

# Investor Perceptions of Macroeconomic Factors When Making Real Estate Investment Decisions in Colombo Municipal Council Area, Sri Lanka

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## Abstract

This research examines the investor perceptions of macroeconomic factors when making real estate investment decisions in the Colombo Municipal Council Area, Sri Lanka. Using stratified sampling and quantitative analysis, the study found that the Gross Domestic Production growth rate and exchange rate positively influence investor perceptions, with 40% and 73% of investors considering these factors, respectively. Despite high inflation, 80% of investors consider real estate as a hedge against inflation. In contrast, Average Weighted Prime Lending Rate and Average Weighted Fixed Deposit Rate negatively affect investment demand, and it considered by 79% and 66% of investors, respectively. The Inflation Rate, Average Weighted Prime Lending Rate, and the Exchange Rate are the primary factors considered by the Real Estate Investors when making investment decisions. The COVID-19 pandemic and financial crisis impacted over 76.5% of investors significantly. Notably, 52% of investors expressed discomfort in investing in real estate under the current economic conditions.

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*Keywords:* Macroeconomic factors; Real estate investment; Investor perceptions; Colombo Municipal Council, Sri Lanka

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## Introduction

The Sri Lankan real estate market, has experienced significant growth, driven by rising urbanization and high demand for residential housing and apartments (Lanka Property Web (Pvt) Ltd, 2023). This demand exceeds supply, leading to increased property prices, especially during the COVID-19 pandemic and in 2022. Especially, the Colombo Municipal Council Area is expanding due to industrialization, high demand, and limited supply. Macroeconomic factors like economic growth, interest rates, inflation, and exchange rates significantly influence investor decisions in the real estate market. Economic growth, typically measured by GDP, is crucial as it reflects a country's ability to produce goods and services efficiently, impacting employment, infrastructure, and overall societal well-being (Ariyawansa & Wickramarathne, 2012). Average Weighted Prime Lending Rate (AWPLR) and Average Weighted Fixed Deposit Rate (AWFDR) are also important, as they reflect the cost of borrowing and the return on fixed deposits, respectively. A negative relationship between lending rates and real estate growth has found in Kenya. (Kamweru & Ngui, 2017). Inflation, which measures the rate of price increases for goods and services, can negatively impact real estate firms, as seen in Nairobi (Kamweru & Ngui, 2017). But it is a crucial factor in understanding its influence in Sri Lankan context. The exchange rate, particularly the value of the Sri Lankan rupee against the US dollar, affects international trade, investments, and tourism, making it a significant macroeconomic factor in this study.

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The real estate market in Sri Lanka has faced challenges due to recent economic crises, resulting in decreased investor inquiries and property supply (Daily FT, 2023). Despite fluctuations in macroeconomic conditions, understanding their impact on real estate investment demand in Colombo Municipal Council Area is crucial.

## **The Objective of the Study**

### ***Main Objective***

To understand the investor perceptions of macroeconomic factors (AWPLR, AWFDR, inflation, GDP growth, and exchange rate) when making real estate investment decisions in Colombo Municipal Council area (CMC area), Sri Lanka.

### ***Sub Objectives***

- I. To identify the relationship between the investor perceptions of macroeconomic factors and the demand for real estate investments in Colombo Municipal Council area, Sri Lanka.
- II. To understand the economic comfortability in the Sri Lankan current economic context in terms of the investors' perceptions.
- III. To provide recommendations for policymakers, investors, and developers based on the study findings.

## **Literature Review**

### ***Global and Local Real Estate Contexts***

Historically, real estate has been a cornerstone of wealth accumulation, recognized for its stability. However, its significance has somewhat diminished in favour of financial instruments like stocks, bonds and other financial instruments. Despite this shift, real estate remains crucial for diversified portfolios due to its tangible benefits, such as rental income and inflation hedging. Investment decision-making in real estate has advanced, incorporating detailed cash flow analyses and risk assessments to evaluate potential returns and mitigate risks (Mercylyne, 2014).

In Sri Lanka, the real estate market, especially in Colombo, has been influenced by factors such as government policies, infrastructure, zoning regulations, and economic conditions. These elements are critical in shaping investor behaviour and market outcomes (Ariyawansa & Wickramarathne, 2012). The Sri Lankan market's growth is also tied to global trends, such as the increasing demand for properties driven by economic factors like GDP, inflation, and exchange rates (Dias, 2020).

### ***Macroeconomic Influences***

Macroeconomic variables play a significant role in real estate investments. Inflation, exchange rates, and GDP are key factors affecting market performance. For instance, inflation typically drives property prices higher, making real estate a valuable hedge, but can also reduce purchasing power, thereby dampening demand. Exchange rate fluctuations impact foreign investment and the cost of construction materials, influencing overall market dynamics. In contrast, GDP growth generally correlates positively with real estate investments, as higher economic activity boosts investor confidence and property demand (Grum & Govekar, 2016).

## **Research Gap**

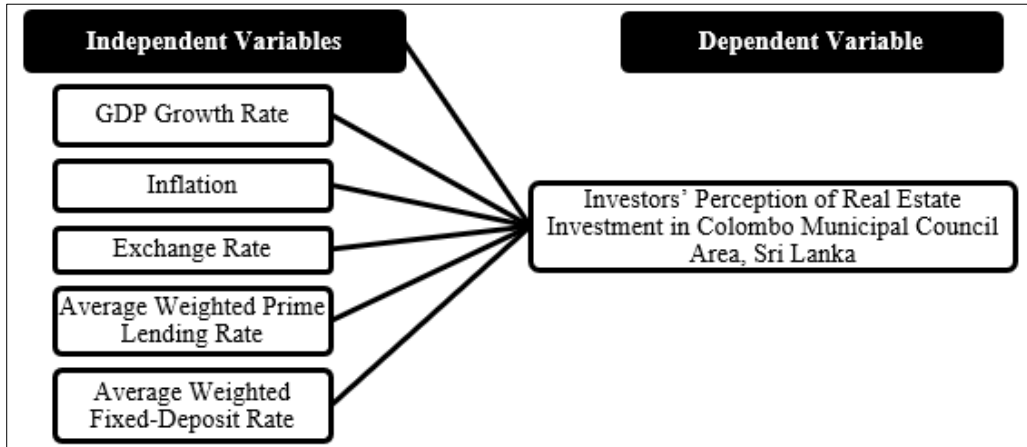
There is a notable gap in literatures concerning the specific impact of macroeconomic variables on real estate investments especially in Colombo Municipal Council area, from the perspective of investor perceptions. This gap is significant as understanding these influences can aid in stabilizing the market and guiding investment strategies, especially in light of recent economic challenges in Sri Lanka (Ramachandra & Zainudeen, 2010).

## **Methodology**

The research employs a descriptive research design using a quantitative approach. The conceptual model developed in this study serves as a foundation for understanding how these macroeconomic

factors affect real estate investment demand in the selected area. The model assumes that fluctuations in these economic indicators directly impact investor perception and market demand.

**Figure 1: Conceptual Framework**



Source: Author Compiled, 2024

All local and international individuals who are interested in or actively investing in real estate in Sri Lanka, including both existing and potential investors is the population for the study. Given that the population size is unknown, the research employs a stratified random sampling technique, utilizing available data from Lanka Property Web (Pvt) Ltd. The sample is stratified based on investor type, categorizing participants into local and international investors, with a proportion of 81:19, respectively, based on investment inquiries received by Lanka Property Web (Pvt) Ltd in 2023. A sample size of 385 participants has been determined to provide a 95% confidence level with a 5% margin of error.

Data is collected via a well-structured online questionnaire and shared among the selected investor database of Lanka Property Web (Pvt) Ltd. Investors who have invested for the last 5 years and are willing to invest for the next 5 years have taken part in this survey. Data analysis involves descriptive statistics to summarize responses and hypothesis testing to explore the relationship between independent and dependent variables and investor perceptions of macroeconomic factors when making real estate investment decisions in Colombo Municipal Council area, Sri Lanka. Perception analysis and correlation analysis were conducted using Microsoft Office Excel and SPSS 16.0 to identify empirical and quantitative relationships in the data. The results are presented graphically and used to draw conclusions and recommendations for policymakers and investors.

100% achieved the required sample size of 385, and out of the total responses, 243 focused on investment preferences within the Colombo Municipal Council area, while the other responses were to invest outside of the selected region. The proportion size of investor type stratum represented in the 243 subset and thereby, it used to sufficiently represent the population and to generalise the research findings.

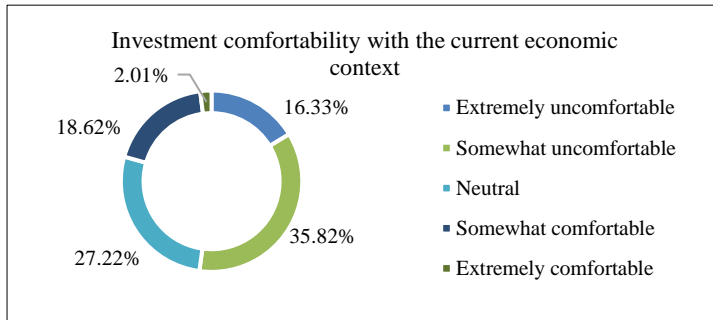
## Results and Discussion

### *Investors' Comfortability with the Current Economic Context*

The majority of respondents expressed discomfort in investing in the current economic context, with 27% being extremely uncomfortable and 35.82% somewhat uncomfortable. Only a small percentage of investors felt somewhat or fully comfortable.

**Figure 2: Investor Comfort Levels**

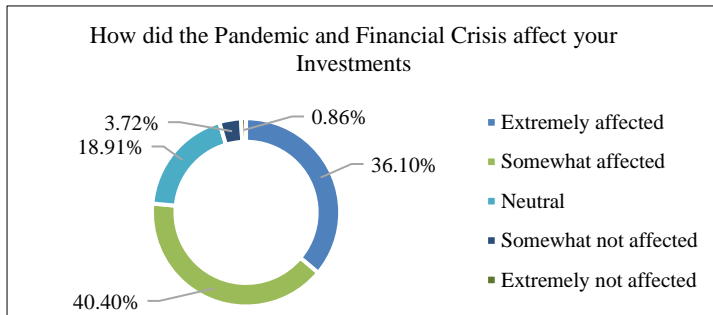
Source: Author Compiled, 2024



**Impact of Crisis and Covid-19 Pandemic**

The pandemic and economic crisis significantly affected investments, with 76.5% of respondents indicating they were affected. Of these, 36.1% were extremely affected, while 40.4% were somewhat affected, which supports the statement of “SL real estate market is grappling from the recent economic crisis” (Daily FT, 2023).

**Figure 3: How did the pandemic and crisis affect investments**



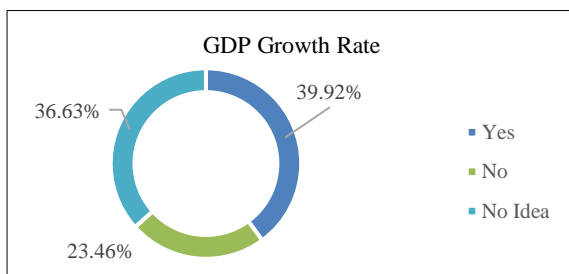
Source: Author Compiled, 2024

**Gross Domestic Production Growth Rate (GDP Growth)**

There is a moderately positive relationship, which Spearman’s rho value stands at 0.582, between real estate investments in the CMC area and the investors’ perception of GDP growth rate.

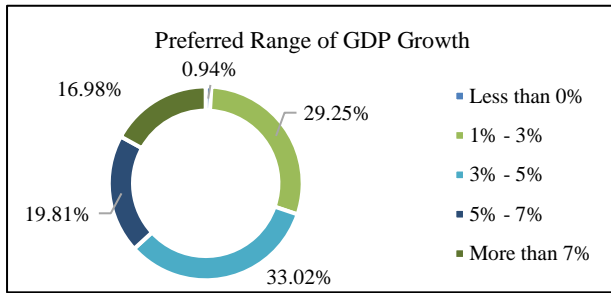
The data analysis shows that most of the real estate investors in Colombo do not prioritize the GDP growth rate in their decisions, and only 39.92% consider it. However, many are still willing to invest at lower GDP growth rates, as 62.27% of investors prefer rates between 1% and 5%, reflecting varied risk tolerances and economic expectations among investors.

**Figure 4: Perception of GDP Growth Rate when Investing**



Source: Author Compiled, 2024

**Figure 5: Preferred Range of GDP Growth**

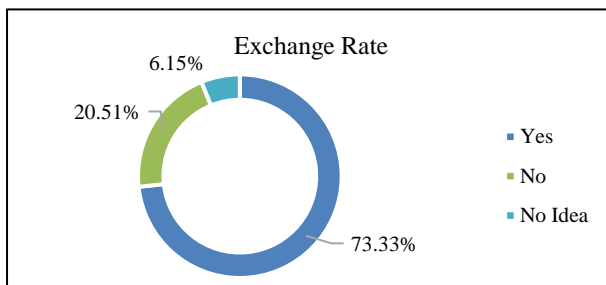


Source: Author Compiled, 2024

**Exchange Rate**

Strong positive relationship, which Spearman’s rho value stands at 0.734 between the real estate investment CMC area and the investor perception of the exchange rate. Figure 6 illustrates that 73.33% of real estate investors consider the exchange rate when making investment decisions, primarily to benefit from rental income in USD. Meanwhile, 20.51% do not consider the exchange rate, likely focusing on residential investments, and 6.15% are unaware of it. Regarding currency preferences, 65.47% of respondents prefer LKR appreciation, while 34.53%, including foreign investors favour LKR depreciation to capitalize on lower transaction costs when the dollar appreciates.

**Figure 6: Perception of Exchange Rate when Investing**

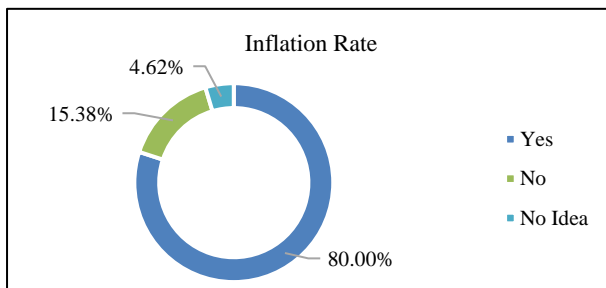


Source: Author Compiled, 2024

**Inflation Rate**

There is a strong positive relationship, which Spearman’s rho value stands at 0.775 between the investor perception of inflation rate and real estate investment demand in the CMC area, as investors use real estate as a hedging strategy against inflation. During high inflation periods, real estate demand increases. Figure 7 illustrates that 80% of respondents consider the inflation rate when making investment decisions. Of these, 38.92% prefer an inflation below 2.5%, and 44.91% favour a rate between 2.5% and 5%. 16.17% prefer between 5% and 7.5%, indicating that lower inflation rates enhance the real estate investments.

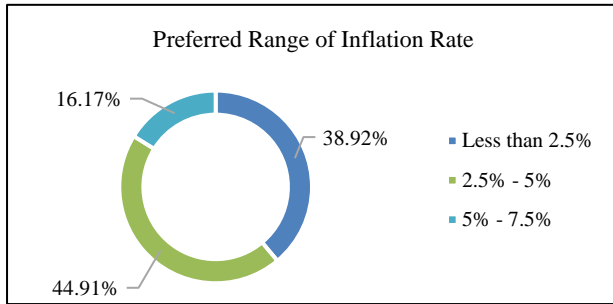
**Figure 7: Perception of the Inflation Rate**



Source: Author Compiled, 2024

**Figure 8: Preferred type of Inflation Rate**

Source: Author Compiled, 2024



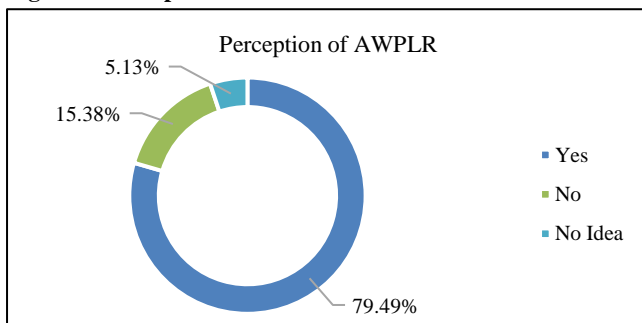
**Average Weighted Prime Lending Rate (AWPLR)**

Spearman’s rho value stands at -0.768 mentioning that there is a strong negative relationship between the investor perception of AWPLR and real estate investments in the CMC area. Figure 9 illustrates that 79.49% of respondents consider the AWPLR for investments, while 15.38% do not and 5.13% are unsure. Investor preferences for AWPLR are; 48.48% prefer below 8%, 38.18% prefer 8%-10%, 10.3% accept up to 12%, and 3% accept higher rates. Over 85% prefer an AWPLR below 10%, indicating that lower rates boost real estate investment demand.

**Average Weighted Fixed Deposit Rate (AWFDR)**

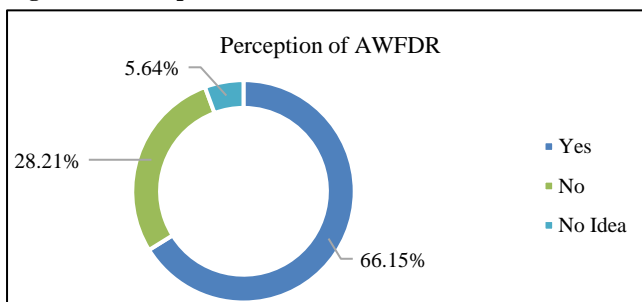
A Strong negative relationship states as the Spearman’s rho value is -0.717, between the investor perception of AWFDR and real estate investment in CMC area. Higher AWFDR always encourage short-term FDs rather than real estate investments. Figure 10 shows that 66.15% of respondents consider the AWFDR, while 28.21% do not and 5.64% has no idea. Regarding fixed deposits, 40.27% withdraw if the rate drops below 12%, 39.6% tolerate rates up to 9%, 13.42% prefer rates of at least 15%, and 3.36% require rates of at least 18% prior to a move.

**Figure 9: Perception of AWPLR**



Source: Author Compiled, 2024

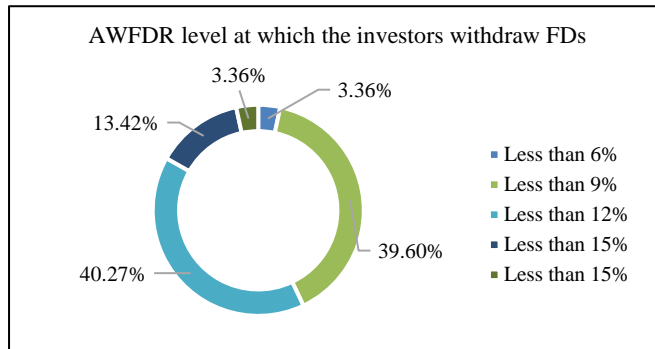
**Figure 10: Perception of AWFDR**



Source: Author Compiled, 2024

**Figure 11: AWFDR level at which the investors withdraw FDs**

Source: Author Compiled, 2024



### Conclusion

The research examines the investor perceptions of macroeconomic factors (AWPLR, AWFDR, inflation, GDP growth, and exchange rate) when making real estate investment decisions in CMC area, Sri Lanka. GDP growth shows a moderate positive correlation with investment demand, while exchange rate, inflation, AWPLR, and AWFDR are strongly correlated, and each influencing investment decisions. Higher inflation was seen as a hedge, though it reduced purchasing power. Conversely, higher interest rates (AWPLR and AWFDR) negatively impacted investor perceptions of real estate investments. The Inflation Rate, AWPLR, and the Exchange Rate are the primary factors considered by the Real Estate Investors when making investment decisions as per the research findings.

Further, the study examines the COVID-19 pandemic and how the financial crisis affected real estate investments. Key findings indicate that over 76.5% of respondents were affected by the crises, leading to reduced investment demand, with 52.15% expressing discomfort in the current economic context. The study highlights the importance of stable macroeconomic policies to support investor confidence and market stability. The findings offer insights for developers and investors in managing risks and making informed decisions in the real estate market.

### Acknowledgements

I extend my deepest gratitude to those who supported me in completing this study. Special thanks to Senior Professor K. Amirthalingam, University of Colombo, for his invaluable guidance and feedback, and to Mr. Daham Gunaratna, Managing Director of Lanka Property Web (Pvt) Ltd, and Mr. Tharindu Jayarathne, Head of Development Consultancy and Research, for their data access, expert advice, and encouragement. I appreciate everyone who contributed, directly and indirectly, to the completion of this dissertation.

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