funds are a very risk-free operation for the management companies, as they will in any case receive their management costs. (Kaarto, 2015, 42)

The following figures (4, 5, 6) demonstrate the value development of the three researched housing investment trusts. All values are presented in index numbers. Ålandsbanken A trust has risen by 19,72% since its beginning, whereas S-Asuntorahasto has gained 37,4% and OP-vuokratuotto lands in the middle with 29,66% growth. Therefore the differences between different trusts can be significant. An investor investing in Ålandsbanken with €20.000 in capital would have gained €3944 before tax, whereas an investor investing in S-Asuntorahasto would have gained €7480 before tax. Although, as is visible in the figure, the profits have declined when compared to the first two years. (S-pankki, 2018; Ålandsbanken, 2018; Osuuspankki, 2018)

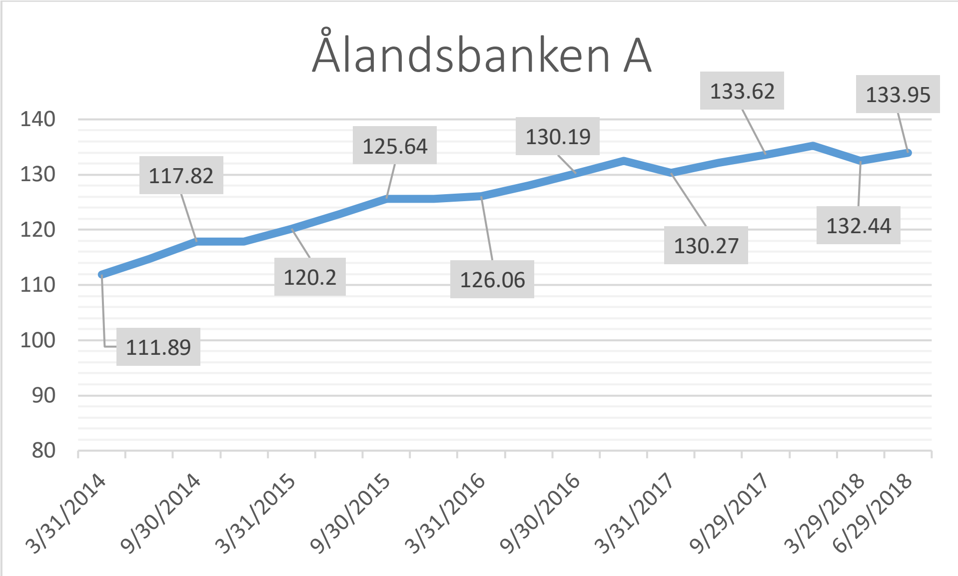

Figure 4 demonstrates the value development of Ålandsbanken A housing investment trust. (Ålandsbanken, 2018)

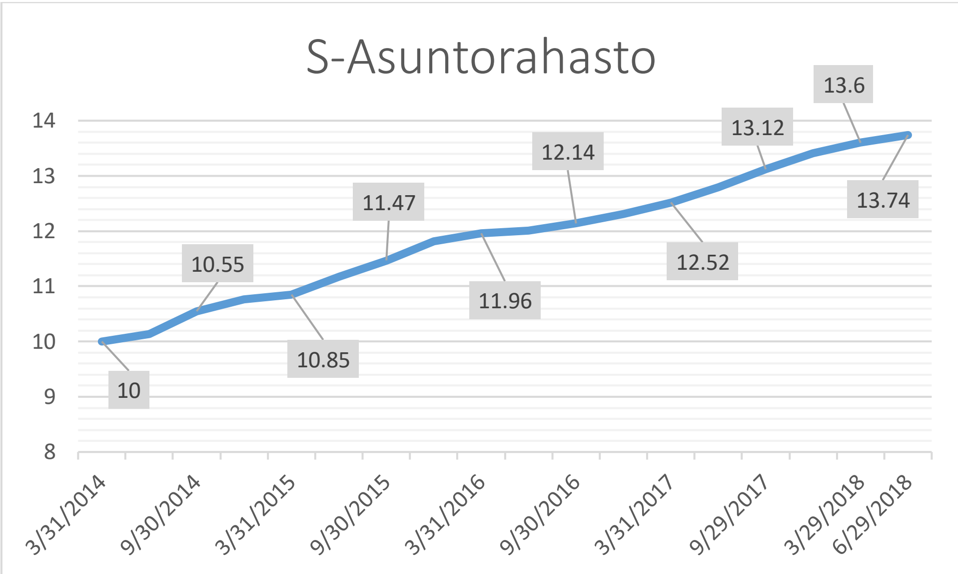

Figure 5 demonstrates the value development of S-Asuntorahasto housing investment trust. (S-pankki, 2018)

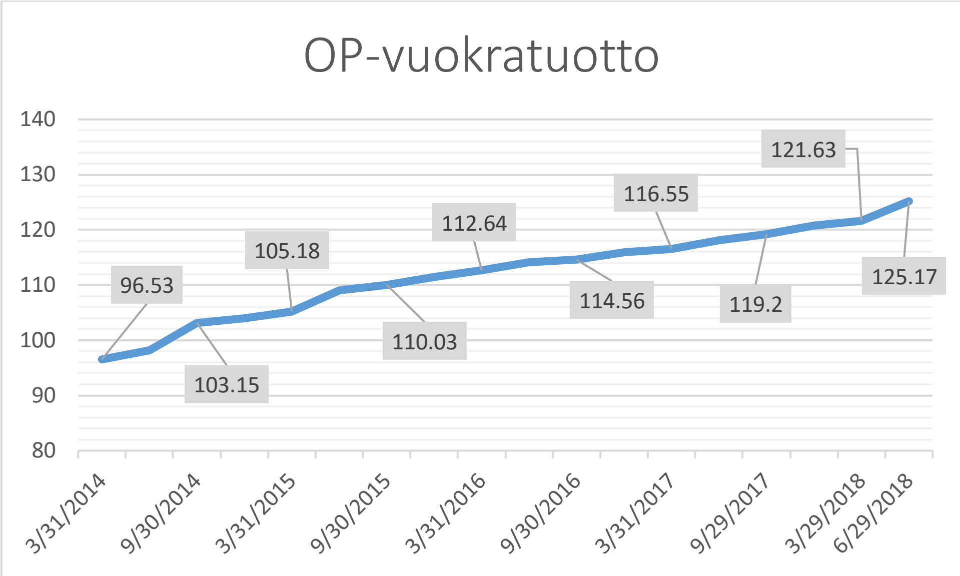

Figure 6 demonstrates the value development of OP-vuokratuotto housing investment trust. (Osuuspankki, 2018)

3.1 Real Estate Investment Trusts

In addition to fund shares offered by fund management companies, an investor has the opportunity to invest in a housing fund managed by a limited liability company listed on the stock exchange. Funds such as this are known as Real Estate Investment Trusts (REIT). In accordance with Law on the tax relief of limited liability companies operating in some residences (Laki eräiden asuntojen vuokraustoimintaa harjoittavien osakeyhtiöiden veronhuojennuksesta 299/2009), REIT funds do not pay income tax, which makes these limited companies an interesting exception among other listed companies. This exemption, however, requires the fulfilment of a number of conditions, such as the obligation to pay at least 75 to 90% of the yearly profit as dividends. (Orava asuntorahasto, n.d.)

REIT is a tax-efficient real estate fund model originated in the United States in the 1960's, which has since spread to Europe (United Bankers, n.d.). REIT funds invest directly into real estate assets, and have different strategies for different real estate sectors. REIT model funds are tax-free at company level, but their activities are heavily regulated. For example, REITs are obligated to pay dividends to shareholders for at least 75 to 90% of the total profit, depending on the legislation of each country (RAKLI, n.d.). Often REIT models also involve regulation of business and debt use. In many countries, such as Finland, REIT funds must be available for public trading (RAKLI n.d.). REIT is a limited liability real estate investment company whose shares can be bought and sold publicly, hence the market for the stocks is operated by the stock exchange. (Kuusenaho, 2014, 17; Kinnunen, 2009)

Only after the so-called tax relief law of 2010 entered into effect the establishment of REIT funds has become profitable in Finland. The Real Estate Fund Act of 1997 was not sufficiently attractive to establish a REIT because of tax issues. The problem areas of the Real Estate Fund Act were addressed at state level when the Ministry of Finance established a workshop in 2004 to think about the development of the Real Estate Fund Act, as the development of real estate investment markets was seen as very significant on both national and international level. (Harju et al., 2006; Kuusenaho, 2014, 17)

As soon as the Law on tax relief came into force the Orava housing fund was established. It is the first and, for the time being, the only REIT consistent with the Real Estate Fund Act. It went public in the autumn of 2013. Orava housing fund invests in housing in different parts of Finland, at present in over 30 different cities. Measured at market value, about 39% of the housing is in the Helsinki region, about 30% in other large cities and about 31% in medium-sized cities. In the end of 2017, the company owned over 1600 apartments. (Orava asuntorahasto, 2018.; Kuusenaho, 2014, 17)

3.2 Taxation

In accordance with the Income Tax Act, trusts are tax-free entities. The trusts do not pay tax on their interest income or capital gains, nor do they pay double tax on their dividend income. The profit on trusts is taxed as capital income. Capital gains on the redeemal of funds and the profits on investment trusts are capital income, of which natural persons and domestic estates pay 30% tax. If the capital income exceeds 30 000 euros, the tax rate is 34% of the amount exceeding 30 000 euros. The tax rate for communities is 20%. (Verohallinto, 2016; Verohallinto, 2017b; Verohallinto, 2018; Lähitapiola, 2018)

Capital gain is generated by increase in the value of the fund unit from the moment of subscription to the moment of redemption. The actual capital gain is calculated by deducting the costs associated with the acquisition of the trust units from the sales price, resulting in the difference being the capital gain (Finnish Ministry of Finance, n.d.). Alternatively, a so-called presumption of acquisition cost method can be used (Verohallinto, 2017c). In such cases, the fund unit owner may deduct 40% of the redemption price if the fund units have been held for more than 10 years as the acquisition cost. If the fund units have been held for less than 10 years, the owner may deduct 20% of the redemption price as the acquisition cost. The value of a fund unit may also fall. A loss from assignment arises if the value of the fund unit has fallen from the moment of subscription to the moment of redemption (Verohallinto, 2013).

The owner of the fund unit does not have to announce the fund units in the tax declaration. The company operating the fund will provide the tax authorities with information about the unit holders, their holdings of fund units and the redemptions of the fund units. If the unit holder has sold fund units during the tax year, the capital gains and losses must be reported in the tax declaration. Alternatively the unit holder must declare this information in the tax proposal. Any losses may be deducted from the capital gains in the same fiscal year or during the following five years. (Ålandsbanken, 2018)

3.3 Costs and risks

The fund lowers the risk of the investor because investments are divided into a number of targets. The fund reduces the effort needed by the investor but it has to be paid for. Subscription and management expenses lower the profit of the investment, but on the other hand the investor gets the benefits of an institutional investor. (Salakka, n.d.)

Making comparisons between different funds are difficult because the costs are not comparable and not very transparent. It does not make it easier that different funds invest directly into housing and some invest in companies or funds investing in real estate. This in itself makes comparison of funds challenging. (Elo, 2017) In addition, the ways of calculating profit margins between funds varies significantly. For example, the majority of funds add the potential shifts in fund value to the profit calculations and some funds do not. Therefore, the fund should not be chosen simply based on the profit margins, but to find out how the fund calculates profit and what it included in the calculation (Hänninen, 2015d).

In addition, the terms used to describe expenditures mean different things in different funds, so the information on costs provided by the funds also differ between funds. For example, so-called running costs may mean different things for different funds, which is why they are not comparable (Elo, 2017). As mentioned before, the investor should look deeper into the funds before making a decision. In addition to key information, it is important to carefully look at the fund’s operating principles, sources of income and cost structure (Hänninen, 2015d). After selecting the target the investor should focus on the capital of the fund. If the real estate managed by the fund have mainly been purchased with debt and interest rates are rising, it is difficult for the fund to yield profit. If, for example, 60% of the capital is covered with debt the fund is still on a solid footing. As with all funds, housing funds are always associated with liquidity risk. If a large amount of investors want to redeem their share at the same time the fund may face problems. Real estate can not be sold in a moment. It is worth finding out whether the fund has a plan for a situation such as this. (Satuli, n.d.)

See (table 5 and 6) highlight the expenses of the examined funds. The minimum subscription fees of the funds are between 200-5000€, making them available for a private investor. Additionally, the funds have also been in the market for a long time. As can be seen, the funds collect a 2% fee of the total invested amount when subscribing to the fund. In addition, all of the funds include a management fee that can be seen as the price for the added ease and for the possibility to invest in a diversified housing market. One of the funds, the Ålandsbanken A, in particular has a high maintenance cost as the fund charges an extra 20% of any annual returns over 5%, lowering the potential profits even further. Moreover, as a special feature of housing investment funds, there is a need for long-term investments due to the nature of the investment, and therefore the redemption fees of the funds vary between 1 to 5%, depending on the length of the investment period prior to the redemption. For example, at the time of writing the redemption fee of S-Bank for an investment longer than 4 years is 1%, for investments between 3 and 4 years 2%, for investments between 1 to 3 years 3% and 4% for investments that are under a year old.

Costs	**S-Group**	**OP**	**Ålandsbanken (A)**
Subscription fee	2 %	2%	2%
Management fee	1,9%	1,9%	1,9%
Ongoing costs (yearly)	2,5%	2,25%	2,68%
Minimum subscription	200	5000	500
Other expenses	-	-	20 % of any annual return over 5%

Table 5 demonstrates the costs of chosen three investment trusts (S-pankki, 2018; Osuuspankki, 2018; Ålandsbanken, 2018)

The cost of redemption (yrs)	S-Group	OP	Ålandsbanken (A)
Under 1 year	4%	5%	4%
2 years	3%	5%	3%
3 years	2%	3%	2%
4 years	1%	1%	1%
Over 4 years	1%	1%	1%

Table 6 shows the costs of redemption according to the length of investment. (S-pankki, 2018; Osuuspankki, 2018; Ålandsbanken, 2018)

4 **METHODOLOGY**

4.1 Research question

1. The primary research objective is to explore which of the two methods of investment is expected to yield higher revenue for a private investor with 20.000€ in capital with a 5 year investment horizon?
    a. What are the most common risks of both types of investment
    b. What are the benefits, obligations and expenses offered by the methods

4.2 Focus of the research

This study is a descriptive and explaining study in nature. The purpose of the study is to clarify the structures of the research phenomena and to identify the probable cause and effect relations that modify the phenomena. The thesis consists of a deductive, theory based analysis that uses existing knowledge to compare which of the investment types is more profitable and worthwhile for a private investor (Yin, 2011, 93-95; Wallimann, 2011, 17-19). The thesis systematizes materials written on the subject and, based on the materials and the conducted interviews, provides an analysis of the profitability of the different forms of investing.

This thesis focuses on finding out which of the two methods of investment is more profitable for a small-scale investor. The main question is, which investment method is more profitable for an individual that has 20.000 euros in capital and a 5 year investment horizon. To compliment this question and to give the reader a perspective about the investments, the thesis will present the most common risks associated with the investment, and deal with the benefits, obligations and expenses offered by the methods. Therefore, the aim is to find out which of the two options would be most profitable for a private investor. The research is based on the assumption that, for a private investor, direct housing investments are more profitable than investments in housing trusts.

4.3 Primary data

Research methods are divided into quantitative and qualitative methods. The methods can be also used together as a mix of both methods, which utilizes both quantitative and qualitative methods (Creswell, 2014, 14). The starting point of the quantitative method is that there is enough of research material, it can be formatted into a table form and conclusions can be made with statistical analysis. However, the quantitative method is far from being suitable for all the research topics because of the high material requirement. A qualitative approach emerges when a researcher has to describe, for example, the nature and causes of a phenomenon and how to answer the questions how and why. In a qualitative research the material is examined more as a whole than in a quantitative research, which may only investigate the statistical behavior of a single variable. (Alasuutari, 2011, 23)

To reseach direct housing investments the original plan was to gather a sufficient amount of data from various sources to give an educated assumption to the reseach questions, but a change of plans was in order when I realized that an expert opinion could be of importance. Therefore I decided to use qualitative method and interviewed two professionals of the field, Vesa Viita from Lähitapiola Real Estate Capital Funds Oy and Pekka Väänänen, the founder of Sibvest Oy, a company specializing on housing investment. Both of the interviewees have extensive experience in housing investment and were chosen because of their insight regarding the subject and because they could give a professional opinion on the subject. The interview was semi-structured, both participants were reached individually via phone and interviewed using pre-made questions, while giving way to any other thoughts the participants might have around the subject. Vesa Viita gave his insight regarding housing trusts and Pekka Väänänen is an expert on direct housing investments. The conversations with the interviewees were recorded and summarized by the author in the analysis chapter.

Three trusts were chosen for an analysis to point out differences between different trusts. The chosen trusts were S-Asuntorahasto, OP-Vuokratuotto and Ålandsbanken Asuntorahasto A. The funds were chosen due to their popularity and particularly because of their availability for private investors. Numerous funds investing in housing and real estate exist, yet only a handful offer subscriptions for a moderate capital requirement of under 5000 euros. S-Asuntorahasto offers subscriptions for as low as 200 euros for their co-op members, OP-vuokratuotto has a minimum subscription of 5000 euros and

Ålandsbanken Asuntorahasto A is in the between by having a capital requirement of 500 euros, which all fit within the capital requirement of the research question. In addition, the funds chosen have been on the market for a relatively long time (4 to 6 years) and are operated by known companies that have a long history on the Finnish market. S-Asuntorahasto is operated by FIM Asset Management founded in 1987, OP-Vuokratuotto is directly operated by OP itself, founded in 1902 and Ålandsbanken started its operations in 1919. (S-pankki, 2018; Ålandsbanken, 2018; Osuuspankki, 2018)

4.4 Interview questions

The questions to both participants were focused on why should an investor choose to invest into real estate trusts instead of acquiring a housing and vice versa. Additionally, what do the professionals consider as the biggests risks concerning both direct and trust investments, and what is expected by the housing investment field in the future in terms of profit margins regarding both ways of investment. Moreover, the interviewees gave their insight regarding the role of housing investors, both trusts and private, in the housing market.

5 **ANALYSIS**

For the thesis it was decided to use qualitative method and interviewed two professionals of the field, Vesa Viita a Portfolio Manager at LähiTapiola Real Estate Capital Funds Oy and Pekka Väänänen the founder of Sibvest Oy, a company specializing in housing investment. Both of the interviewees have extensive experience in housing investment and were chosen because of their insight regarding the subject and because they could give a professional opinion on the subject. The interview was semi-structured, both participants were reached individually via phone and interviewed using pre-made questions, while giving way to any other thoughts the participants might have around the subject. Vesa Viita gave his insight regarding housing trusts and Pekka Väänänen is an expert on direct housing investments.

5.1 Interview: Pekka Väänänen

The first inverviewee is Pekka Väänänen, the founder of Sibvest Oy. Väänänen has invested in housing as a full-time job for years and has also published a book about direct housing investment aimed at private investors. Väänänen has extensive expertise in direct housing investment and how to invest in the housing market on a professional level. In the following paragraphs Väänänen gives his insights regarding the questions.

Why choose direct housing investment instead of housing investment trusts?

Väänänen states that it depends largely on the individual and available resources. The benefits are much better ways of influencing the value of the investment as there are multiple ways to profit off of direct housing investments. For example the investor can renovate the unit and selling it with profit or by renting it out with a higher rent. Nowadays when the scale of Sibvest Oy has increased, the company buys housing units in bulk which leads to a lower buying price of a single housing. Väänänen repeats that the main reason to choose DI is the possibility to influence the profit of the investment, unlike in investments to housing trusts.

What is the significance of private investors in field of housing investment and the housing market?

The presence of private investors is very significant. Väänänen points out that in the current headlines and in the public debate some commentators do not like the large number of private investors, but without private investors the housing markets would not work as well and the supply of housing, especially in growth centers, would be too small and it would not keep up with the growing demand. This would be the case even though a large portion of new supply is managed by funds and institutions.

What are the upsides and downsides of direct housing investments compared to housing trusts?

Väänänen points out, that direct housing investment requires more effort, such as the monitoring of paid rents, the readiness to conduct maintenance on the housing, such as renewing broken household appliances and the readiness to re-rent the housing unit if the tenant decides to leave. In addition, DI also requires more resources and has a larger risk, because the capital is tied to a limited number of targets in a limited market area, unlike in housing investment trusts, where the decentralization has already been done by investing in a larger geographical region and in multiple targets. However, Väänänen states that the biggest risk arises from investor itself. If the investor does not study the investment sufficiently and uses too large a debt leverage the risk is also higher. Väänänen states that a situation where too much leverage is used is when an investor buys a housing unit that has been heavily funded by loan by the condominium or if the own-equity part of the loan is covered by, for example, against the investor's own home. For an individual with good income this leverage might not be too large, but if a month of two without a tenant causes damage to the investor's finances the leverage may be too large. Väänänen notes that investing and the use of leverage should always be in relation to own income and financial situation. In addition, excessive leverage is likely to cause a negative monthly cash flow for the investor, which is not necessarily an excessive expense with a single housing unit, but in the case of 10 housing investments, most of the investments have to generate monthly positive cash flow, especially when considering the possible rise in interest rates and months without a tenant. However, if an investor is able to buy the housing at the right price and uses leverage in proportion to his own financial situation, the risks are under control. Väänänen says direct housing investing is a matter of character, ie if a person does not want investing to include any extra effort, a housing fund can be a better option. According to Väänänen, however, the potential income is better in direct housing investments, meaning that in return for the extra work the investor will be compensated with better profit.

What are the biggest risks of direct housing investments?

Direct housing investment is having all your eggs in one basket, ie the lack of decentralization. However, the biggest risk arises from investor itself. Not having done enough background reseach of the target of investment of by using too much debt leverage versus the investors personal income and financial situation. By background reseach, the interviewee means, for example, the financial situation of the housing company, any upcoming renovations and the future of the area where the housing is located. Väänänen presents a calculation where the expected return on a housing would be 12% yearly. This means that the purchase price of the item has been inexpensive compared to the current rental rate. In such a situation, the investor should carefully think if the 12% annual return is realistic in the future, as the likely reason for the low purchase price is the decrease in demand in the area. This can, in turn, lead to a declining return percent in the future or the investor may have to sell the housing at a lower price than it was purchased for. Väänänen presents a theory: the less interesting the place, the better the percentual rental income and vice versa. If something is too good to be true, it probably is.

What are the expected returns of direct housing investments in growth centers?

According to Väänänen's investment principle, direct investment in housing is based on cash flow, ie the rental income of a unit and any potential increase in housing value is a mere bonus. According to him, when picking a housing unit to invest in, it is a risk to rely on any increase in housing value, which is always only speculation. Väänänen notes that investing in the centers of large cities, such as Turku, Tampere and Helsinki is unlikely to exceed 4% in annual return. Thus, for a traditional cash flow investor, the centers of growth centers are generally ruled out as investment targets. However, Väänänen still believes in long-term value increase also in growth centers. At the same time, he notes that when a city is net migratory and growing, the city spreads more widely, meaning that the suburbs around the city center can be a good investment for their lower cost compared to downtown housing, where the rising of value in percentages can be even better than in downtown.

What is the future of direct housing investment?

The change in interest rates will change the form of housing investment and it is inevitable at some point in the future. The future actions of the financiers, such as banks, will play a significant part. Among other things, loan can be more difficult to get and the rules on bank lending can be tightened. A major financial crisis can likewise bring about change. Väänänen points out that the way we live is unlikely to change in the near future, so housing investment will be worthwhile even in the future. In addition, the continuation of urbanization is worth noting when choosing units to invest in, because the investor should avoid buying from a location that residents are migrating away from. Regional differences will therefore further increase in the future. However, even though the rental income would be weak or negative, if the housing is located in a city center where no new housing supply is built, the apartment can still be an excellent investment and be debt free in 10 years, after which the cash flow is only positive.

5.2 Interview: Vesa Viita

Why choose housing investment trusts instead of direct housing investment?

Viita unambiguously states that decentralization and the ease of investment are the main reasons. In direct investment, an investor can reach higher return because of the lack of intermediaries, but in the trusts the investor will benefit from decentralization. Viita notes that if there is even only one empty month per year in the investment property, the return on investment is quickly eaten away. Thus, the return on the housing trust is more secure and less risky. However, if an investor understands the market, is skilled, aware of the risks and is able to find housing on the market at a good price, direct real estate investment can be more a better choice. However, if the investor wants to sleep in peace, he notes that he should consider investing in housing funds.

What is the significance of housing funds in field of housing investment and the housing market?

The impact is significant, states Viita. Housing trusts have had a significant impact in building new housing. This is, according to Viita, the direct result of the high demand for housing trusts. Viita also notes that housing investment trusts have a normalizing effect on housing prices by increasing the supply in growth centers during high demand. If and when the funds accumulate a large amount of capital, and for example a financial crisis occurs in the market, or if the housing in the trusts are sold when they are of a certain age, the funds can shake the whole market. Viita asks a question; now that there is a lot of housing funds, can they, in themselves, destabilize the market when the market is going through a rough patch?

What are the upsides and downsides of direct housing investments compared to housing trusts?

There is a price to be paid when purchasing ease and lower risk. A smaller risk is equal to lower returns, according to Viita.

What are the biggest risks of direct housing investments?

One of the biggest risks is the situation where the investors raise their money out of the trust, and the trust would have to sell their own apartmetns to repay the investor's capital. In addition, interest risk is always present, ie when interest rates rise in the future, trusts using debt leverage may lose their entire profit. In the current situation where the expected return in growth centers is about 4,5% a year, raising interest rates between 2.5% and 3% will eat away the profits from trusts using 50% leverage, which includes most trusts. However, Viita states the trusts can protect themselves against interest risk more efficiently than private investors by using derivatives.

What are the expected returns of housing investment trusts in growth centers?

In growth centers, where most of the trusts invest, around 4.5% return on investment can be expected. Viita notes that at present the profit margins are unlikely to be better when investing into housing trusts.

What is the future of housing investment trusts?

Viita notes that everything depends largely on how the interest rates on loans evolve. If interest rates on loans are maintained at the current level and the prospects for raising them are cautious, housing investment trusts will continue to be a reasonably popular investment option. However, should the interest rates rise, the trusts with a large debt leverage will not remain very attractive. According to Viita, one of the main reasons why property and housing have been invested so much in recent years is that the return is not quite available elsewhere due to low interest rates. That is, if the interest rate level rises, the bare minimum is that the number of new housing trusts will decline, but according to Viita, housing funds will hardly be removed as they have already established their position on the market.

5.3 Interview findings

The interviews with investment professionals were in line with the previous research on the subject. Both of the interviewees stated that direct housing investments are more profitable, and as Kaarto (2015) stated, even if the investor needs to do more background research, continuously monitor the state of the investment, do maintenance and be able to withstand higher risk caused by the lack of decentralization. Most of all there are multiple ways to profit from direct investments by both rental revenue and potential rise in housing value. Väänänen also highlighted that a direct housing investor should focus on the cash flow generated by the investment, as any potential rise in housing value is always pure speculation, even if historically housing prices have been rising. The interviewees also agreed on the need for a specific character of the investor, as Väänänen stated that direct housing investing is a matter of character and Viita said if the investor wants to have good night’s sleep, housing trusts are a better choice. In benefit of housing trusts both Väänänen and Viita stated that the ease of investing, the so-called invest and forget method supports investing into housing trusts. In addition, as the trust are made of thousands of different housing units in different geographical areas, the investment benefits off decentralization. If a single tenant stops paying rent or damages an apartment an investor investing in housing trusts will not have any significant loss of profit. However, as Viita and Väänänen both state, an investment that is less risky and easier to manage comes at a cost. Both ways of investment are still very welcome on the market, as without either of them the interviewees stated that the market would be much more imbalanced than it currently is.

According to the interviewees, even when considering all the possible risks mentioned, the biggest risk for direct housing investors rises from the investor itself. Although a financially stable investor with large income is naturally able to handle more risk, not studying the investment in detail or using too large a debt leverage is a sure way to fail on the housing market. Väänänen and Viita approached the risk from a different direction. Väänänen emphasized that if the investor does not do his homework or invests with too much loaned money, the risks are much higher. Viita, on the other hand, underlined that if an investor knows the market and risks, is skilled and thus is able to find and purchase housing at a good price, DI can be a better choice. Both of the professionals thus agreed on the risks and the ways to counter or minimize them. However, the risk of too much leverage applies to some housing trusts as well. If and when the interest rates rise, trusts with too much leverage will quickly be unable to make a profit for the investors. Moreover, if a major financial crisis should hit the market, there is a risk of a mass selling of housing trusts by the investors, which could plunge the trusts into a crisis as the trusts would have to sell their housing property to pay back the investor’s capital. Although, even if the profit margins fall, housing trusts will hardly be removed from the market as they are already well established. Overall the findings of the interviews are in line with the previous reseach conducted for the thesis.

6 **CONCLUSION**

The purpose of the thesis was to survey housing investment options offered to private investors in Finland while focusing on housing investment trusts and direct housing investments.

Attention was paid to the benefits, expenses and obligations of each method to illustrate their suitability for investors. The main research question was which of the two methods of investment is expected to yield higher revenue for a private investor with 20.000€ in capital with a 5 year investment horizon, with two sub questions being what are the most common risks of both types of investment and what are the benefits, obligations and expences offered by the methods. The assumption was that, for a private investor, direct housing investments are more profitable than investments in housing trusts.

The direct investing is the most common way of investing into the housing market. The issues favouring direct housing investments are numerous, such as that in direct investment the investor is able to directly influence the value of the investment, for example, by deciding on renovations or by partaking in the decision-making of the housing company. Additionally, the investor can raise the profit margins by adjusting the level of rent to match the desirability of the housing. However, it is not entirely free of burden as the investor will have to look for an apartment suitable for his investment plan, find a good tenant and possibly do a renovation that can be seen as extra work that can leave the investor with nothing but a large bill. In addition to this, the housing company may face a large, unexpected renovation that can be expensive. Moreover, the tenant can stop paying the rent or even cause substantial damage to the apartment, even if the investor researched the tenant’s background. As a result, continuous monitoring of the investment is required and as Väänänen stated, direct housing investment is a matter of character and is thus not suitable for everyone. Direct housing investments are also prone to risk due to the lack of decentralization of investment, e.g. having all your eggs in one basket, which can cause unwanted surprises for the investor because of, for example, a significant drop in housing prices, a drop in regional rent level or a significant rise in the charges of the housing company. All of which could all be avoided with more decentralization of investment, as they are all matters occurring in a specific region, most likely due to negative population growth in the area. However, once the housing is picked correctly, the rent level is defined, the tenant is carefully selected and the contract is well prepared, direct housing investment can be a very profitable business, even so that the profits of direct housing investing, especially when combined with debt leverage, far outnumber the profits of any funds researched in the thesis.

Housing investment trusts, on the other hand, significantly lower the risks associated with direct housing investments, such as the location, housing company and the tenant. They open a pathway to housing investment for investors that might not have sufficient capital to acquire a personal housing investment, or might want to an easier and less risky way to invest in the housing market by outsourcing all the management tasks to the portfolio manager of the trust, leaving the investor with more free time. By investing in a trust, the investor minimizes the risks associated with direct housing investments, such as the lack of decentralization, expensive renovations and the tenant. The private investor gets to benefit from institutional scale decentralization, and the fund will take care of signing and evicting tenants and renovations, which can be a key factor for some investors that lack the enthusiasm to constantly manage their investment. However, as all good things, this too comes with a cost. To compensate for the ease of investing and general effortlessness, the investor pays a steady fee to the management company operating the trust, such as management fees and fees occurring from the selling and buying the housing in the trust. The fees can vary significantly between different funds which is something the investor must look into before investing, as the higher the management costs, the less profit the investor will gain. However, trust operation comparisons between different trusts is also difficult, as some invest directly into housing and some invest in companies or trusts investing in real estate. This in itself makes comparison of funds difficult. As Viita stated, the funds offer a relatively good profit of 4,5% for investment, but even so they are no match to direct housing investment’s profit margins currently available. However, the mentioned issues do not automatically mean the trusts are a poor investment, but rather something the investor should consider before making an investment.

A possible rise in interest rates in the coming years could force private investors to stop exploiting debt leverage and in turn lower their profit margins. In this case, a well financed and financially independent fund could outperform direct housing investing due to the size of the trust that allows them to buy housing under the market price, which would raise the trust’s profit margins. At the moment, in most cases the housing funds use 50-80% of debt leverage to support the trust’s investment activity, to speed up buying or constructing new housing and to drive up their profits in hopes of new investors. As mentioned, the trusts are rather risk-free operations for the management companies, as they will in any case receive their management costs. If the profit margins would be the same as they are in direct housing investments, the trusts would be an undisputed first pick for any investor. However, the price of decentralization and lower risk are the fees the investor must pay the management company of the trust, which will inevitably and considerably lower the long term profits of the investment.

The interviews further verified the research findings. Both of the professional investors, the other a direct housing investor and the other a portfolio manager of a housing investment trust, stated that direct housing investment, if done with proper consideration and expertise is more profitable than investments in housing trusts. With the biggest risk being the investor itself, it could be said that if one were to start direct housing investing, proper knowledge and judgment are the minimum requirements if the investor wants to minimize his risks and maximize his profits and ease of mind.

To conclude the findings, even though there are clear risks especially associated with direct housing investments, the profit margins do not leave any suspicion as to which of the ways of investment is more profitable; direct investment profits far outnumber the profits of any trusts researched in the thesis, especially if the investor utilizes debt leverage.

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APPENDIX 1

Tax deductible costs may include the following

- Water, electricity i.e. costs to the extent that the landlord has paid them
- Costs incurred from obtaining a tenant, for example to the real estate agent
- Rental collection charges and costs incurred from terminating the tenant's contract
- Travel expenses from checking the housing
- Interest incurred from acquiring income and loan maintenance charges, as well as expenses from getting the loan
- Renovation expenses of the housing with certain conditions and limitations
- Renewal of household appliances
- Real estate tax
- Study material; books, seminars and trainings that are associated with housing investing