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New residential models turn profit enablers for developers

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Traditional homeownership models are changing. Some of the biggest trends affecting residential real estate going forward will be the aspirations and buying power of millennials and the needs of ageing senior populations. Property developers are responding with alternative housing ideas to cater to these shifting needs, preferences and rising urbanisation pressures.

The emergence of the build-to-rent ("BTR") housing model as an alternative to the standard build-to-sell ("BTS") development has not yet emerged in Asia ex Japan. BTR developments refer to apartments built specifically to be rented out for stable long-term income. BTR is distinct from traditional private rental accommodation in that BTR usually involves a single landlord for the entire development retaining long-term ownership and renting out the units. More prevalent in the US, where the industry is estimated at USD 3.3 trillion and accounting for more than 25% of local real estate investment[1], it is also a familiar concept in Germany and the Netherlands where a large proportion of BTR housing developments are institutionally-held.

In Asia, home ownership is culturally considered a priority and has produced solid returns, even outpacing GDP growth. Property developers have, therefore, typically focused on BTS schemes – and in an openly competitive market like Singapore, developers have been able to successfully move residential inventory through the BTS channel at a reasonable clip. But regulatory risk is high in the residential housing space, with frequent macro prudential measures introduced to improve affordability and reduce speculation. High front end stamp duties also reduce the capital gains potential of this asset class.

Looking into the future, we anticipate that developers may consider the BTR model structured as a Real Estate Investment Trust (REIT). In this part of the world, institutionally-owned residential real estate structured as REITs only exists in Japan. In fact, accommodation-related REITs are among the most attractive to global investors, as seen by their lower yields and yield spreads, which indicates that the asset class is in high demand. Accommodation

REITs are still nascent in Asia Pacific ex Japan but are poised to become a dynamic growth area to rival accommodation REITs in the rest of the world.

We are also cognisant of the millennial generation's changing consumption habits. This group forms a large demographic (see Fig 1) that will dictate ownership and rental patterns in the future. Research suggests the millennial renters will include young professionals, couples without children and many others who may move frequently for their jobs. Despite lease tenures of typically less than 12 months, in practice renters tend to stay in their apartments for an average of more than four years, making this channel a steady and recurrent income stream (see Fig 2).

Governments are now studying the BTR models and may issue land for this specific purpose to developers. China and Australia serve as examples of BTR models that were recently introduced. Since 2018, the Chinese central government has encouraged developers to launch rental-only projects as one long-term solution to an overheated real estate market. Similarly, Australia's federal government policy concession that allows institutional investors to acquire residential rental-only property through a managed investment trust structure has paved the way for the BTR model to gain traction.

Fig. 1. Asia Pacific's millennials will be the biggest consumers by 2030[2]

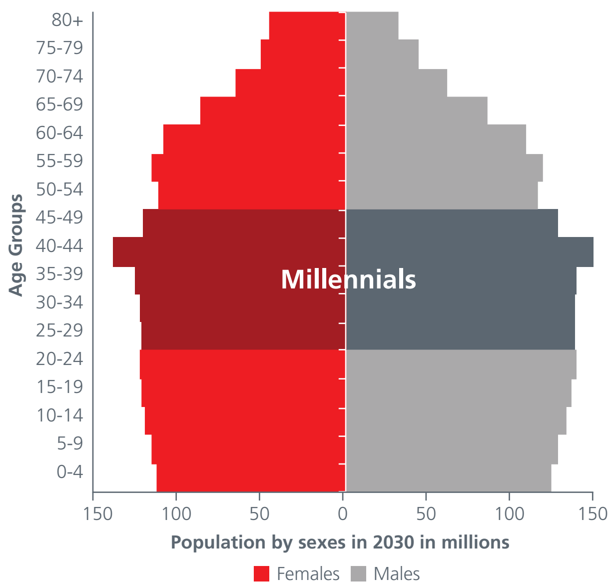
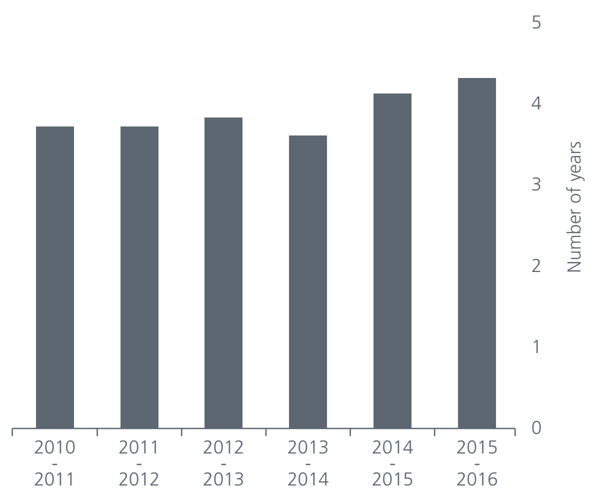


Fig. 2. Length of time in rented homes is up in the UK[3]



SERVING CUSTOMISED NEEDS

Besides long-term residential stays, there are other BTR models that cater to different needs and segments. These include co-living, student accommodation and retirement villages. These properties suit a particular demographic over different stages of their lives, based on changing needs.

The co-living concept, for example, sells on convenience, cost, community and collaboration. In addition to offering temporary short-term accommodation, co-living facilities can foster a sense of community and safety whilst tackling issues of loneliness for globally mobile workers or those looking to fulfil shorter-term housing needs. The rent also conveniently covers a range of facilities and utilities such as housekeeping, wi-fi, furnishing, maintenance, etc. That most of the co-living facility management today tends to be app-based is an added attraction for the current tech-savvy generation. The co-living operator can thus use technology to capture and offer the whole spectrum of related services to tenants. With only 3-5% market penetration across the Asian region, we think co-living has a strong runway for growth.

The co-living market segment is uniquely positioned to capture demand for more flexible living options while allowing property developers to earn a premium rental yield, as the price point tends to slip in between that of the more traditional long-term renter and that of a fully serviced apartment. The BTR model also helps to absorb and cushion vacancies through the cycle.

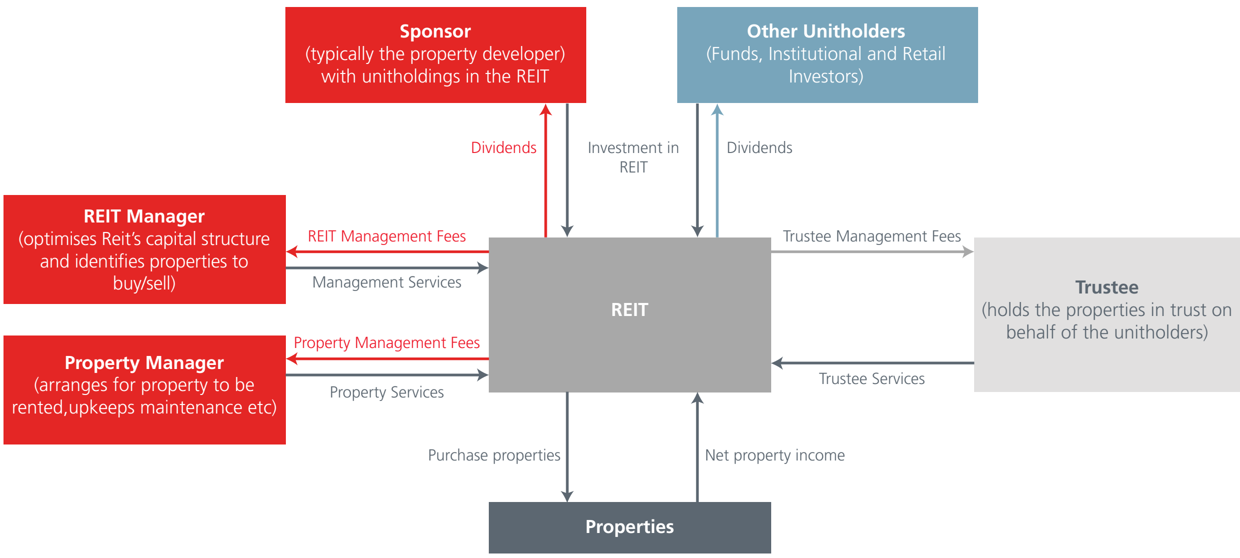
Student accommodation is another example of a BTR model in play. This segment has evolved from being an alternative asset class into a mainstream investment, as it is seen as a more defensive sector and less susceptible to economic cycles. These properties are sometimes co-owned by universities, with facilities and community development (e.g. pastoral care) suited specifically for the student population. Growth in this segment comes from inflation, rising penetration in institutionally-run properties and sheer growth in the student population. The Australian government, for example, is aiming for 40% of its 25 to 34-year olds to hold a degree by 2025, up from 27% currently. Student numbers have surged by over 50% over the last decade. Globally, the trend is similar with the mobile student population expected to increase to 8 million by 2025 from 5 million in 2019[4]. The supply shortage is evident; in India, a mere 20% of the current student demand is met by university operated purpose-built student accommodation.

Yet another sector that is generating interest is that of retirement villages. Many mobile urbanites opt to exit their existing residence to enjoy community living among like-minded seniors – where social and some support services are provided. This is the period before a higher level of assisted living is required, when the individual may need nursing care. Such living spaces are very common in the US, Europe and Australia but have not yet made much inroads in Asia. We believe this gap between a large potential pool of demand and current supply of purpose-built retirement accommodation represents huge untapped potential given that Asia Pacific is experiencing rapid demographic ageing.

SCOPE TO MONETISE BTR ASSETS VIA REITS

There are clear financial benefits for developers to divest BTR assets into REITs. This option allows the developer to monetise the assets to fund other development projects and still capture the entire fee stream paid by the REIT (see Fig 3).

Fig. 3. REITs enable developers to earn recurrent income[5]



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It is usually common for the sponsor of the REIT to fully own the REIT manager and the property manager. The sponsor then enjoys the recurring management fees earned by these subsidiaries. In addition, after the REIT is listed, the sponsor could still retain some investment in the REIT for dividend income and capital gains. REITs have efficient tax structures, as many do not pay corporate taxes nor dividend taxes, depending on the jurisdiction. They also have inflation hedged rentals in the form of CPI-pegged rents.

In contrast, in a BTS scheme, developers typically earn one-off sale transactions. Besides, the success of this scheme hinges on the ability of the potential buyers to place a down payment and obtain a mortgage loan from the bank. The gig economy may pose obstacles to the traditional mortgage model where one needs a proven, long-term income stream to qualify for bank financing.

Moreover, in the current low-for-longer interest rate environment, investors (e.g. insurers, sovereign wealth funds and pensions) are constantly hunting for higher yielding, long duration assets. BTR investments are less sensitive to economic cycles and offer scope for the recurrent returns stated above.

The attractiveness of residential REITs is evident in Fig 4; the lower dividend yields of the residential REITs in the US and Japan versus the overall REITs index indicate they are more expensive and therefore in demand. They also offer a positive spread over 10-year government bond yields.

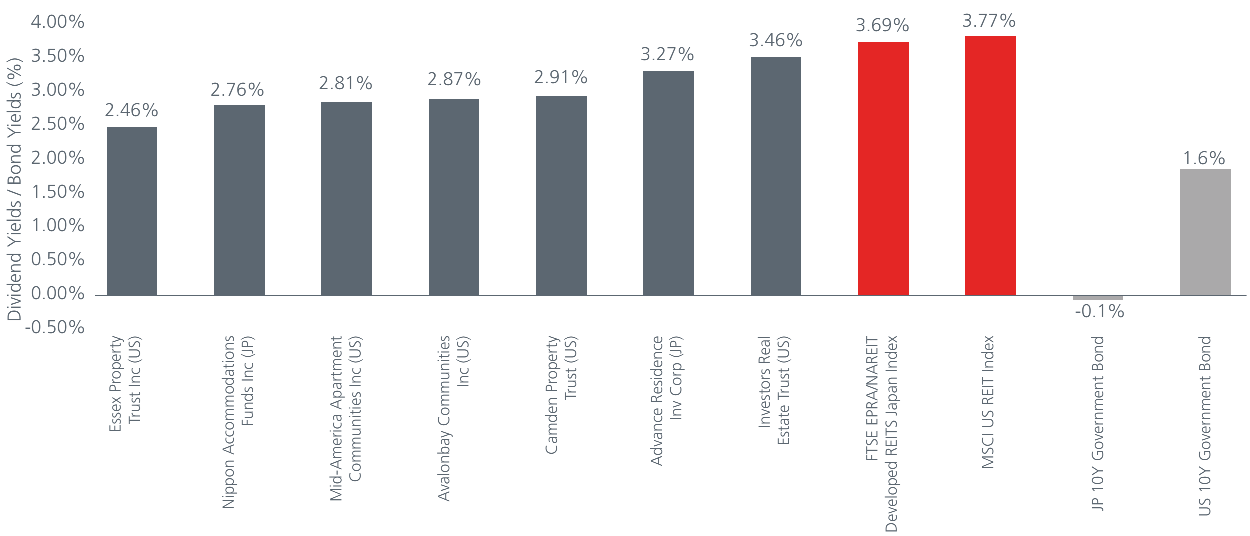
For policy makers, BTR models widen housing options, improve affordability for first-time home owners and also offer faster housing solutions to meet urbanisation pressures. Singapore's public housing under the Housing Development Board's temporary long-term 99-year leases serve as an example.

OPPORTUNITIES AMIDST THE CHALLENGES

A supportive financial backdrop is required for developers to be able to build and offer quality facilities at affordable rents. Equally the availability of land sites can pose an issue. In Singapore, for example, the government has to set aside land to meet both urban planning and population needs. Often times, the decision will favour the optimal use of the land.

BTR models could provide a new investment avenue for real estate in expensive, global cities and developers that embrace these new living models stand to benefit. Similarly, investing in funds that invest in and/or companies that own these models allow investors to enjoy a steady stream of rental income and the growth of assets in the REIT fund.

Fig. 4. Higher demand for residential REITs reflected in its lower dividend yields[6]



Sources: [1] https://www.ashurst.com/en/news-and-insights/insights/build-to-rent/ [2] Eastspring Investments based on World Population Prospects in 2030 by United Nations (2019) [3] https://www.ft.com/content/fec5b908-59a9-11e8-bdb7-f6677d2e1ce8 [4] OECD forecast referenced in Global Student Property Report 2019 by Knight Frank [5] Eastspring Investments, Singapore [6] Bloomberg as at 11 Feb 2020