Asia-Pacific Living Outlook 2024-2026

Bouwinvest Real Estate Investors

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Introduction

The share of living investments is set to grow significantly in institutional real estate portfolios. Not only traditional multifamily housing, but also upcoming subsectors like Student Housing and Senior Housing are becoming highly sought after living investments.

Although the level of maturity and housing market structure differs between Asia-Pacific countries, the overall trend is that significantly more rental housing is needed, especially in the heavily undersupplied affordable housing segment.

While looking at the macro-economic environment, occupier- and investment market, we discuss key topics like migration, climate change and climate adaptation, regulatory change and social impact. We believe that institutional investors with strong ESG ambitions and a long-term investment horizon are in the position to tackle these challenges and support future housing demand.

In this Outlook, Bouwinvest discusses these developments with a specific focus on advanced Asia-Pacific living markets, each with its own characteristics, opportunities and challenges. We hope you find this outlook informative. If you would like more information or want to discuss investment opportunities; please contact us at Bouwinvest.

Executive summary

Emerging living sector

- Driven by demographic shifts, ongoing urbanisation, a growing middle class, and evolving lifestyle preferences, demand for living properties continues to outpace supply, not only multifamily but also upcoming subsectors like student housing and senior housing.
- Listed real estate can offer opportunities not readily available in private markets, adding to opportunities in the living market, such as healthcare, disabled accommodation and manufactured housing.
- Specifically, a more favourable fiscal position for build-to-rent investors in Australia is expected to boost the sector and increase investor interest.

Strong market fundamentals

- The Asia-Pacific region is very diverse, supporting diversification opportunities.
- Strong demographic growth boosts the rental markets in Australia and New Zealand. Household growth, due to the growth in single person households, is supportive of rental markets in Japan and South Korea.
- Home ownership is financially unfeasible for many Asian-Pacific households, leading to additional pressure on rental markets.
- Investors, developers and occupiers are increasingly recognising the economic benefits of sustainable buildings to help reduce financial risks and increase long-term value.

Tailwinds become stronger

- GDP growth in the Asia-Pacific region is projected to outpace the US and Europe, supporting the long-term trend of a rapidly institutionalising living sector.
- Central banks in the Asia-Pacific region are widely expected to cut policy interest rates at some point in 2024. Timing and magnitude depends on decisions made by other major central banks, most notably the Fed.
- Geopolitical developments receive increased attention. The living sector, as a needs-based and safe-haven investment opportunity, stands to benefit.

Attractive entry moment

- Unlike other global residential markets that have witnessed moderate peak-to-trough capital declines, the two most transparent living markets in the Asia-Pacific region (Japan and Australia) have not experienced capital value declines in the same period.
- Institutional investment volumes in residential real estate in the Asia-Pacific region are still modest in an international context, but they are growing fast, providing early mover advantages.
- Investor interest is high, 2024/2025 could prove a highly attractive entry moment.

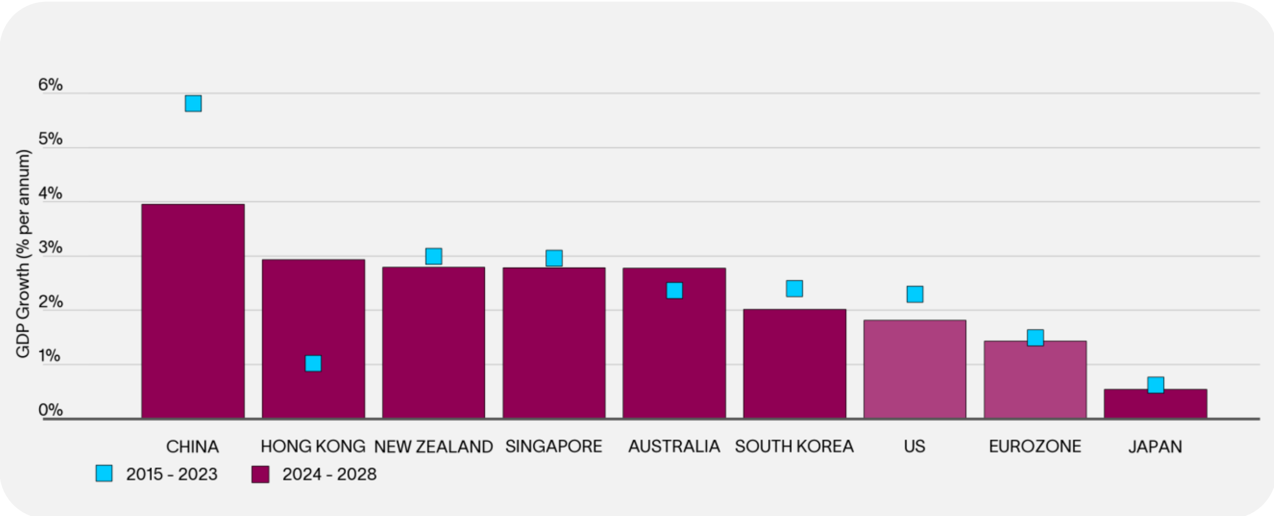
Contents

Setting the scene for Asia-Pacific's evolving living sector

The Asia-Pacific living sector is a growing and rapidly institutionalising asset class

The outlook for the Asia-Pacific living sector is very promising. The region accounts for about two-thirds of the world's population and half of global GDP. The Asia-Pacific region continues to benefit from strong fundamentals driven by long-term megatrends. Many of those long-term trends support the living sector, such as: demographic- and household growth, urbanisation, ageing societies and the rise of the middle class in large emerging Asia-Pacific nations. Two in three members of the global middle class will be in Asia by 2030, which is expected to have a positive impact on the growth of other developed APAC countries. GDP growth is projected to outpace the US and Europe over the outlook period (see graph below).

Figure 1: GDP growth (% change per annum)



Source: Oxford Economics (2024), Bouwinvest Research (2024)

In addition, the Asia-Pacific region is increasingly seen as a 'core' region and already accounts for one-third of the global investable universe, including a growing living sector (see also page 18). Furthermore, the region is marked by the growing importance of sustainability and the increased pace of institutionalisation.

As a result, Asia-Pacific institutional investors are making a gradual and managed shift from core, traditional real estate sectors to more investments in niche and growth segments of the market. According to the latest ANREV investment Intentions Survey, together with logistics, the residential sector is the most preferred sector in the Asia-Pacific region in 2024.

Japan has already established itself as a mature residential for-rent market and Australia too is quickly developing its residential build-to-rent (BTR) sector, in addition to a flourishing student housing market. Other markets that see growing interest in the livingsector are New Zealand, Singapore and South Korea, where many characteristics of the local market are the same as in other parts of the world, such as a worsening demand / supply imbalance, an expensive home-ownership market and rising rents.

'Asia-Pacific institutional investors are gradually shifting from core, traditional real estate sectors to higher-growth segments, with the residential sector emerging as the most preferred.'

Living sector more than just multifamily housing

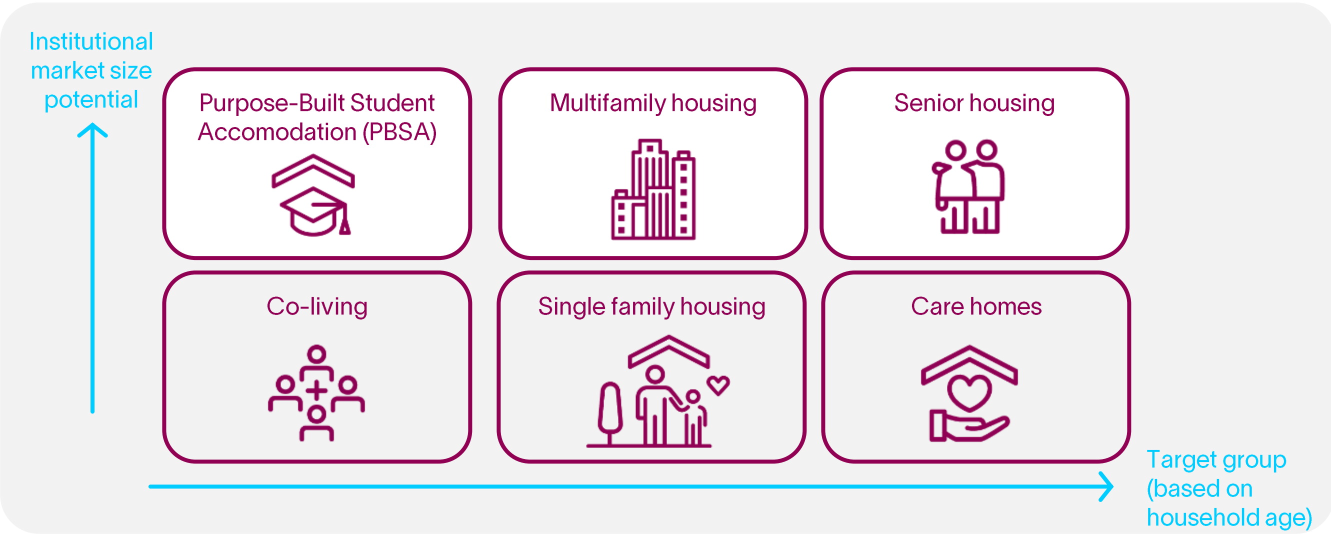
Driven by demographic shifts, ongoing urbanisation and evolving lifestyle preferences, demand for living properties continues to outpace supply.

Overall household growth across the region is expected to be positive, at around 1% p.a. between 2024 and 2026, aided by an increase in the number of one-person households. The prime rental age cohort of 25-39 years old is expected to show sustained growth in selected markets in Asia-Pacific and will boost demand for multifamily housing relative to single family housing. Given high price-to-income ratios in the home-ownership markets, the overall trend is that significantly more rental housing is needed, especially in the heavily undersupplied affordable housing segment.

Also, the share of 80+ inhabitants in Asia-Pacific is expected to increase significantly for countries such as Japan, South Korea and China, boosting demand for care homes.

Moreover, provision rates for student housing (Australia only) show a demand-supply gap as the number of student beds available compared to the total number of students is approximately 5%. This demand-supply gap is expected to be structural, making the case for student housing investment very attractive.

Figure 2: Living landscape*



Source: Bouwinvest Research (2024)

- *This overview is simplified, as we recognise that more living subsectors are available, including more shared living, manufactured housing, serviced residency, childcare and healthcare concepts.*

This Asia-Pacific Living Outlook delves into the investment potential of the Asia-Pacific living sector, focusing on multifamily housing and PBSA.

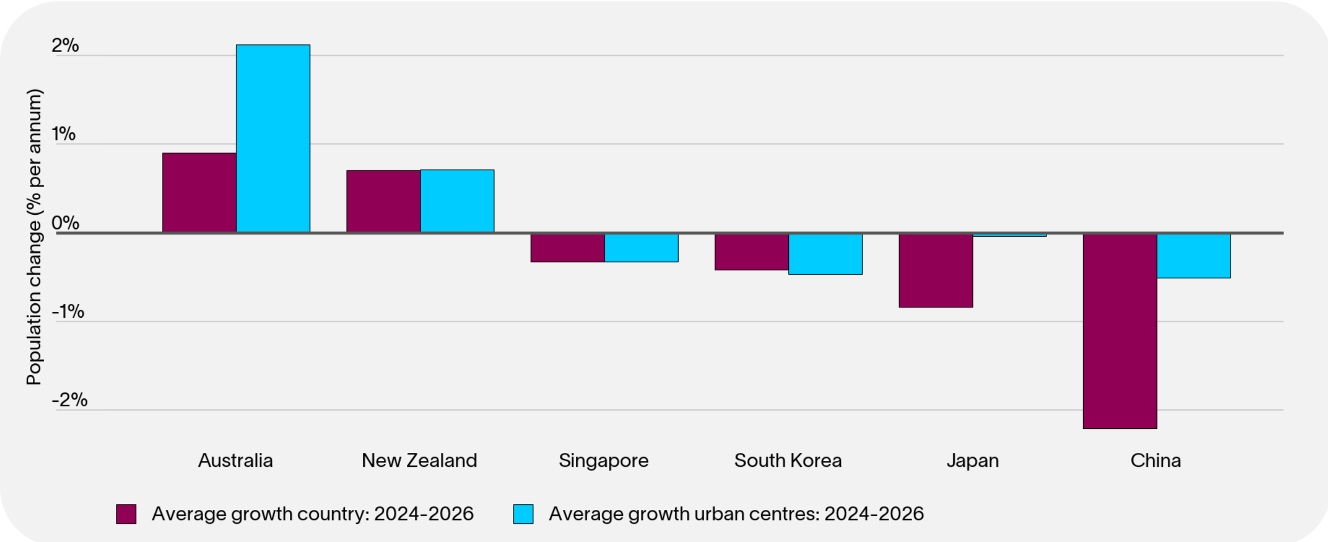
Demographic trends supportive of strong market fundamentals

Demographic developments

Markets within the APAC region are heterogenous when it comes to their overall population growth. Projections indicate Australia is to receive roughly seven million new inhabitants between the end of 2022 and 2040, which is an expansion of 25% in terms of its current population. New Zealand is set to grow by around 15% over that same period, translating to over 750,000 people. Strong demand driven by the sheer volume of population growth in both Australia and New Zealand is remarkable, making a strong case for investment in their respective BTR sectors. For Australia, we have seen this translate into vacancy rates that hover around 1%, in combination with steep rental and house price growth in most large cities.

'Migration patterns, an ageing housing stock and the lack of affordable housing create a range of opportunities in Asia Pacific residential markets.'

Figure 3: Population of 25-39-year-olds (% change)



Source: Oxford Economics (2024)

The figure above shows the annual growth of the prime rental age group of 25–39-year-olds, both on a national level (blue) and at respective urban centres. Urban centres are defined as follows: Australia – Sydney, Brisbane, Perth, Melbourne, Adelaide ; Japan – Tokyo, Osaka, Nagoya, Fukuoka ; Singapore ; South Korea – Seoul, Busan ; New Zealand – Auckland ; China – Beijing, Shanghai, Shenzhen, Guangzhou.

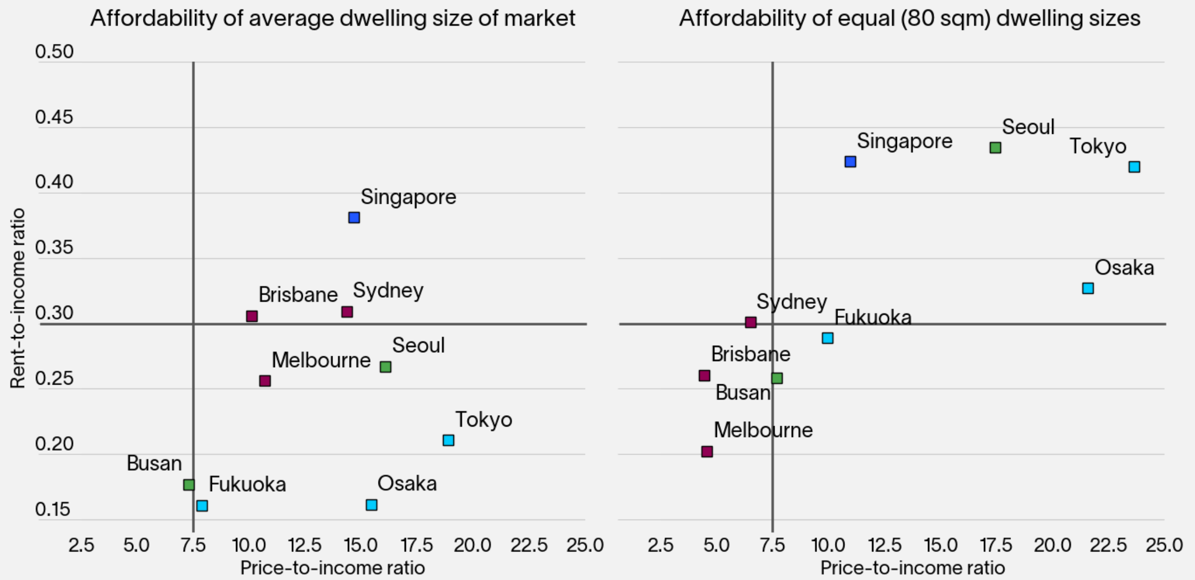
The total populations of South Korea and Japan are set to decline by 5% and 10% respectively between 2022 and 2040. At first glance, this makes these two markets seem significantly weaker versus the Australian and New Zealand markets, although these numbers do lack some nuance. The (internal) migration patterns of young people, an ageing housing stock, the lack of affordable housing in urban centres and even a lack of suitable housing solutions for short stays are creating a range of opportunities in residential markets in both countries. When taking their respective capital cities as examples, we see that Tokyo's population of the 25 to 39 age groups is set to remain stable over the forecast period. Seoul's population decline is in part a result of its very poor affordability, driving the growth of the surrounding urban areas in the greater Seoul metropolitan area.

Challenging affordability strengthens case for renting

We have seen a partial correction in house prices across Australia, New Zealand and South Korea due to their respective higher interest rate environments. This correction started in early 2022 and continued into the second half of 2023, following a two-year period of rapidly increasing house prices. Prices in most large cities have started to climb again since then, except for some parts of Seoul, where prices continued to decline in early 2024. Japan and Singapore have shown different patterns. In Japan, tight monetary policy contrasts with other markets, resulting in the continued rise of house prices. Demand for Singaporean homes pushed house prices upwards throughout 2022 and 2023, despite its higher interest rate environment, as the hub grew at the expense of its large regional competitor, Hong Kong.

The above-mentioned correction in house prices has not driven many cities in the APAC region back into affordable territory. In the graph below, we have defined affordable as house prices as 7.5 times the nominal household income, or monthly rental costs as 30% of nominal household income. In the left-hand graph, we have used the house and rental prices of the average home found on the market (in terms of size), showing that virtually no city has an accessible owner-occupier market when compared with local income levels, perhaps except for Busan and Fukuoka. Adjusted for size, the traditionally more spacious Australian housing market becomes more affordable, while the traditionally more compact Japanese homes become significantly more unaffordable. Seoul's owner-occupier market remains the same when corrected for size, but its rental segment becomes less affordable as rental units are on average smaller than owner-occupied housing.

Figure 4: Affordability of a selection of Asia Pacific markets



Combining the rent-to-income ratio with the price-to-income multiple gives us insight into the affordability landscape within Asia Pacific markets – and subsequently reveals whether the current market favours buying or renting a property. Source: ULI, Knight Frank, Savills, Mozo, CEIC, Oxford Economics, national statistic bureaus.

'virtually no Asian Pacific city has an accessible owner-occupied market when compared with local income levels.'

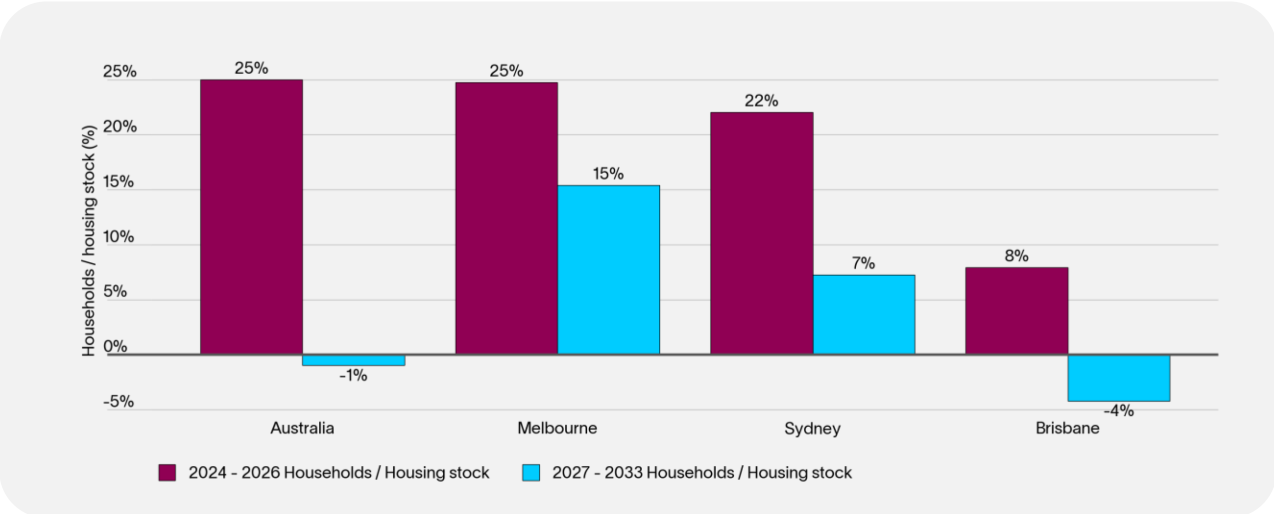
The above left figure shows that the housing markets of the larger Japanese cities of Tokyo, Osaka and to an extent Fukuoka, are pricing out many households from the owner-occupier market. This contrasts with their for-rent markets, which often provide an affordable living option for households in these cities. House prices rose by 7% in Tokyo and 12% in Osaka in the course of 2023, which has also translated into rising rents for family-sized rental units (+70 m2) in both cities. In Tokyo, we see a recovery in rental occupancy rates to 97%, which is half a percentage point shy of the pre-pandemic occupancy high. Rents are following a similar trajectory, steadily climbing towards their pre-pandemic levels – growing by an aggregate 3.5% in 2023.

In the Australian rental sector, strong demand, particularly driven by robust immigration trends toward major urban centres, has intensified the strain on existing housing stock. The vacancy rates in Australia's five largest cities have remained below 2%, with year-on-year market rental growth rates ranging from 17.5% in Brisbane to 27.5% in Sydney in the second quarter of 2023, according to Knight Frank. Prospects for significant short-term relief in housing pressure appear limited, given lack of supply relative to anticipated demand. Moreover, the disparity between available homes and median household income, particularly evident in markets like Sydney, where housing costs are more than 14 times the median income, is likely to propel more households towards the rental market. In addition, limited future development is expected to result in limited rental additions going forward, making the occupier market very strong.

‘Prospects for significant short-term relief in housing pressure appear limited, given lack of supply relative to anticipated demand.’

Melbourne’s housing market has been slightly ‘healthier’ than Sydney’s, as the city has added more homes in recent years relative to households, owing to its lower land values, which makes it easier to underwrite new projects. House prices and rents have risen more slowly since the onset of the pandemic, which has made Melbourne a more affordable city relative to local incomes. This affordability will also drive population growth going forward, as a sizeable share of immigrants and households priced out of Sydney will opt to live in Melbourne instead. The resulting projected imbalance between household growth and home additions should in our view lead to rents ‘catching up’ to Sydney and Brisbane relative to incomes over the coming years.

Figure 5: Household and supply growth in Australia



Source: Oxford Economics (2024), State of the Nation’s housing report ’22-’23.

A ratio above 0.0% signals that household growth is projected to surpass housing starts in the designated market.

Lower visa approval rates unlikely to result in significant relief for Australian PBSA demand

Last year, more than half of the Australian migrant population comprised international students, with a total of approximately 270,000 individuals entering the country primarily for educational pursuits. The momentum of international students appears to be accelerating, as universities are seeing new records in applications for the upcoming academic year.

However, projections indicate a potential decline in student arrivals due to reduced visa approval rates in the wake of prime minister Anthony Albanese's plan to reduce the number of 'non-genuine students', with an anticipated decline of around 90,000 student visas for the 2023/2024 academic year. There has been a significant reduction in the number of visa approvals for students from India, Pakistan and the Philippines, according to a report by the Australian Financial Review, in contrast to many East-Asian nations, which have so far seen little difference. The impact is also most likely to be felt by smaller private institutes that teach mostly (or only) internationals in both the higher and vocational education sectors, while better-known universities are expected to continue to see growth in their student numbers.

We believe the near-term demand for student housing will only see limited relief because of these measures. The anticipated commencement of new supply is expected to ramp up mostly after our forecast period of 2024-2026, due to current construction costs, the higher cost of debt and planning restrictions for student housing, while robust demand is projected to persist over that same period. As indicated above, relief from the regular for-rent market appears to be non-existent during the forecast period, due to minimal vacancy levels. Using data from key universities (institutes where impact is expected to be limited) in Melbourne, for example, forecasts indicate that the student population is set to expand by 164,000 students between the end of 2022 and 2028, while only 4,300 institutional beds will be added over that same period, resulting in an equilibrium rate of 21 students per bed in 2028, up from 19 in 2023.

Rents are likely to increase at the fastest pace in Melbourne over the forecast period, followed by Perth and Adelaide. While a recent report by CBRE reports a 90.000 home deficit in Sydney and a 50.000 deficit in Brisbane, the rapid acceleration in market rents from the end of 2022 onwards limits potential for future outsized growth versus the above-mentioned cities, where the spike in rents has been (significantly) lower.

Blend of hotels and multi-family fills supply gap in Asia Pacific living markets

For non-natives looking for a temporary residence, the living markets of Japan, South Korea and Singapore can be difficult to navigate. Contracts will often span two years and (smaller-scale) Japanese and Korean landlords are sometimes more selective in their tenant base.

Traditional full-service hotels on the other hand may be unsuitable for longer stays due to their higher prices and limited offer of amenities. This is creating a gap, where tenants wishing to stay longer than a few weeks – up to a year – have a difficult time finding accommodation. The co-living and serviced apartment sectors target this group of tenants by providing a reliable short-term stay option. Tenants for this segment include, among others, digital nomads, expats, blended travellers (business + leisure), project groups and regular tourists. Governments throughout the region have been more flexible in their entry policies in recent times, which has attracted more remote workers to their cities. International travel has so far seen a sharp recovery from the decline in traveller numbers due to the pandemic, with Tokyo being the main beneficiary in the region so far.

In general, the serviced apartment segment is priced higher than the co-living segment. Most serviced apartments have ensuite kitchenettes, with access to a residence lounge & other amenities, while co-living units are studios with a shared social & amenity/community space. The room size is generally smaller than in a serviced residence. The average daily rate for these segments ranges 10% to 40% lower than traditional hotels (depending on length of stay and demand), but occupancy rates tend to be significantly higher due to the relatively high share of long-stay guests, often boosting RevPAR to levels above those of traditional hotels.

In popular areas like Seoul's Gangnam or the central parts of Tokyo's five wards, stay duration is expected to be significantly closer to a traditional hotel, as more regular tourists are expected to account for a larger share of overall guest numbers.

We believe both serviced and co-living apartments are positioned to offer attractive total returns in the APAC region. By incorporating some of the strengths of both multi-family and hotels, in our view the sector fits into the post-pandemic landscape and we therefore expect substantial growth over the next few years.

'Serviced and co-living apartments incorporate the strengths of both multi-family and hotels which fits the post pandemic landscape.'

ESG policies influenced by more regulation and increased focus on social impact

Investors, developers and occupiers are increasingly recognising the economic benefits of sustainable buildings to help reduce financial risks and increase long-term value. This is done by lowering operating costs, vacancy rates and financing costs, which ultimately leaves investors with a more attractive asset at exit. Increased regulation is an important driver behind the development and implementation of more ambitious ESG policies across Asia Pacific.

Environmental

Investors are increasingly prioritising decarbonisation to maintain asset value. Many managers are adopting science-based tools, like CRREM, to assess and predict asset stranding risks. However, incomplete utilities data and lack of data collection systems in the living sector poses a challenge for effective decarbonisation strategies. While the focus has traditionally been on operational carbon emissions, there is growing recognition of the significance of embodied carbon, leading to increased tracking of whole lifecycle emissions, including investing in circular buildings that use renewable materials (e.g. bio-based and timber). Consequently, there is a shift towards brown to green initiatives, with retrofitting and repurposing buildings seen as valuable opportunities to enhance asset value and resilience.

Climate change poses systemic risks to the Asia-Pacific housing markets, prompting investors to integrate climate change risk assessment into their processes, focusing on physical asset-level risks and the increased impact of extreme weather events. Prioritising business continuity and mitigating financial losses through understanding asset vulnerabilities are essential strategies for ensuring real estate resilience in the face of climate change.

Social

The focus in Asia-Pacific has been on environmental factors such as reducing CO2-emissions as a more tangible target, while the impact of social factors is more difficult to measure. A good example may be Bouwinvest Australian Enabled Living strategy which aims to have a positive impact on social goals. This is achieved by developing well located, accessible and purpose-built homes to facilitate people living with disabilities, which allows them to interact in their urban communities and provides a positive impact on their quality of life and mental well-being. Also, developers are incorporating features such as accessible design, green spaces, and amenities that promote well-being and community engagement.

Within the living sector, affordable housing is an issue in many Asia-Pacific countries. The high cost of housing has led to concerns about social exclusion, homelessness and an imbalance in housing markets. In response, Asia-Pacific countries have introduced several initiatives to stimulate development of newly built (or renovated) stock. It is therefore an attractive real estate strategy, as it both addresses social needs and creates stable cash flows in challenging economic environments.

Governance

ESG regulations in the Asia Pacific region are evolving and different countries have their own specific regulations and initiatives. Each country has some flexibility in how they enforce specific ESG regulations in the context of their own national laws. For example, BEAM in Hong Kong concentrates on energy, CASBEE in Japan takes earthquake resilience into account and green star in Australia focuses on environmental impact, as well as well-being. As a result, there are variations in the strictness of regulations across various Asia-Pacific countries. Australia and New Zealand are known to be the countries with the most rigorous regulations that should stimulate high ESG ambition levels.

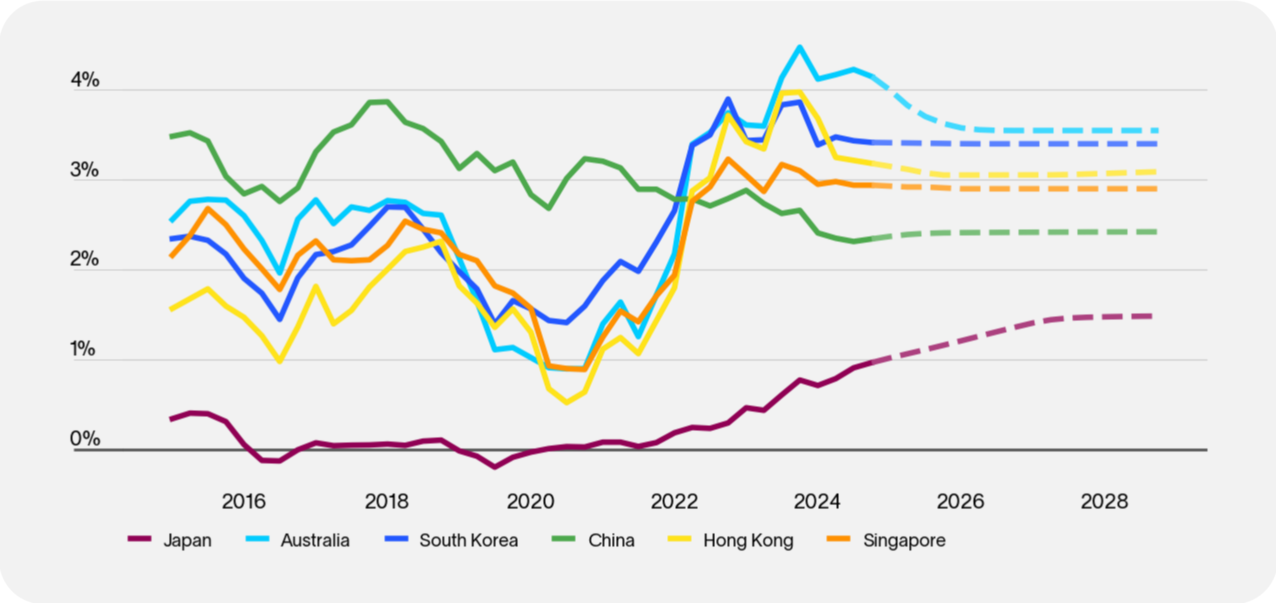
In general, governance practices are being strengthened to ensure transparency, ethical behaviour, and accountability in the real estate sector. Real estate developers and investors are encouraged to stay up to date on the latest regulations and best practices in each country to ensure compliance and promote sustainable and responsible practices.

Asia-Pacific macro-economic environment
Building on growth

Lower interest rates supportive to living real estate

it seems likely that the monetary tightening cycle has ended (with Japan being the exception). Inflation rates in most Asia-Pacific countries have moved closer to their central bank's target levels, providing room for rate cuts. Asia-Pacific is widely expected to cut policy interest rates at some point in 2024. However, the timing and magnitude will depend on decisions made by other major central banks, most notably those made by the US Fed. As the US economy is performing well and elevated inflation is proving persistent, expectations for the first rate cuts are frequently being pushed forward. Also, it is widely anticipated that we will not see a return to ultra-low policy interest rates we saw in the recent past. Nevertheless, if 10-year government bond rates (as a proxy for the risk-free rate) decline in anticipation of rate cuts, this could alleviate some pressure on refinancing and normalise property spread levels.

Figure 7: 10-year government bond interest rates in Asia-Pacific



Source: Oxford Economics (2024)

Geopolitical landscape changing, living sector seen as safe haven

Headline news in the region has long been dominated by topics such as strong Asian economic growth, infrastructure investments, the emerging middle class and urbanisation. Recently, however, challenging real estate market conditions (mainly China), ESG developments and heightened geopolitical tensions have been added to the mix.

Most political observers think it is likely that the US will continue to maintain its strict stance towards China, no matter which political party wins the next US Presidential election. Protectionist measures between the two largest economies in the world could threaten Asian exports and global economic growth.

In addition, pressure between China and NATO members over Taiwan is building and growing Chinese influence in Hong Kong is shaping Western opinion on Hong Kong's autonomy and its independent rule-of-law. In this environment, investors are looking for safe, defensive and stable havens and countries such as Japan and Singapore are openly competing for the relocation of activities from Hong Kong. The living sector, as a needs-based investment opportunity, could benefit from these developments.

Regulatory landscape balancing rights and responsibilities of landlords and tenants

Without any supranational legal order in the Asia-Pacific region, as in the European Union, the legal framework for real estate investments varies significantly from country to country.

Like the US, the Australian regulatory framework for investing in real estate strategies is governed both on a federal and on a state level. The Foreign Investment Review Board (FIRB) plays a central role in overseeing foreign investment in Australian real estate, particularly for residential and agricultural properties. Under FIRB regulations, foreign investors are typically required to seek approval before acquiring certain types of real estate.

The primary regulatory body overseeing foreign investments in Japan is the Ministry of Land, Infrastructure, Transport, and Tourism (MLIT), particularly through its department known as the Japan Real Estate Institute (JREI). The Foreign Exchange and Foreign Trade Act (FEFTA) regulates foreign investment in Japan and requires certain types of real estate transactions involving foreign investors to be reported to the Ministry of Finance (MOF) or undergo approval from relevant authorities.

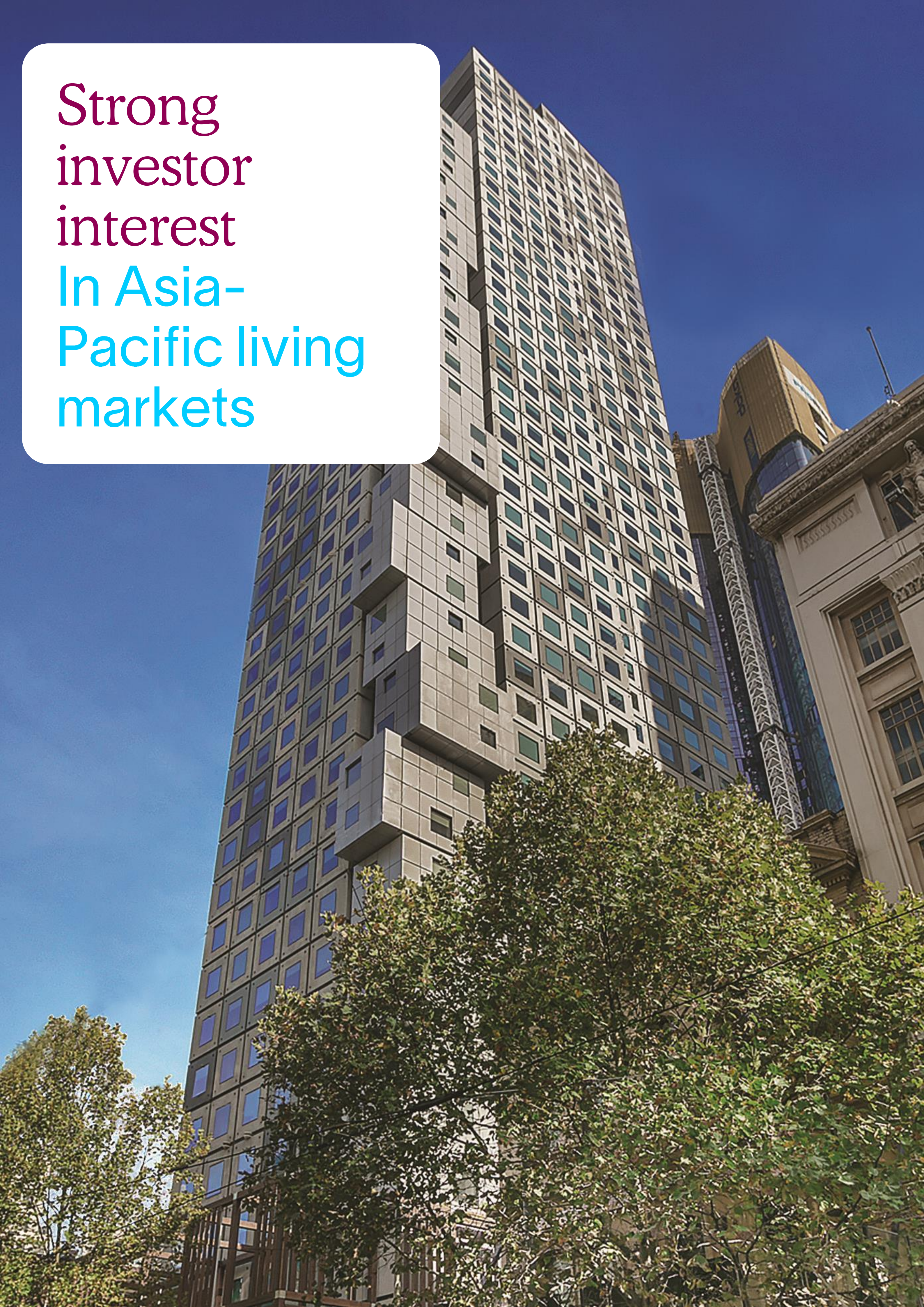
Like other western countries, Japan and Australia are in the process of introducing measures to improve tenant rights and protections to strengthen tenants' security of tenure, limit rent increases and enhance safeguards against unfair evictions. As both countries continue to grapple with housing affordability challenges and shifting demographics, it is likely that tenancy laws will continue to evolve to address emerging issues and priorities, with a continued emphasis on balancing the rights and responsibilities of landlords and tenants, while promoting fair and equitable housing practices.

‘Fiscal support to boost the new construction of homes.’

Pan-APAC investments are generally structured through Singapore, which provides various tax exemptions for funds. In investment jurisdictions such as Japan and Korea, REIT-like regimes can often result in a reduction of the effective tax rate to 10-15%. In China, Hong Kong and Singapore, most properties are held in taxable companies, but tax on capital gains could be capped at 10% (China) or even reduced to 0% (Hong Kong, Singapore) depending on actual structuring

In a welcome development, in its 2023-24 Federal Budget the Australian government announced changes in the tax treatment of eligible Build-to-Rent (BTR) projects to support the sector. More specifically, the Government indicated that it would reduce the final withholding tax rate on fund payments to 15% from 30%. Consultation will be undertaken on implementation details, including any minimum proportion of dwellings being offered as affordable tenancies and the length of time homes must be retained under single ownership. So, it remains to be seen how the new rules will ultimately work out in practice, but Bouwinvest has good faith in the applicability of the reduced rate for certain investments.

Strong investor interest In Asia-Pacific living markets

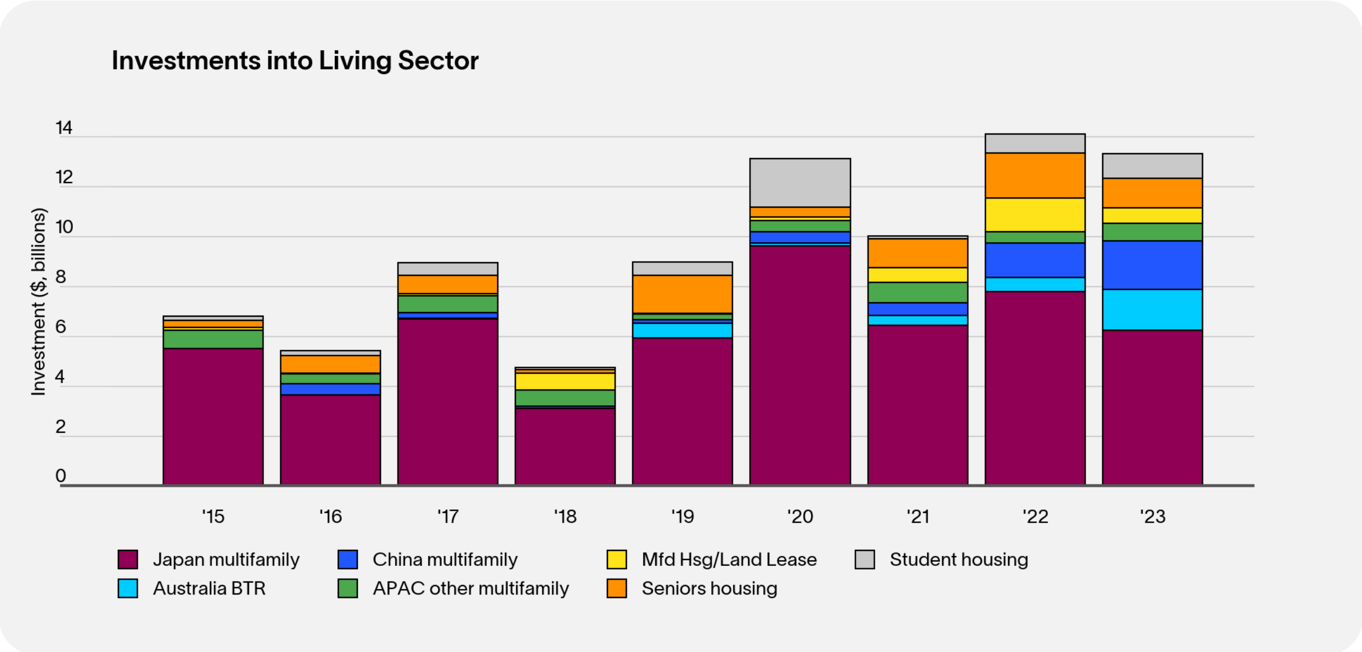


Living deal volumes set to grow

In general, the APAC region has not been immune to global events, but saw a milder downturn compared with Europe and North America. However, the impact of higher rates has differed substantially between countries and sectors. Australia, New Zealand, Singapore and South Korea are dealing with higher rates, while the low-interest and lower inflationary environment in Japan resulted in limited impact in the country. In addition, we have noted that yield expansion has been partly offset by strong fundamentals in several occupier markets, such as student housing and residential BTR in Australia. Therefore, unlike other global markets that have seen peak-to-trough capital declines of 10% to 25%, the two most transparent living markets in the Asia-Pacific region (Japan and Australia) have not experienced capital value declines. Instead, capital value growth has been stable or even modestly positive over the past two years.

In comparison with total living sector deal volumes in major markets such as the US ($119 billion) and Europe ($31 billion) in 2023, Asia-Pacific living deal volume is still modest ($12 billion). In relative terms, too, Asia-Pacific investment volumes in residential real estate are still much lower than in other major geographies, with the US accounting for approximately 30% of total transaction volumes and Europe approximately 25%, versus less than 10% for the Asia-Pacific region. However, Asia-Pacific is trending up, as can be seen in the graph below.

Figure 8: Investments into Living Sector



Source: MSCI, Bouwinvest Research (2023)

Japan used to be the sole beneficiary of investor interest, but due to favourable fiscal and legal developments, as well as solid fundamentals, Australia has established itself as an attractive destination for investment capital. Other Asia-Pacific countries are also emerging as appealing locations for potential residential investments. New Zealand is showing many parallel trends with Australia, but its market size is much smaller, and it is less advanced in its institutional maturity level.

South Korea used to be characterised by the local practice of the Jeonse system, but we have seen a gradual shift towards the global standard of monthly rental payments. Jeonse deposits are typically set at 50% of the market value of the home but can go as high as 70-80% in high demand areas like Seoul. The landlord essentially receives half their home's value in liquidity as a no interest loan; the tenant lives in a home without having to pay monthly rent and gets their full deposit back after the lease ends.

Singapore does not have a large institutionalised residential sector but has a long history of serviced residences due to its open economy, attractive amenities, a large and growing number of international visitors and significant base of foreign citizens.

China is seen as a challenging market to invest in. Although yields have not been pressured by the interest rate hikes seen in other markets, investors have been cautious given other macro, ESG and geopolitical risks. China's economy is still feeling the impact of its challenging real estate market conditions, which began in 2020 after authorities sought to rein in the significant borrowings of property developers. Investment in real estate and infrastructure were once significant sources of economic expansion and that has now changed. This is why analysts indicate it may prove difficult to achieve the 5% annual GDP growth target set by the government. Current forecasts show lower annual GDP growth at 4.0%.

Opportunities in niche segments

In addition to regular-for-rent apartment buildings, other investment opportunities may lie in more niche segments of the living market. Japan and Australia are leading the way on this front. Given Japan's demographic profile, senior housing can offer performance potential. This segment of the market in Japan is large and growing but fragmented and with limited institutional ownership. The market is sizeable, with a total value of around US$ 80 billion, while only $ 4 billion (5%) is held by institutional investors. Listed property companies own senior housing assets with a total value of $ 1.6 billion, which is nearly half of total institutional ownership. The yield premium above regular for-rent cap rates is estimated to be approximately 50 to 100 basis points. We expect institutional ownership to grow in the future.

One example of an impact investment Bouwinvest made in Australia was in 'Specialist Disability Accommodation' (SDA). These are high-quality, purpose-built homes for people with 'extreme functional impairment' or 'very high support needs', who are eligible for housing support under National Disability Insurance Scheme (NDIS). NDIS is backed by all the main political parties, and we deem structural long-term support of the policy very likely. Even though the percentage of people with disability is declining, strong population growth in Australia is pushing up the absolute number of people with a physical disability. The SDA framework is looking to mobilise institutional capital to build this type of home, as there is a significant supply shortage. It is estimated that it will take another 10 years to meet government targets.

'Senior-, student and manufactured housing, specialist disability accommodation, childcare and healthcare real estate, all stand to benefit from long-term structural trends.'

Childcare, student housing, manufactured housing and healthcare real estate are examples of the various living and care segments that stand to benefit from several longer-term structural trends, such as: affordability, urbanisation, declining household sizes, sustained population/household growth, an increased propensity to rent and desire for flexibility, significant ageing and consequent increase in the demand for care. These segments are also seen as less cyclical, which could support a more defensive portfolio build-up.

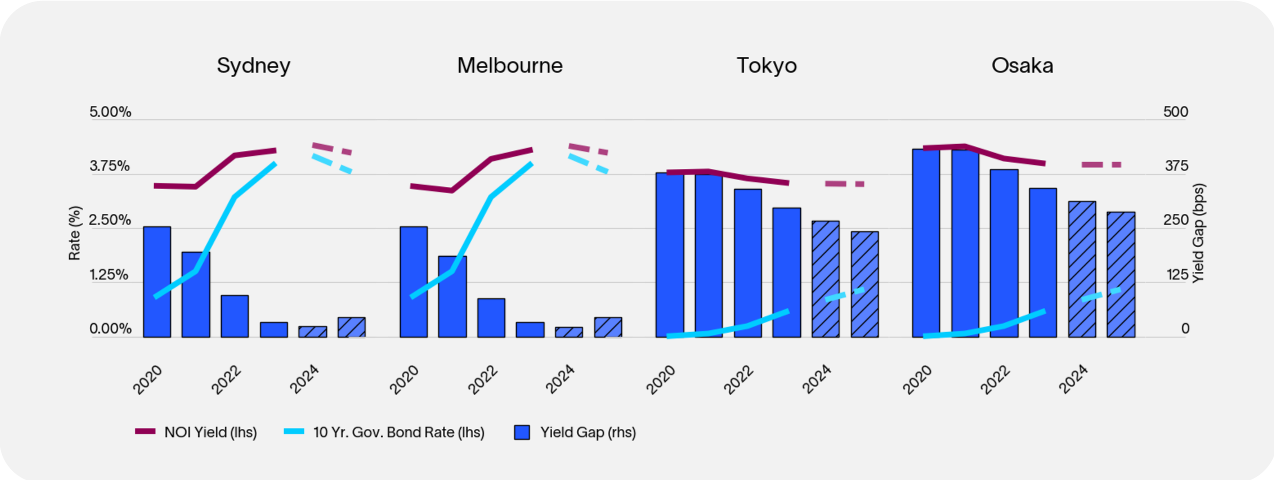
Moreover, Asia-Pacific living investment opportunities are sometimes difficult to access via private markets. This makes it interesting to keep track of opportunities in listed markets. In addition to accessibility, listed real estate has many other positive characteristics that support the utilization of both listed and non-listed investment options, such as liquidity, high transparency levels, fiscal benefits, early indicator function and diversification.

In Q4 2023, listed companies in the Asia-Pacific region recorded positive total returns. Even though some of those gains have diminished in recent months, academic research supports the view that listed real estate markets have predictive power for the private property markets and are leading the private markets by between nine and 18 months. If listed property markets can maintain their positive momentum, private markets may be close to bottoming out and could recover in the second half of 2024 and beyond.

Property yield spreads for Australia and Japan

In the graph below we have plotted risk-free benchmark rates (10-year government bond rates) for Japan and Australia (light blue line, LHS), as well as net initial yields for residential real estate (purple line, LHS). The spread differential is visualised in the blue bar (RHS). As can be seen, residential spread levels are low for Sydney and Melbourne. With net initial yields around 4.0% to 4.5%, hardly any spread is left if you compare property yields with the (theoretical) risk-free rate an investor can obtain by investing in Australian government bonds. Usually, investors require a property risk return premium of around 200 to 250 basis points, especially since the Australian living sector is only just starting to institutionalise and still needs to prove itself. Assuming that this type of spread level is sustainable, the expectation is that future rental growth will be significant and / or that investors expect risk-free rates to fall soon. As 10-year government bond rates for Japan are close to zero, spread levels are significant. As we have stated above, future benchmark interest rates may go up, lowering expected spread levels to what we believe are still sustainable and attractive levels.

Figure 9: Yield spread between Net Initial Yields and risk-free rates



Source: DWS (2023), Oxford Economics (2024), Adapted by Bouwinvest Research

'Assuming that Australian spread levels are sustainable, the expectation is that future rental growth will be significant and / or that investors expect risk-free rates to fall soon.'

Reach out for more detailed insights

Please contact us for more information

General contact details

Postbus 56045
1040 AA Amsterdam

+31 (0)20 677 16 00
info@bouwinvest.nl

Jeroen Beimer
Head of Research
+31651364928
j.beimer@bouwinvest.nl

Gijs Plantinga
Director of Strategic Business Development
+31610906682
g.plantinga@bouwinvest.nl