

Multi-family property investing in Japan – The population paradox

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Beyond the headlines

Shrinking and rapidly-aging population. Low economic growth. Muted inflation. These are some of the misconceptions around real estate investment in Japan. Given such branding, investing in Japan multi-family residential assets may seem paradoxical. However, when we look beyond the headlines we see the valuable investment opportunities in the sector.

Population decline is not uniform across Japan. Major cities such as Tokyo, Fukuoka, Nagoya and Osaka (core markets)¹ are actually experiencing population growth (**Exhibit 1**). Demographic changes, such as the increasing number of small households and shifting lifestyles, are driving demand for multi-family rental apartments.

Over the last 20 years investor interest in the Japan property market has also grown. Notwithstanding historically low economic growth, Japan has the largest institutional real estate market in Asia Pacific, and attracts a sizable share of the region’s investments. Notably, the market for Japan multi-family properties has developed into an institutional asset class, and is now the largest in Asia Pacific in terms of transaction volumes. Our own outlook on the Japan multi-family sector remains positive, and we believe the resilient income and attractive risk-adjusted returns from these assets prove beneficial to a real estate portfolio.

AUTHORS

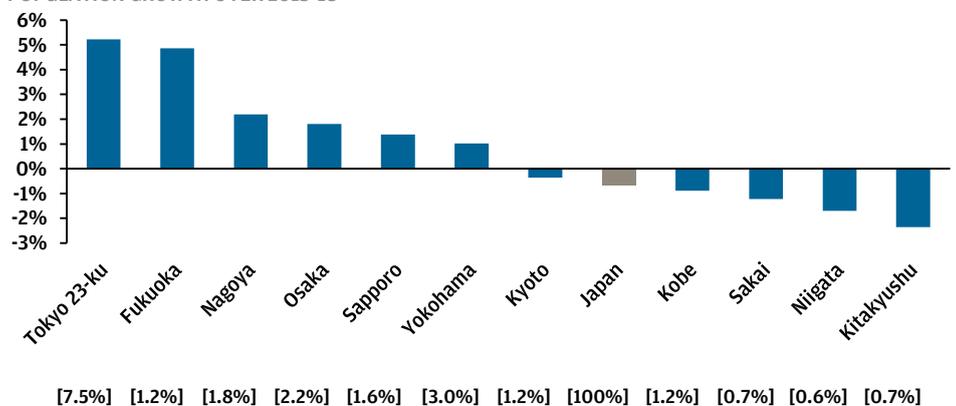


Kenneth Tsang
Head of Research & Strategy,
Real Estate Asia-Pacific



Nicole Phua
Research & Strategy,
Real Estate Asia-Pacific

EXHIBIT 1: POPULATION GROWTH VARIES ACROSS CITIES IN JAPAN
POPULATION GROWTH OVER 2013-18



*Figures in [] refer to city population as a percent of total Japan population as of December 2018.
Source: City government statistics, as of August 2019.

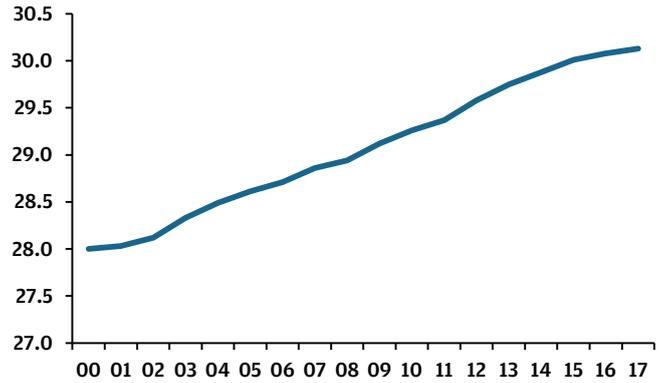
¹ Refers to Tokyo 23-ku, and the cities of Osaka, Nagoya and Fukuoka.

Demographic shifts - the rise of small households

In Japan’s core markets, the number of households has been increasing at an annual rate of 1.5% over the last five years, faster than the population growth rate.² Such household growth is largely driven by positive net migration, as people relocate from other regions for better job prospects. In Tokyo, there are 2.1 job vacancies for every applicant, which is higher than the national average of 1.6 jobs per applicant - both historical peaks.³ Aside from employment opportunities, people are also moving to live closer to where they work. Japan’s population has been gravitating from prefectures toward city centers, contributing to rising population densities in the core markets.

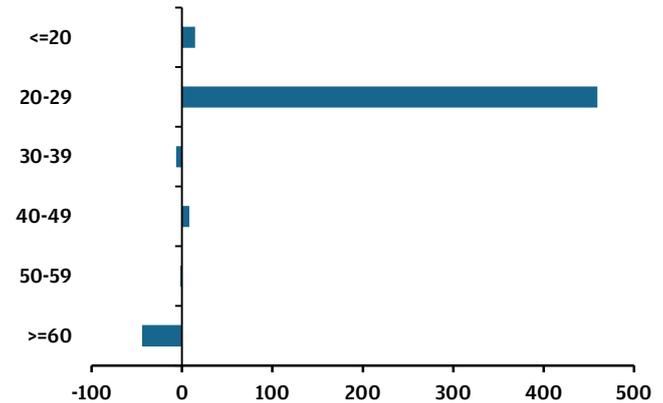
Household size is also shrinking as a result of secular lifestyle shifts. In the core markets, 73% of households are comprised of one to two persons,⁴ as young people are increasingly delaying marriage and the age at which they have children. The average mean age at first marriage for males and females rose to 32.3 in 2017, up from 31.0 a decade ago (Exhibit 2). The average age of first child birth for women also increased, from 28.9 in 2007 to 30.1 in 2017 (Exhibit 3). With more people remaining single or having children later, Japan’s core markets are experiencing a growing number of one to two-person households and a decline in the average household size. This structural trend is expected to be more entrenched as an increasing number of young people migrate to cities (Exhibit 4). Indeed, the number of single and coupled households in the core markets is forecast to increase by 3.0% and 1.8%, respectively, from 2020 to 2025.⁵

EXHIBIT 3: ...AND STARTING FAMILIES LATER
MEAN AGE AT FIRST CHILD BIRTH (YEARS)



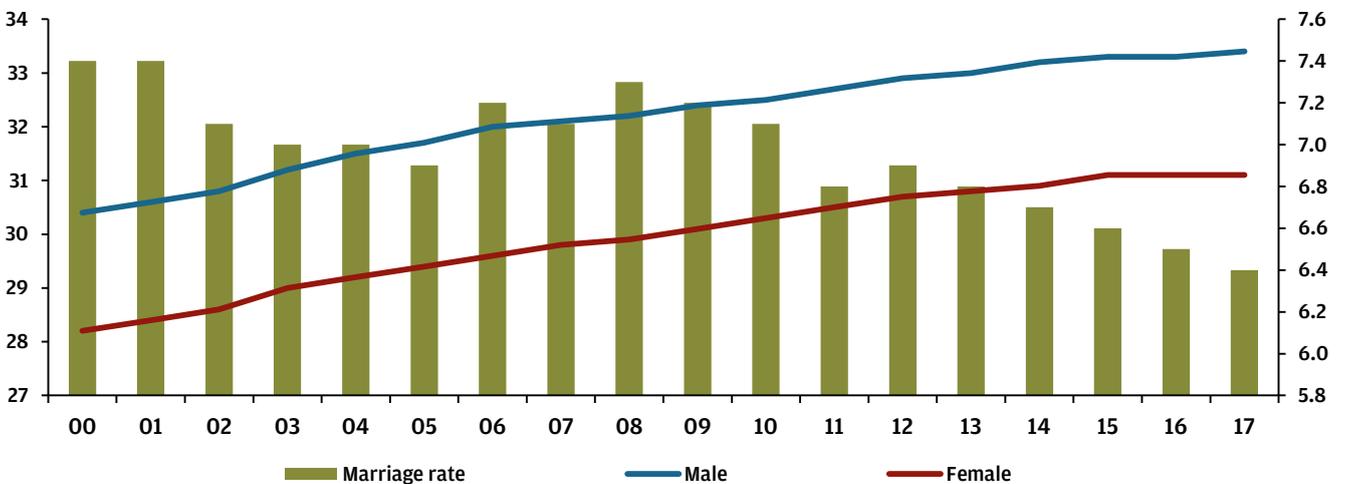
Source: National Institute of Population and Social Security Research, as of August 2019.

EXHIBIT 4: NET MIGRATION DRIVEN BY MIGRANTS BELOW 30 YEARS OF AGE
NET MIGRATION TO GROWING CITIES BY AGE ('000 PERSONS, 2014-18)



Source: Tokyo, Osaka, Nagoya and Fukuoka city government statistics, as of August 2019.

EXHIBIT 2: JAPANESE ARE DELAYING MARRIAGE...
MEAN AGE AT FIRST MARRIAGE (YEARS)



Source: National Institute of Population and Social Security Research, Tokyo city government statistics, as of August 2019.

² Tokyo, Osaka, Nagoya and Fukuoka city government statistics, as of August 2019.

³ Bloomberg, as of August 2019.

⁴ Japan statistics - 2015 Population Census, as of August 2019.

⁵ National Institute of Population and Social Security Research, as of August 2019.

Multi-family in demand

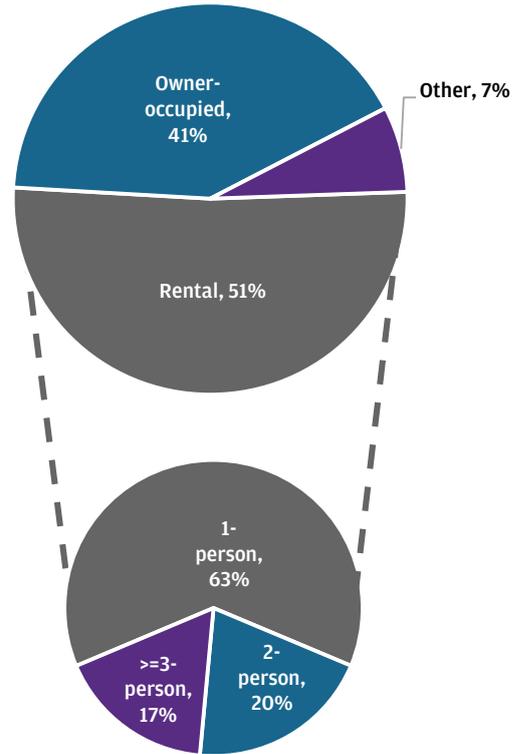
These demographic and lifestyle shifts have been driving demand for rental housing - a popular residential option for small households. In the core markets, about half of all dwellings are rentals, 80% of which are occupied by one and two-person households (Exhibit 5). These households prefer to live in studio or one-bedroom multi-family apartments, and typically spend about 25-30% of their income on rents. Apartments within short walking distance of train stations are the most sought after.

Given strong occupier demand, multi-family properties owned by J-REITs and unlisted funds tend to be well-leased. In the core markets, occupancy registered at 97% in 2018 (Exhibit 6). Rents have also been increasing; according to the Sumitomo Mitsui Trust Research Institute, open market rents of studio apartments in core markets have risen by about 1.8% per annum over the last five years (Exhibit 7).⁶

With the growing number of small households, we expect demand for multi-family units to be sustained. In addition, as condominium prices get more expensive, we anticipate more households would prefer to rent than purchase a property, which further reinforces the demand for multi-family. While the supply of multi-family has been increasing with demand, future supply is likely to be constrained by escalating construction costs. We anticipate multi-family occupancy to remain high and rents to incrementally increase on the back of steady income growth. Moreover, with rising female participation in the paid labor force, dual-income households are anticipated to increase, further supporting rental growth (Exhibit 8).

EXHIBIT 5: RENTAL DWELLINGS ARE LARGELY OCCUPIED BY SMALL HOUSEHOLDS

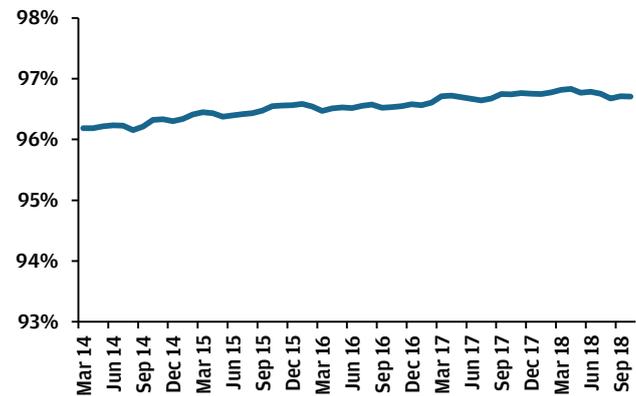
COMPOSITION OF DWELLINGS IN CORE MARKETS



COMPOSITION OF HOUSEHOLDS LIVING IN RENTAL DWELLINGS

Source: Ministry of Land, Infrastructure, Transport and Tourism, 2015 Housing and Land Survey, as of August 2019. "Other" refers to non-conventional dwellings such as inns, dormitories and shop-houses.

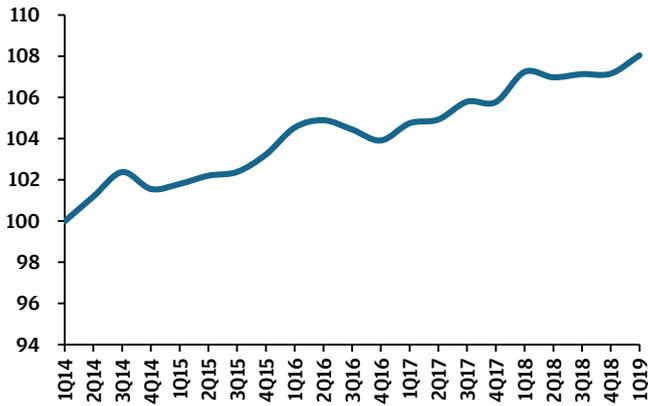
EXHIBIT 6: OCCUPANCY IS HIGH AND INCREASING
OCCUPANCY (CORE MARKETS)



Source: Association of Real Estate Securitization, as of August 2019.

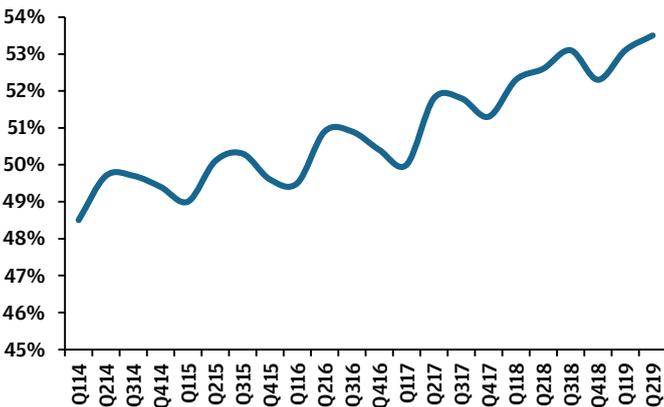
⁶ Estimate based on weighting by prefecture GDP as of 2015, as of August 2019. Historical time series are based on the same weights applied across time.

EXHIBIT 7: RENTS ARE RISING IN CORE MARKETS
STUDIO RENT INDEX (CORE MARKETS, 1Q14 = 100)



Source: Sumitomo Mitsui Trust Research Institute, as of August 2019.

EXHIBIT 8: MORE WOMEN PARTICIPATING IN PAID LABOR
FEMALE LABOR PARTICIPATION RATE



Source: CEIC, as of August 2019.

Enhancing income resiliency and risk-adjusted returns

In addition to a positive market outlook, Japan multi-family assets could also provide a number of benefits to a real estate portfolio based on its attractive risk-adjusted returns and resiliency of income.

Historically, the sector has provided low return volatility and high return per unit of risk when compared to office assets (Exhibit 9). The shorter lease term of multi-family allows for nimble adjustments to market conditions. During the Global Financial Crisis (GFC), occupancy of multi-family assets saw a smaller decline when compared to office assets, and recovery was faster; the drawdown in returns was also more moderate for multi-family relative to office.

Furthermore, Japan multi-family offers stable and resilient rental income. This resiliency is partly due to demographic demand drivers, which are more secular in nature and less susceptible to market volatility. Moreover, multi-family is distinct from other sectors in terms of tenant concentration, where each tenant contributes to a small portion of the overall multi-family income. Leasing risks are therefore more diversified in a portfolio of multi-family properties, further fortifying the stability of multi-family income.

Investors in multi-family assets could also take advantage of the low borrowing costs in Japan, which are expected to remain stable in the medium-term. Prudent use of leverage on multi-family properties could generate solid levered returns for a real estate investment strategy. For multi-family assets with steady cash flows, income returns could be in the range of 6% with moderate borrowings. Furthermore, given the low interest rates, investors may also benefit from positive carry for hedging currency risk.

Despite the contradictory headlines, we believe an investment in Japan multi-family represents a valuable opportunity, and an allocation to this sector could benefit the investment portfolio.

EXHIBIT 9: JAPAN MULTI-FAMILY OFFERS ATTRACTIVE RISK-ADJUSTED RETURNS

	15-year annualized return	15-year annualized volatility	Return per unit risk	GFC drawdown
Multifamily	4.6%	4.6%	0.99	-2.2%
Office	4.8%	6.4%	0.74	-8.2%

Source: MSCI-IPD, as of December 2018. Returns are unlevered and pre-tax.

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