How landlords invest: missing pieces of the housing system jigsaw

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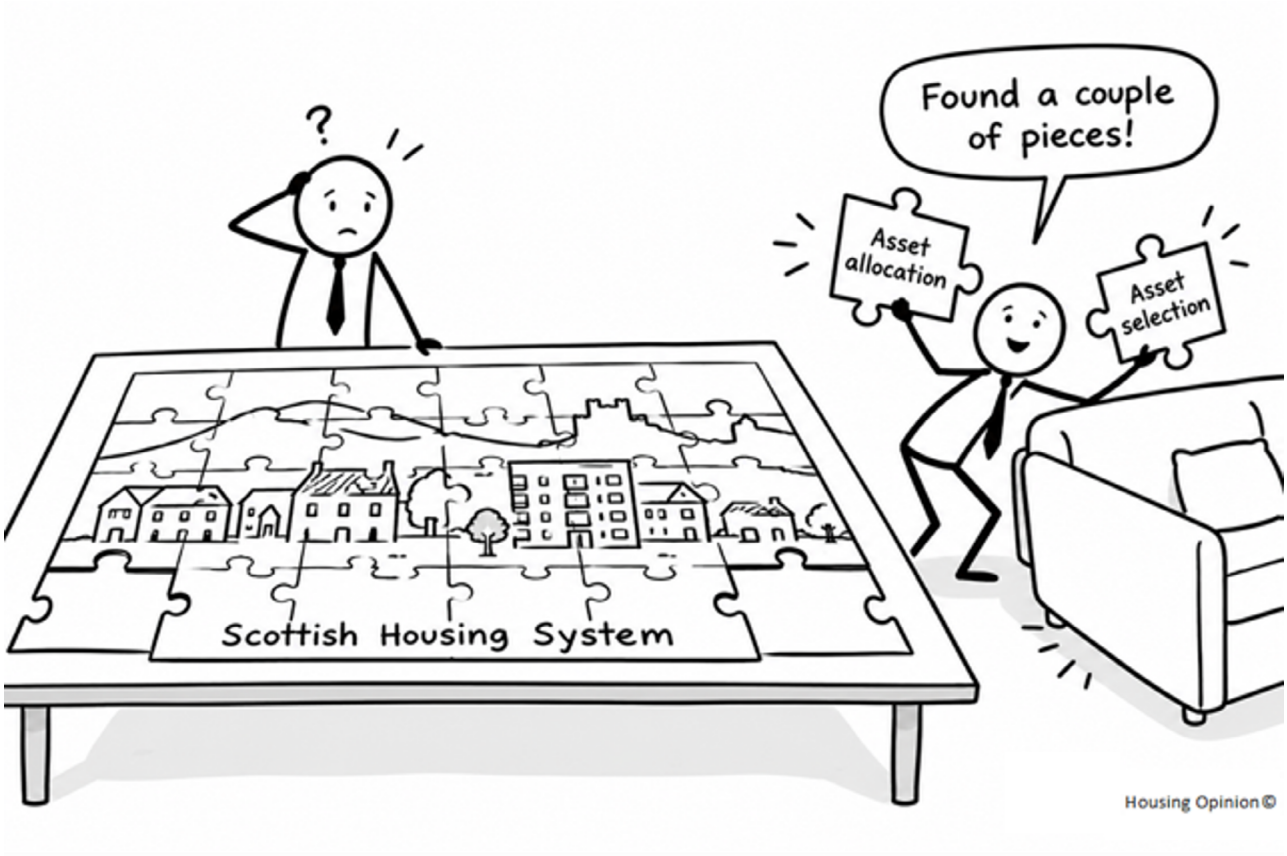
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Summary

This short briefing paper summarises the findings from two peer-reviewed studies which investigate distinct aspects of landlord investment decision-making. The first examines the decision to include Private Rented Sector (PRS) assets in their investment portfolio (asset allocation), while the second examines the decision of which properties to acquire (asset selection). Taken together, the studies demonstrate how landlord investment behaviours shape the composition and functioning of the PRS and highlight opportunities for more behaviourally informed housing policy.



Introduction

We can visualise the Scottish Housing System as a jigsaw with each piece representing an important component of the overall picture. The Scottish PRS forms a sizable and important part of that jigsaw. Although many factors have contributed to the status quo, there is little doubt that the sector has been shaped and will continue to be shaped by the investment behaviours and decisions of private landlords. While sector outcomes could undoubtedly be improved by understanding how those decisions are made, policy debates and prescriptions tend to overlook these sector inputs, instead focusing on sector outputs, such as statistics on the size of the sector, rent levels and conditions. In short, some of the pieces of the jigsaw that reveal how the PRS functions are missing.

The first study sought to understand the asset allocation decisions of landlords (Watson, 2026a). These decisions shape the content and performance of landlord investment portfolios, but also have implications for the scale of the sector and its position within the wider housing system.

Its companion paper (Watson, 2026b) explores landlord asset selection decisions. These decisions determine which properties landlords acquire, with implications for portfolio performance. Importantly, they also dictate the type, size, condition, location and quality of properties in the sector, as well as the markets and type of tenants served.

Both studies draw on a mixed-methods investigation of Scottish private landlords, combining survey evidence with in-depth interviews.

Taken together, these papers produce two missing pieces of the jigsaw, shedding light on how small-scale landlords invest in the sector, with implications for landlords, policymakers, tenants and other sector stakeholders.

Asset allocation: why invest in residential property?

Asset allocation is concerned with the decision to hold residential property rather than, or alongside, other investments. The first paper, 'All of their eggs in one basket', found that many landlords approached this decision informally.

Although 97% of landlords reported owning at least two types of investment, thereby constituting an investment portfolio, less than half regarded themselves as owning one. Excluding their PRS investment, landlords held an average of 3.3 investments, most commonly equity in their own home (88%), a private pension (65%), stocks and shares (47%), a cash ISA (44%) and a stocks and shares ISA (35%).

This highlights a significant disconnect between established investment definitions and how landlords themselves perceive and categorise their investments. It also points to portfolio neglect, with landlords failing to consider or manage their various investment assets (including within the PRS) as a unified portfolio with potential implications for investment risk and returns.

The findings reveal that landlords who built investment portfolios often did so opportunistically, circumstantially, intuitively, over time, adopting a naïve approach to diversification in which they sought to avoid putting "all the eggs in one basket" or to "squirrel" money away in different locations. The paper conceptualises this as a form of "intuitive accumulation".

Many landlords favoured PRS investment due to a fear or dislike of alternative investments. This aversion often arose after they or someone they knew sustained sometimes significant losses in volatile non-PRS investments, often stocks and shares, which discouraged further investment. These combined experiences led to a form of "asset anchoring" underpinned by the knowability and tangibility of property (Watson, 2025), which made it difficult for some landlords to conceive allocating capital to non-PRS investments.

The default discounting of alternatives led to several landlords framing their asset allocation decision as a dichotomous choice between "bricks-and-mortar" and the "bank" (e.g. cash), which was also well understood as an investment asset. Importantly, the decision to invest in housing was therefore not always the outcome of a comprehensive comparison of investments and in many cases the decision was informed by a range of heuristics and cognitive biases.

This has clear implications for portfolio performance in terms of the optimality of both risk and reward and raises questions regarding over-exposure. It also poses a dilemma for Governments seeking to encourage their citizens to expand holdings of financial assets.

Asset selection: which properties are purchased?

Asset selection is concerned with the decision of which properties to acquire. The companion paper, 'How residential property investors select properties', follows landlord investment decision-making into the housing market. It finds that landlords broadly follow a three-stage process in which they access, simplify and appraise the choice frame to identify properties considered suitable for acquisition.

The "choice frame" is the set of properties available for a landlord to consider. Having identified the initial choice frame, landlords applied preferences through a range of investment criteria including investment orientation and return, property location, target market served and property type to simplify it.

The paper coins the term "path-dependent frame contraction" to describe how an initial preference in one criterion can constrain subsequent choices, progressively narrowing the range of properties that will be considered. The process resulted in differences in the shortlists created by landlords, but homogeneity within individual shortlists.

By way of example, at the time of the research, over 10,000 residential properties were listed for sale on Rightmove in Scotland. However, just three of these met one research participant's combined return requirements, chosen location, target market and preferred property type. While this is an extreme example, it illustrates the point.

After reducing their choice frame, landlords tended to undertake a property appraisal comprising financial analysis and an in-person physical assessment. Generally speaking, the latter was taken more seriously than the former.

As in asset allocation decision-making, landlord asset selection decisions appear influenced by a susceptibility to heuristics and biases. Landlords often evaluated prospective investment properties against their own personal preferences and standards, a phenomenon conceptualised as "personal standards projection bias". In the case of selecting target markets served, there was some evidence of landlords relying on stereotyping and assumption as opposed to empirical evidence or direct experience. While it is entirely reasonable for landlords to set investment criteria, policymakers should recognise that these decisions shape the sector and the markets the PRS serves, potentially contributing to exclusionary outcomes.

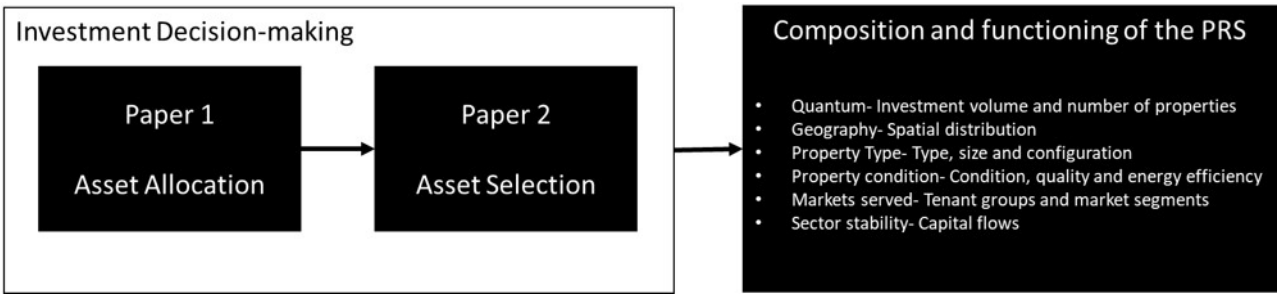
Evidence of rational maximisation and bounded rational satisficing

Taken together, the findings demonstrate that landlords exhibit both rational maximising and bounded rational satisficing behaviours when making asset allocation and asset selection decisions. However, the tendency amongst many landlords is towards the latter, with a strong reliance on heuristics and cognitive biases, previous experience, personal preference, gut feel and pragmatism in investment decision-making.

Seeing the bigger picture: implications for housing policy

Read together, the two papers distinguish two related policy questions: how capital is allocated to residential letting, and where that capital goes once it has been allocated. These are not trivial pieces of the jigsaw; they are edge pieces that ultimately bound and shape the sector's position within the wider housing system and its underexplored role in supporting the wider economy. They also influence the make-up, functioning and stability of the private rental housing market, not to mention the individual impacts upon landlord and tenant outcomes (Figure 1). Despite this, policy is currently designed, implemented and enforced with little consideration of landlord investment behaviours.

Figure 1: How landlord investment decision-making shapes the composition and functioning of the PRS



With sector challenges spanning supply, affordability, conditions, energy efficiency and access remaining persistent, and in some cases progressively worsening, policymakers need to acquire a much better understanding of the actors gatekeeping these outcomes.

These jigsaw pieces offer a starting point for doing so and for developing more behaviourally informed housing policy to encourage more balanced and socially desirable investment patterns in the PRS, whilst also recognising its important role as an investment for a sizeable proportion of the population.

More specifically, once policymakers decide on a coherent vision for the sector, the insights from the asset allocation paper present an opportunity for policymakers to influence whether landlords invest in the PRS, how much they invest and whether they retain or redeploy capital on divestment. The insights from the asset selection paper present an opportunity for policymakers to influence where landlords invest, what properties they purchase and which tenant groups and markets they serve.

The Scottish housing system jigsaw is rather large and complex. With no picture to guide them[1], policymakers can't afford to lose pieces down the back of the couch.

References

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1 Other than my housing system map! See https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6808698