Intelligent Investment

# Is Multifamily Asia Pacific's Next Big Investment Opportunity?

VIEWPOINT

Urbanisation, declining housing affordability and regulatory change are driving investor interest in multifamily in several Asia Pacific markets.

CBRE RESEARCH
SEPTEMBER 2021

Although multifamily has been regarded as an institutional grade asset class in the U.S. and Europe for some time, Asia Pacific's strong culture of home ownership has resulted in a relatively small investible universe.

## Introduction

Japan, which is home to the bulk of regional multifamily stock, has been the lone exception, with the country's large, liquid, and resilient multifamily market attracting robust interest from both foreign and domestic investors over the past decade.

More recently, a range of factors such as urbanisation, declining housing affordability and regulatory change have piqued investor interest in multifamily in several other Asia Pacific markets, most notably mainland China and Australia.

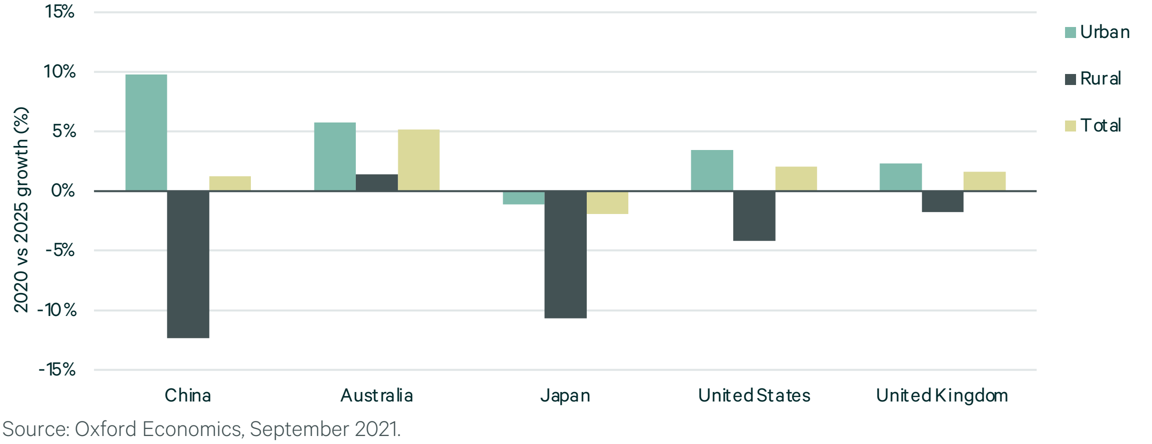
This Viewpoint explores the growth drivers behind multifamily investment in Asia Pacific; profiles the region's established and growing multifamily markets; and explains how investors can access this increasingly attractive sector.

### Regional Macrotrends Drive Multifamily Demand

Several key macrotrends are driving investor demand for multifamily assets in selected Asia Pacific markets. These include, but are not limited to, the following:

– Asia Pacific continues to urbanise relentlessly, with more than 2.3 billion people living in its cities in 2019[1]. As people move to cities to secure employment and improve social mobility, many are seeking rental housing. Among major markets, mainland China and Australia are seeing the rapid expansion of their urban populations (Figure 1), with growth well above rates in the U.S. and UK.

**Figure 1: Forecasted urban and rural population growth by country (2020 vs 2025)**




Source: Oxford Economics, September 2021.

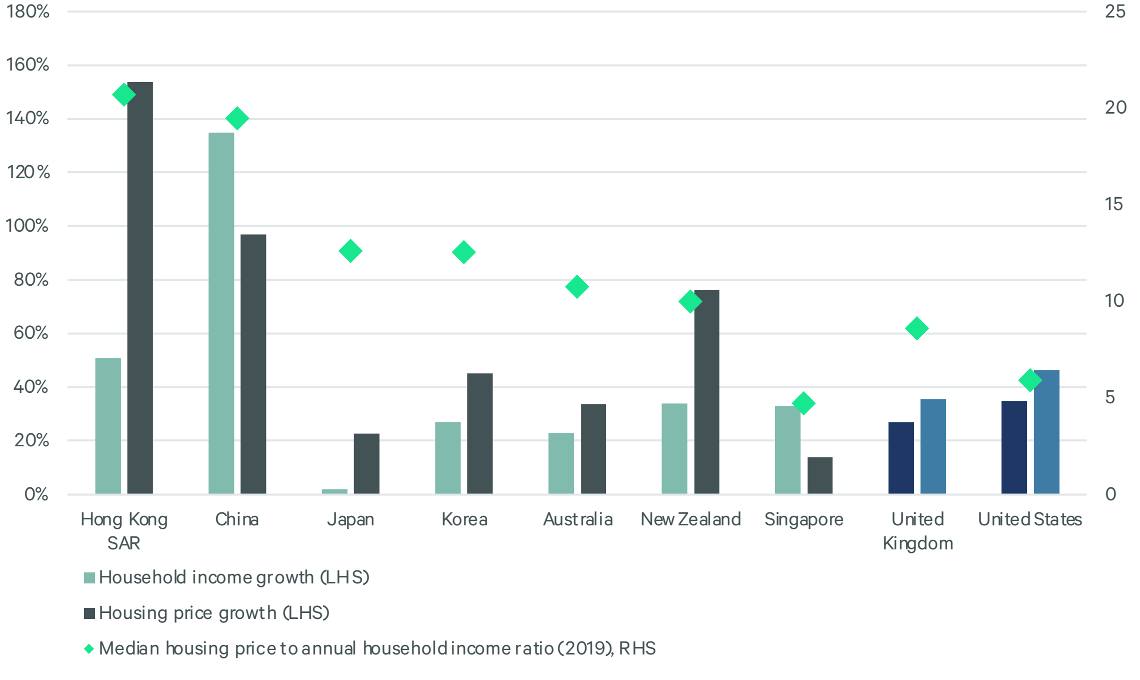
[1] The Future of Asian & Pacific Cities, United Nations Development Corporation, October 2019.

- Housing affordability is declining as residential price growth outstrips rises in incomes. While this is also an issue in the U.S. and Europe, the situation in Asia Pacific is acute, with the average cost of a home in major markets in the region now higher than 10 years' average salary (Figure 2). Singapore has a relatively lower housing affordability ratio than other major markets thanks to the Housing Development Board's comprehensive policies.

- In response to the challenges posed by urbanisation and declining housing affordability, several markets have introduced polices supporting residential development. Unveiled last year, mainland China's 14th Five-Year Plan (2021-2025) aims to increase land supply for subsidised rental properties and encourage banks to provide credit lines for construction. Authorities also plan to encourage conversions of vacant commercial properties to multifamily, or long-leased rental apartments as they are usually referred to in this market. In Australia, the New South Wales and Victoria state governments have reduced land taxes for eligible build-to-rent developments by 50% until 2040, while the Queensland state government has launched a build-to-rent pilot project to provide targeted rental subsidies to developers to deliver affordable housing within build-to-rent developments.

**Figure 2: Housing price growth vs household income growth (2010 vs 2019) and median housing price to annual household income ratio (2019)**



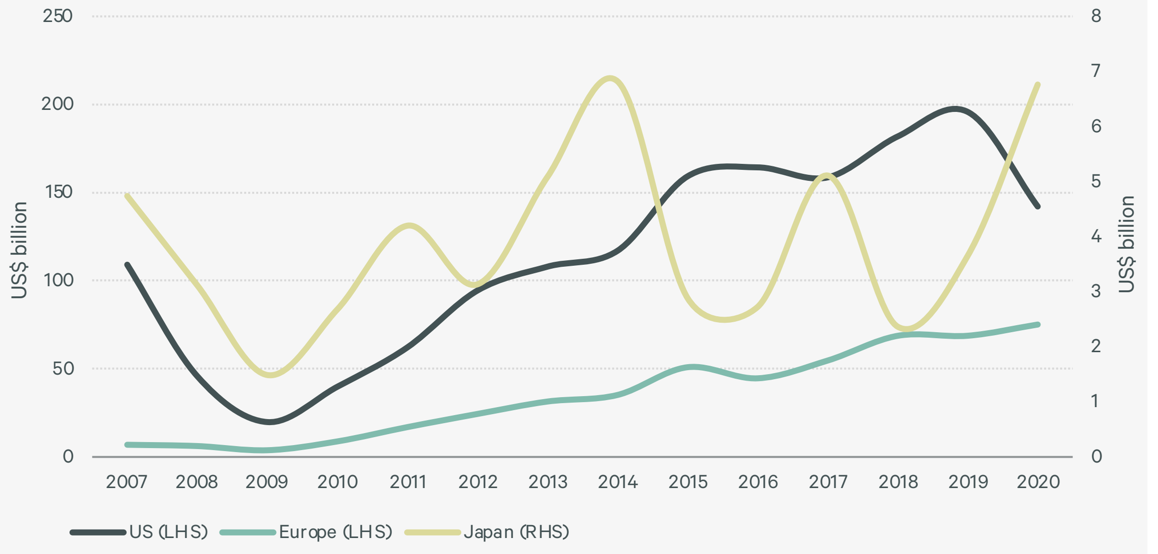

Note: The median housing price to annual household income ratio for mainland China is the average of four tier I cities, Korea is Seoul, Australia is the average of Sydney and Melbourne, New Zealand is Auckland only. United Kingdom covers London only while the U.S. covers New York only.

Source: Oxford Economics, CEIC, Demographia, E-house, May 2021.

## Investors Eye Multifamily Opportunities

While demand for Asia Pacific multifamily is increasing, investment turnover lags some way behind that in the west (Figure 3). Japan, the region's most developed multifamily market, registered US$6.8 billion worth of transactions in 2020 (19% of overall real estate investment volume), compared to the U.S.'s US$142 billion (36% of overall real estate investment volume) and Europe's US$75 billion (24% of overall real estate investment volume).

**Figure 3: Multifamily investment turnover in the U.S., Europe, and Japan**




Source: RCA, CBRE Research, May 2021.

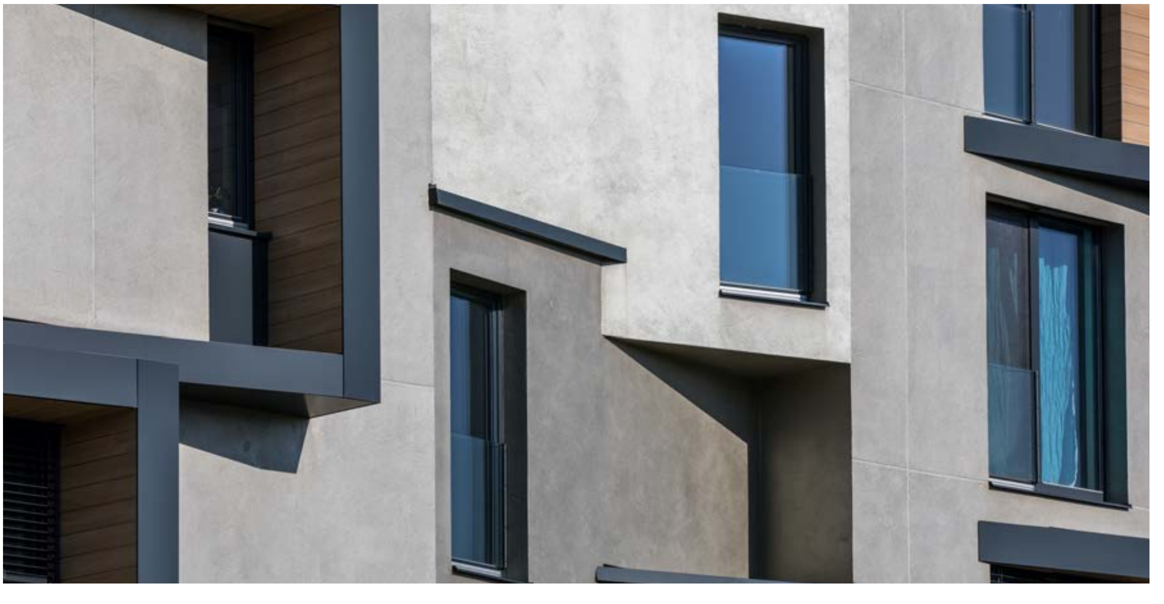
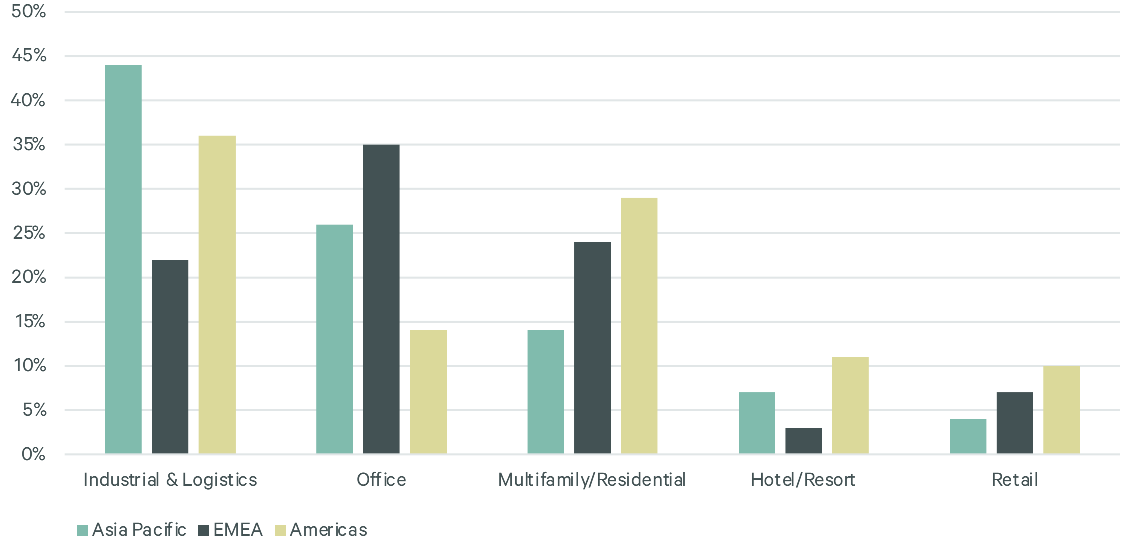


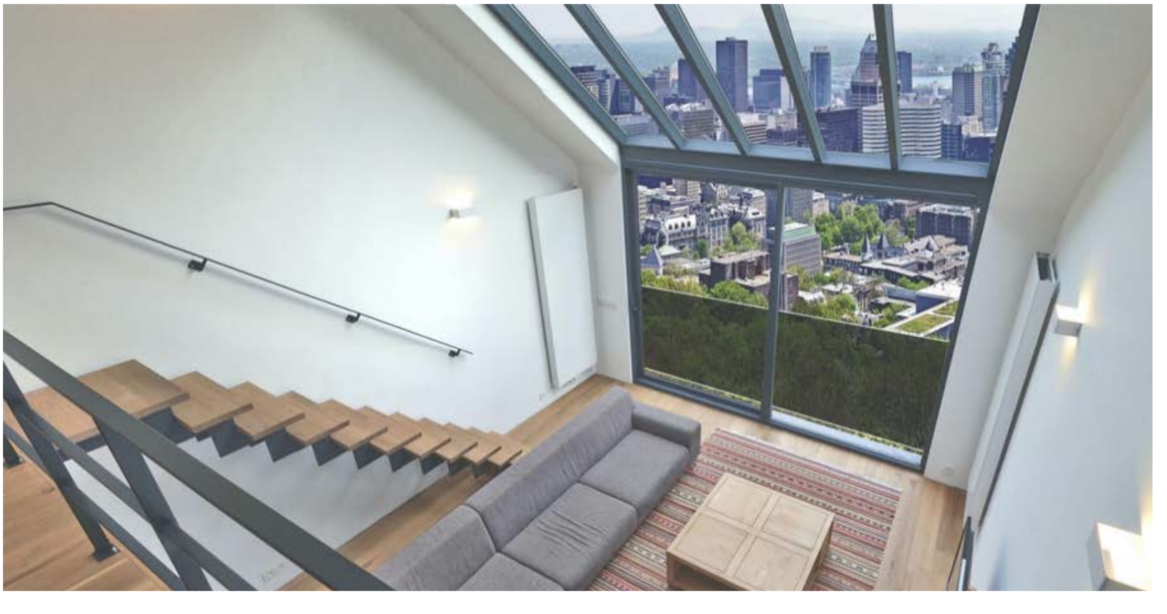
**Figure 4: Preferred sector for investment in 2021**




Source: Global Investor Intentions Survey, CBRE Research, February 2021

Despite the impact of the COVID-19 pandemic and competition from other sectors, rising demand from investors who are increasingly cognisant of the sector's growth potential and its defensive qualities ensured multifamily ranked as the third most popular sector for investment in CBRE's 2021 Asia Pacific Investor Intentions Survey (Figure 4).

While Japan remains the major focus for multifamily investment, opportunities are emerging in Australia and mainland China, where authorities are seeking to develop institutional grade rental housing markets catering to burgeoning demand from younger generations.



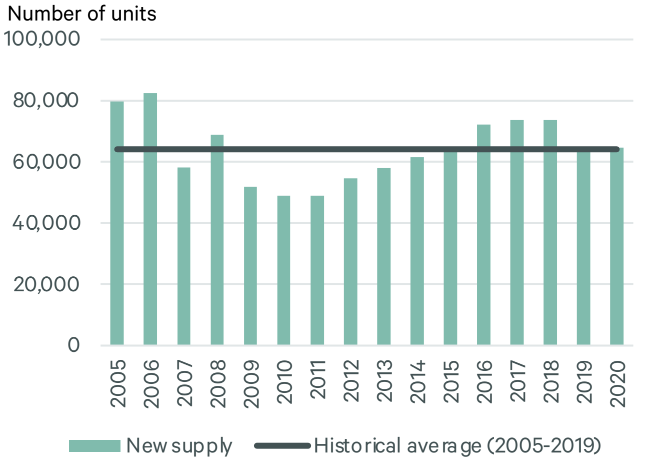
## Japan: Asia Pacific's Leading Multifamily Market

Multifamily has been among Japan's most resilient property sectors over the past decade, with robust demand and a steady, albeit manageable, flow of new supply (Figure 5). New rental residential construction starts have kept in line with the long-term historical average, supporting resilient rental performance.

Since 2007, condominium rents in the Tokyo 23 Wards have comfortably outperformed those for Grade A offices in the same district (Figure 6). Condominium rents exceeded the previous peak in 2008 and have maintained steady performance in H1 2021. In contrast, Grade A office rents fell by around 3% over the same period.

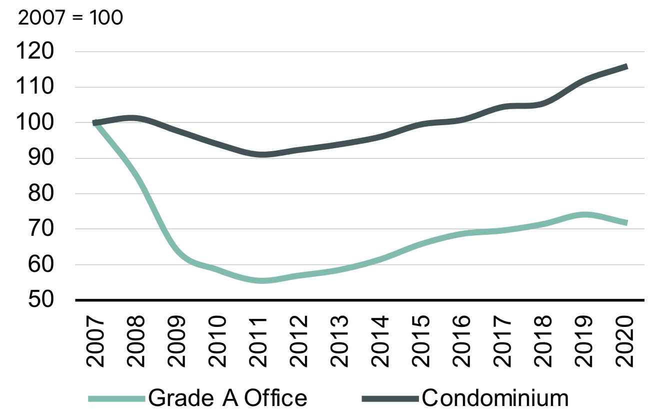
The impressive performance of multifamily properties has generated interest from overseas buyers in a market that has historically been dominated by local investors, particularly J-REITs. In 2020, foreign investors accounted for the highest proportion of investment volume in Japan's multifamily sector, backed by several major portfolio transactions, the largest of which was Blackstone's acquisition of a portfolio of 220 multifamily properties from Anbang Insurance. Intense competition for Japan multifamily is prompting some investors to seek forward purchasing opportunities from developers. By taking on leasing risk in newly built properties, investors can capture higher returns. This approach enables investors to build relationships with developers, ensuring they can access product while reducing competition.

**Figure 5: New rental residential construction starts in Tokyo**



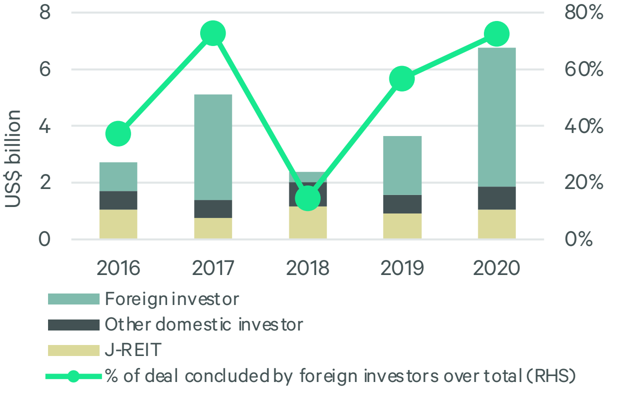

Source: Ministry of Land, Infrastructure, Transport and Tourism "Housing Starts", CBRE, Q1 2021.

**Figure 6: Tokyo 23 Wards rents by sector**




Source: Tokyo Kantei (NLA is less than 30m$^2$), CBRE Research, February 2021.

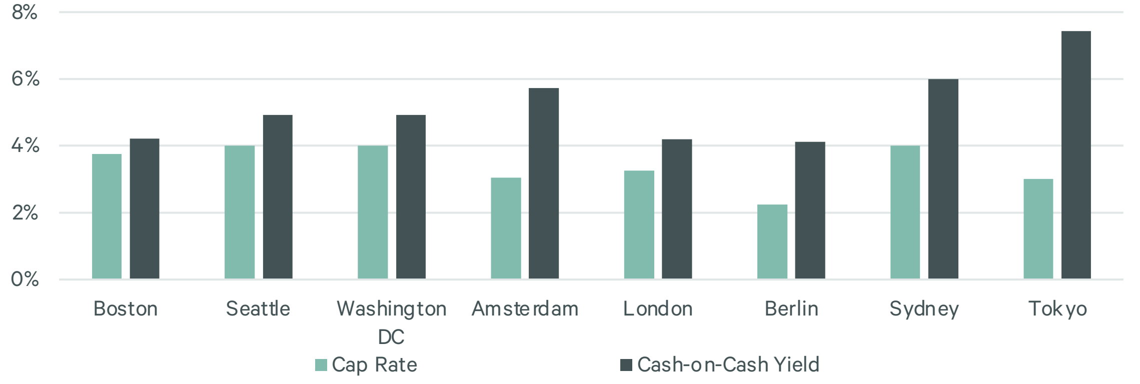
**Figure 7: Japan residential turnover by investor origin**




Source: RCA, CBRE Research, February 2021

In addition to its resilience and defensive qualities, Japan multifamily offers attractive yield compared to assets in other markets. Multifamily cap rates are around 3% in Tokyo, a relatively lower level than those in other major global markets. However, the availability of high LTV ratios and the low cost of debt in Japan has ensured the outperformance of multifamily cash on cash yield including leveraged returns (Figure 8).

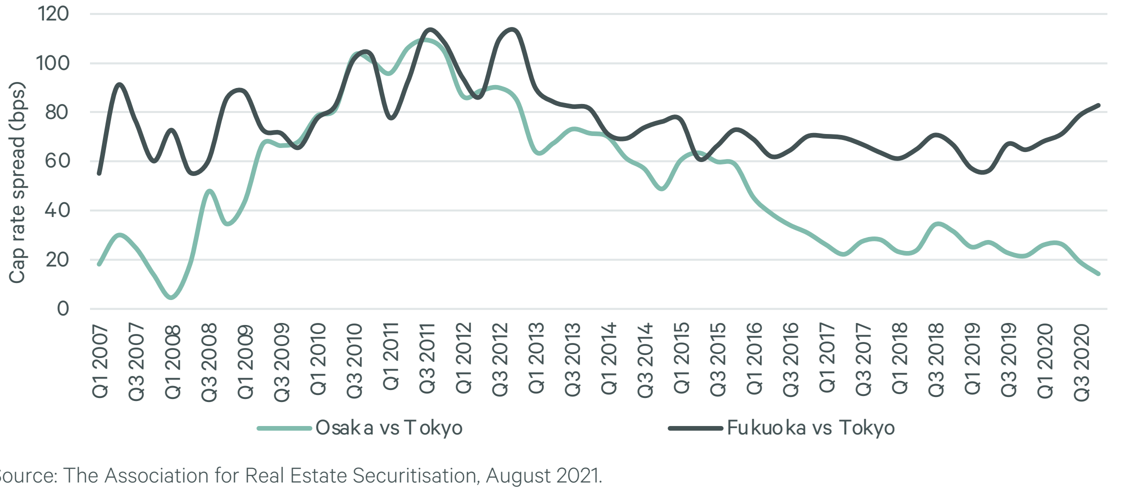
**Figure 8: Multifamily cap rates and cash-on-cash yield**




Note: Assuming LTV ratio is 65% for US markets, 60% for Amsterdam and Berlin, 55% for London, 50% for Sydney and 70% for Tokyo
Source: CBRE Research, August 2021

With multifamily yield having tightened in Tokyo in recent years, CBRE advises investors to consider regional cities offering relatively higher returns, such as Osaka and Fukuoka (Figure 9). The recent spike in the cap rate spread between Fukuoka and Tokyo was due to cap rate compression in the latter. While Japan's population will continue on an overall downward trend, investors can nevertheless avail of opportunities in the Tokyo 23 Wards, satellite cities adjacent to Tokyo including Kawasaki, Saitama and Fukuoka, all of which will continue to see net population growth in the number of people of working age (15 and 64) in the years to 2025. While the working age populations of Nagoya, Osaka and Yokohama are forecasted to undergo a mild decline, both cities have recorded net migration to their city centres in recent years, a trend expected to continue.

**Figure 9: Multifamily cap rate spread between regional cities and Tokyo**



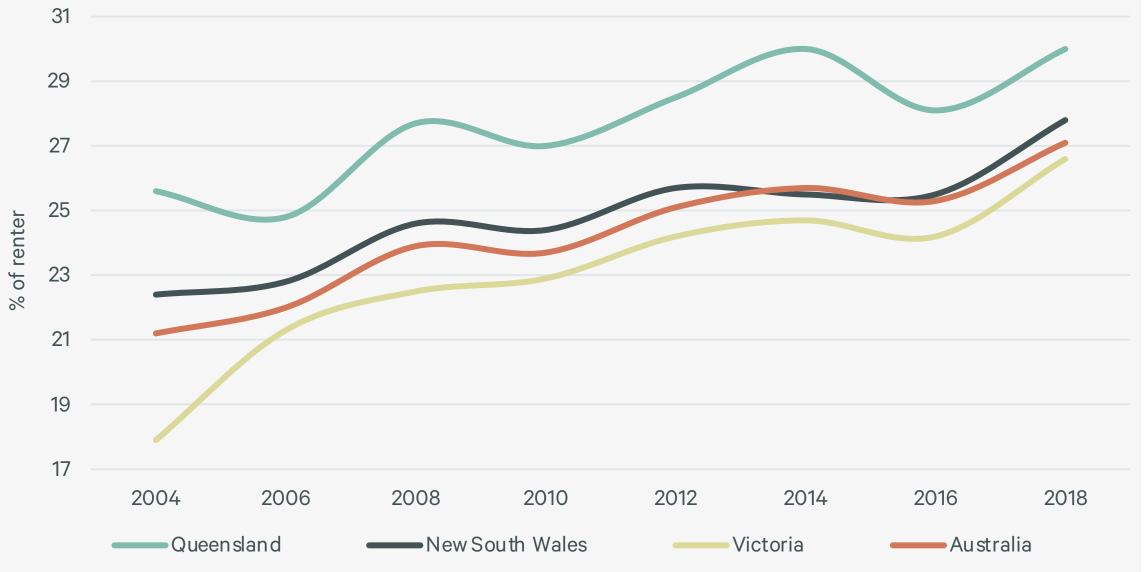

Source: The Association for Real Estate Securitisation, August 2021.

## Australia: Tax Reform Increases Viability of Build-to-Rent Development

Australia is emerging as a market of interest for multifamily (or build-to-rent as it is referred to in this market) investors, supported by an expanding population of young renters, declining housing affordability, a lack of professionally owned and managed residential buildings, and a general drift towards higher density residential development. Australia's proportion of renters has been on an uptrend since the early 2000s, with around 27% of the country's population living in privately-owned leased accomodation in 2018 (Figure 10)

Pandemic-led border closures will likely lead to slower population growth in 2021 due to the reduction of net overseas migration. However, overseas migration will return when border restrictions are relaxed in 2022, with population growth set to resume thereafter.

**Figure 10: Proportion of renters in private accomodation by state**




Source: ABS, July 2019

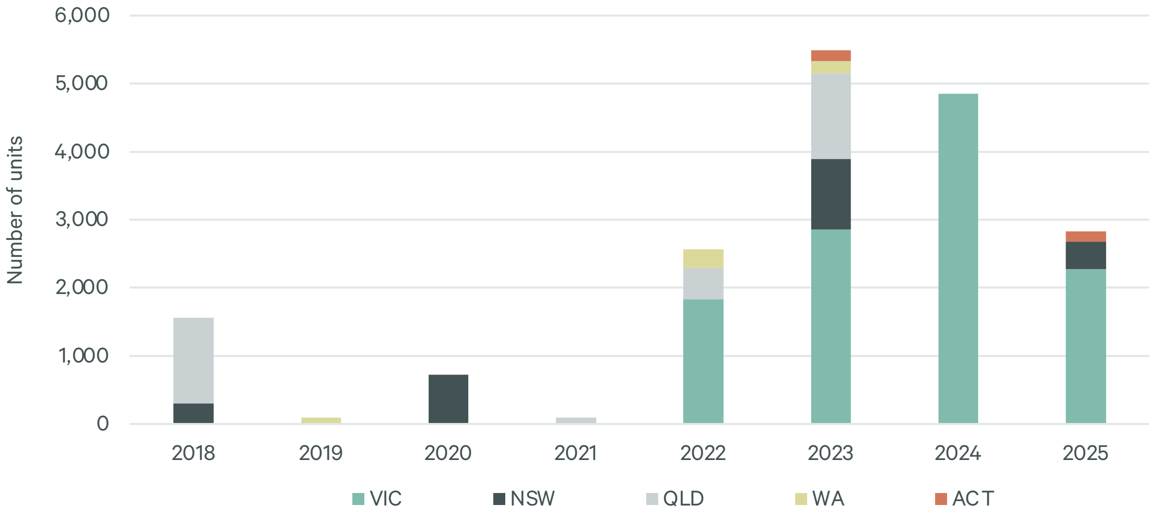
Build-to-rent developments in Australia are mainly driven by local developers, which account for 75% of future supply. The remaining 25% will be constructed by overseas groups from the U.S., Canada and Singapore.

While new development is occurring nationwide, most new stock is in urban locations in Sydney and Melbourne (Figure 11). Melbourne will account for the bulk of new build-to-rent residential supply over the next five years owing to its wider availability of development sites at more affordable prices compared to those in Sydney.

70% of build-to-rent projects due to be completed in the coming five years are large institutional grade schemes, each providing more than 350 units. This approach allows developers to achieve operational efficiencies through economies of scale.

**Figure 11: New supply of build-to-rent (BTR) projects by state**




Source: CBRE Research, September 2021.

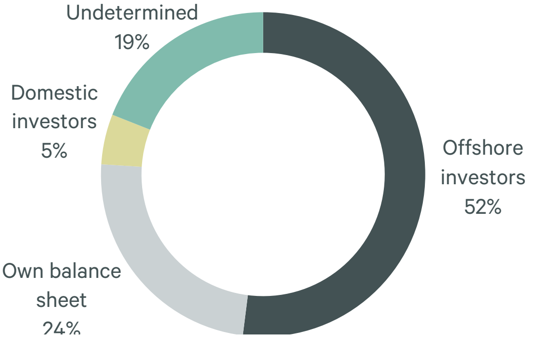
The relatively small number of build-to-rent development projects by foreign groups to date has largely been due to taxes on land value, Goods and Services Tax (GST) and withholding on rental income, along with holding structures and construction costs. These factors weaken returns and erode profit margins, ensuring many build-to-rent projects fail to hit investors' return targets.

However, recent moves by the New South Wales and Victoria governments to cut land taxes by 50% and exempting foreign investors from a surcharge on land tax and stamp duty mark a major step towards opening the sector to investment. These revision apply to build-to-rent projects of at least 50 units, and which commenced construction on or after 1 July 2020.

Authorities will continue to review withholding taxes on Managed Investment Trusts, through which foreign institutional investors can invest into build-to-rent residential at a lower tax rate similar to that for commercial property. They will also consider allowing build-to-rent to claim back GST, which will drive savings and enlarge the investor pool in the sector. These measures are widely expected to be enacted in the near future.

With the taxation issue yet to be resolved, investors are using alternative channels to access build-to-rent. These include investing in equity platforms; forming partnerships with local developers; and investing in build-to-rent focused funds. With banks remaining conservative towards providing financing for multifamily projects due to lack of pre-sales security, there are opportunities for investors to provide either senior or mezzanine financing to local developers to construct projects; a route already being pursued by several offshore investors (Figure 12).

**Figure 12: Sources of funding for BTR projects**




Source: CBRE Research, January 2021.

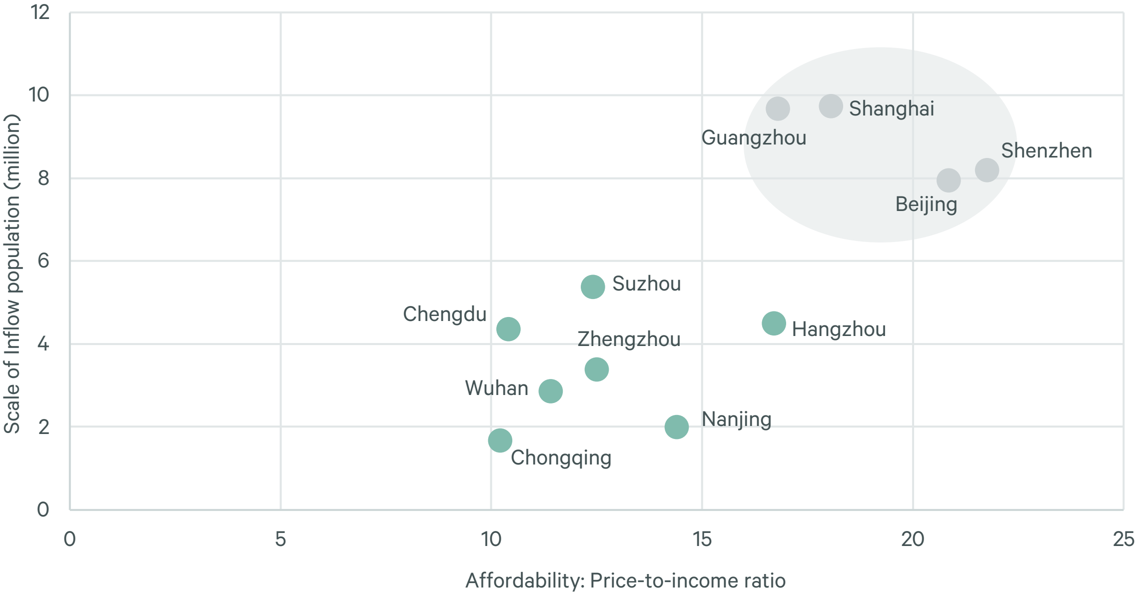
## Mainland China: Huge Market Potential

Although the size of mainland China's multifamily sector remains small, the country's population of 1.4 billion, 64% of which lived in cities as of 2020; rapidly falling housing affordability; and comprehensive policy support for the development of rental apartments indicate significant growth potential.

Recent years have seen rapid growth in the size of the country's renter population. According to a local research institute, mainland China's total renter population reached 220 million in 2020 and is expected to expand further to 240 million by the end of 2022. One of the major drivers of the rapid expansion of the country's renter population is the wide purchase restrictions set by the government including rating system, 'hukou' policy and social security insurance payment requirement. Young professionals are required to meet certain criteria before they are eligible to purchase residential property. Together with high housing prices, this forces many young mainland Chinese into rental accomodation.

As the locations of the strongest population inflows and lowest housing affordability, the four tier I cities of Beijing, Shanghai, Guangzhou, and Shenzhen are the focus for investors (Figure 13). Selected tier II cities such as Hangzhou, Nanjing and Suzhou also hold strong appeal. With Suzhou hosting a large life sciences industry, and Hangzhou and Nanjing both established as hi-tech hubs, these cities continue to attract young professionals seeking work opportunities. Local data sources show mainland China's population cohort aged 21-30 accounted for over 60% of nationwide rental housing demand in 2019. This age group accounted for nearly 22% of the country's total population in 2020, equivalent to over 310 million people.

**Figure 13: Floating population and housing affordability in major cities in 2019**




Source: E-house China, Demographia, CBRE Research, 2020

Since the onset of the COVID-19 pandemic, renters in mainland China have displayed strong demand for high quality rental apartments, particularly centrally managed buildings featuring modern facilities, cleaning services and a safe and convenient environment. With individual landlords typically unable to provide such an offering, there is a growing niche for institutionally owned and managed residential accomodation. The availability of this type of product remains limited compared to private homes and urban villages, indicating substantial room for growth.

Developers are the major suppliers of centralised rental apartments in mainland China, with rental apartments typically built into existing projects. Vanke Boyu, Longfor Goyoo and CIFI Lingyu, which in Q1 2021 possessed portfolios containing a total of more than 380,000 units including future supply, are among the country's leading developers.

Rental apartment operators, which include Ziroom Apartment, Mofang, Cjia.com and V Linker, are among the other major players in the sector. Initially, most such companies adopted an asset light approach featuring a sublease model. However, following financial difficulties experienced in 2020 by Danke Apartment, one of the country's largest online apartment rental platforms, several local governments including those in tier I cities released rules to regulate the leasing market including limiting rental deposits to a maximum of one month in Beijing or up to three months in Shenzhen and Shanghai and requiring deposits to be held in escrow accounts. This has led to some consolidation within the sector, with some operators opting to acquire assets for conversion in response to an investor shift toward operators possessing underlying assets. Recent examples of this trend include V Linker's acquisition of dormitory buildings adjacent to an industrial park in Pudong, Shanghai.

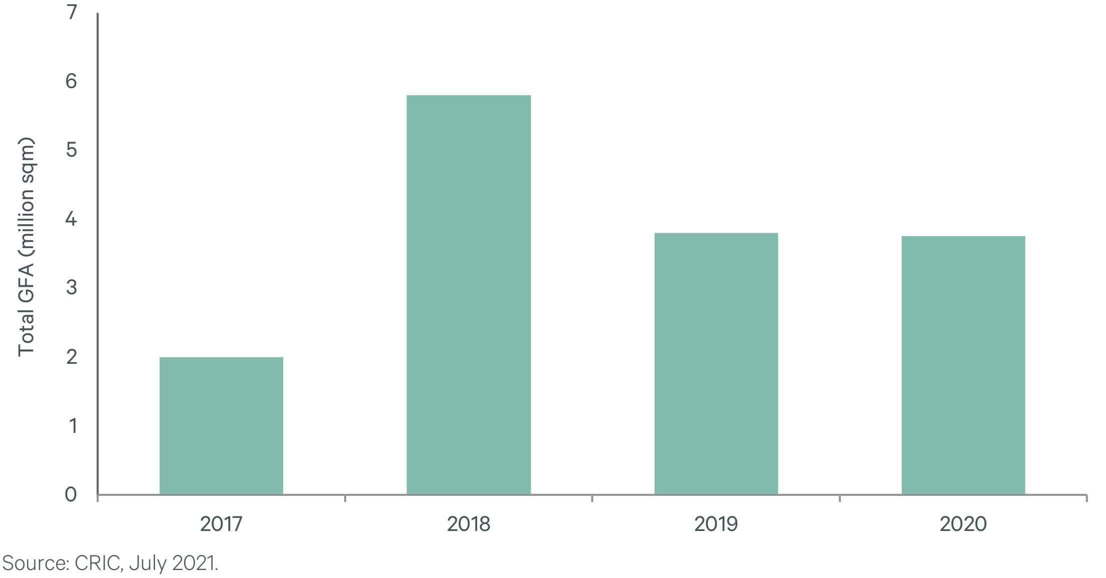
While the cost of land continues to pose a challenge for developers seeking to create long-term rental apartment projects that can generate an attractive yield, recent years have seen city authorities start to provide land for build-to-rent schemes as part of the central government's efforts to support the development of a rental apartment industry (Figure 14).

In Shanghai, the number of land parcels made available purely for rental apartment development accounted for nearly 40% of total land supply between 2018 and 2020. Hangzhou and Nanjing are also offering land for rental apartment development, including assets designated for specialised talent. Prices of land for rental apartments are typically lower than those for general residential sites. In Shanghai, the land price discount is around 30% to 45%, with most sites awarded to state-owned developers.

To access the mainland China rental apartment sector, investors are advised to consider indirect investment channels include forming partnerships with developers and investing in equity platforms. Examples of these approaches include CPPIB's formation of strategic partnership with Longfor in 2018, and APG's investment in Greystar's China focused multifamily fund in 2019. Other options include converting underperforming hotels into rental accomodation, although this route remains confined to local investors.

More recently, regulators have introduced a number of tax incentives on rental apartments. From October 2021, value added tax (VAT) on rental housing companies who provide rental apartments to individuals will be reduced from 5% to 1.5%. Meanwhile, real estate tax on corporations providing rental units to individuals or professional scale rental housing companies will be cut from 12% to 4%. CBRE expects these incentives to boost returns for investors in the coming years. With subsided rental apartments covered in C-REIT guidelines in 2021 and set to be included as underlying assets in the domestic REIT market in the near future, this could provide a potential exit route for investors.

**Figure 14: Total land supply for rental apartments from 2017 to 2020**




Source: CRIC, July 2021.

## Conclusion

Urbanisation, rising housing prices and regulatory change will continue to spur the development of multifamily markets in Asia Pacific in the coming years, driving strong end-user demand and drawing more institutional capital to the sector.

Significant barriers still remain, however, with many cities in Japan experiencing a population decline, uncertainty over taxation structures remaining in Australia, and land availability and exit routes potential obstacles in mainland China.

In the latter, despite a strong preference for home ownership as a route to wealth creation and the central government's mantra of "houses for living in, not for speculation", housing prices that are already beyond the reach of many are driving the development of a build-to-rent asset class in a market that holds enormous growth potential.

**Figure 15: Recommended multifamily investment channels and focus markets**

| | Investment channels: | Focus markets: |
|---|---|---|
| **JAPAN** | • Direct acquisitions on the open market<br>• Forward purchases from developers | Tokyo 23 Wards, Fukuoka, and other regional cities benefitting from net population inflows |
| **AUSTRALIA** | • Partnering with developers<br>• Committing capital to real estate funds<br>• Project financing to developers | Sydney and Melbourne |
| **MAINLAND CHINA** | • Partnering with developers or operators possessing underlying assets<br>• Asset conversion<br>• Potential project financing to second-tier developers | Tier I cities and selected tier I cities such as Hangzhou, Nanjing and Suzhou |

Source: CBRE Research, September 2021.

### Contact

Henry Chin, Ph.D.
Global Head of Investor Thought Leadership
Head of Research, Asia Pacific
henry.chin@cbre.com.hk

Jonathan Hills
Senior Director,
Asia Pacific
jonathan.Hills@cbre.com.hk

Leo Chung, CFA
Director,
Asia Pacific
leo.chung@cbre.com.hk