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## Residential

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China focus: Why conversion is sometimes the best strategy

Residential's recession-resistant appeal







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REAL ESTATE INVESTMENT MANAGEMENT

230 PARK AVENUE  
NEW YORK, NY 10169  
[WWW.CLARIONPARTNERS.COM](http://WWW.CLARIONPARTNERS.COM)

## How to contact us

### Senior Editor, Real Estate

#### Jonathan Brasse

jonathan.b@peimedia.com,  
+44 20 7566 4278

### Editor

#### Evelyn Lee

evelyn.l@peimedia.com, +44 20 3640 7511

### Special Projects Editor

#### Helen Lewer

helen.l@peimedia.com, +44 20 7566 5478

### Senior Reporters

#### Arshiya Khullar

akhullar@peimedia.com, +852 2153 3149

#### Kyle Campbell

kyle.c@peimedia.com, +1 646 545 4428

### Reporters

#### Lisa Fu

lisa.f@peimedia.com, +1 212 937 0384

#### Christie Ou

christie.o@peimedia.com, +852 2153 3247

### Contributors

**Marine Cole, Mark Cooper, Jesse Koppi**

**Stuart Watson**

### Head of Investor Research

**Nicole Douglas**

**Managing Editor, Production: Mike Simlett**

**Head of Production: Greg Russell**

**Production Editors: Daniel Blackburn,**

**Adam Koppeser**

**Copy Editor: Eric Fish**

**Head of Design: Miriam Vysna**

**Senior Designer: Lee Southey**

**Designers: Denise Berjak, Carmen Graham,**

**Glen Reynolds**

**Head of Marketing Solutions, Real Assets Group**

**Nick Hayes**

nick.h@peimedia.com, +44 20 7566 5448

**Marketing Solutions Manager**

**Annie Liu**

annie.l@peimedia.com, + 852 2153 3843

**Subscriptions and reprints**

subscriptions@peimedia.com

**Customer Service**

customerservices@peimedia.com

**Editorial Director: Philip Borel**

**Director, Digital Product Development:**

**Amanda Janis**

**Director of Research & Analytics: Dan Gunner**

**Managing Director, Americas: Colm Gilmore**

**Managing Director, Asia: Chris Petersen**

**Group Managing Director, Brands and Markets:**

**Paul McLean**

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# PERE

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# Insight

## Residential overview In the late stages of the economic cycle, investors increasingly appreciate the recession-resistant qualities of residential real estate

**A**s this protracted business cycle stretches on, real estate asset classes underpinned by structural factors that protect their value in the event of a downturn are looking more and more appealing to many investors. That is a trend that has supercharged interest in logistics and residential property, *writes Stuart Watson*.

Logistics has just experienced one of its best-ever years, but investing at scale in the smallest of the four main asset classes is a perennial difficulty. By contrast, residential property constitutes around three-quarters of the world's real estate stock, so scarcity is less of a concern, even though the institutionally investable element of the asset class, chiefly rented multifamily apartment blocks, makes up only a small proportion of the total. Meanwhile, the mega-trends driving demand for the asset class are at least as favorable as they are for warehousing.

"Rental residential is primarily driven by demographic demand as opposed to the business cycle or business expansion.

That makes it a stable investment perfect for institutions at a time when investors are starting to think more conservatively about their portfolios, and which lends itself to more recession-resistant asset classes," argues Bob Faith, founder and chief executive at residential real estate company Greystar.

"Urbanization means jobs are being created in the cities and population growth is occurring there. Combine that with dramatically increased mobility of the population and it leads to a desire for less permanence in housing choices, which leads to renting rather than owning."

Furthermore, even those who would like to buy are increasingly unable to do so: "We see multifamily housing as a forced rental story," says Jeremy Plummer, global chief investment officer at CBRE

Global Investors. "Affordability challenges for home buyers are not going away, so there is growing rental demand in urban areas all over the world."

Some investors also see residential as a way to tap into the economic upside of fast-growing cities. "The demand for multifamily in those markets is very much driven by job creation, so it is a way of responding to markets where we think local economies will outperform compared with their domestic markets in general," says Hilary Span, head of real estate investments for the Americas at the Canada Pension Plan Investment Board. "For example, in the US we have large investments in multifamily in the Bay Area around San Francisco."

There is "enormous demand" from investors for the asset class globally, claims Faith: "When you look at the history of returns in rental housing versus other asset classes, the returns are as high or higher but there is a lot less volatility." According to Real Capital Analytics, \$11.21 billion was raised for pure residential strategies globally in 2018, a substantial increase on the previous year's figure of \$8.92 billion.

### Picking strategies

When it comes to selecting strategies to access the sector, many investors still start with the US, which remains by far the largest and most mature rental housing market. Jeanette Rice, head of multifamily research for the Americas at CBRE, calculates that in 2018 multifamily investment volumes totaled \$172.6 billion, a 19-year high. "Multifamily was the top sector for property investment for the third

**\$173bn**

**Volume of transactions in the US multifamily investment market in 2018**





Stable foundations: demographic demands make rental residential an attractive investment, even in down cycles

year in a row. The appetite from domestic institutions and foreign capital is very strong.”

Equity seeking a home in the US multifamily market has increased the volume of development, says Tim Wang, head of investment research at New York-headquartered manager Clarion Partners, but the growth of demand has kept pace. “At the end of 2018, the nationwide average vacancy was only 4 percent, a cycle low. New supply is high, but most investors overlook the demand side of the story, which is at a record high. That theme will continue in 2019. The reason is that the 79 million in the millennial generation is the largest in US history, bigger than the baby boomer generation of 75 million, and they will stay in the rental cohort for a longer period of time, for both social and economic reasons.”

Europe’s multifamily investment market is smaller, and has historically been focused on Germany’s large rented housing sector – transactions totaled \$57.9 billion in 2018, according to RCA – but it is growing, says Marcus Cieleback, group head of research at German investment house Patrizia. “Since the financial crisis, ownership rates across Europe are

declining. There is now a large number of households that have purchasing power and will make attractive tenants. They are a target group for institutional residential investors in markets like the UK, Ireland and Spain, which have not traditionally been multifamily markets.”

Cieleback observes that some pan-European investors have been talking about investing in residential for years, but have only started to do so in a meaningful way in the past six to 12 months. They will benefit from “quite attractive” returns in the coming year, he predicts. “Income returns will be between 3 to 4 percent unlevered plus capital growth of 1.5 to 3 percent unlevered. Levered you can get 7 to 8 percent total return.”

In Asia, China offers the potential for first-mover returns as the government moves to facilitate the creation of rented residential, but the most mature institutional market remains Japan. “One of the attractions is that debt costs are extremely low so you can earn attractive cash-on-cash yields from a very stable asset class,” says Plummer. “Rents are growing slowly but steadily in Tokyo, which has a growing population despite the demographic headwinds for Japan

overall. If you are looking for 6 to 7 percent total return, most of which comes from income, it is pretty attractive.”

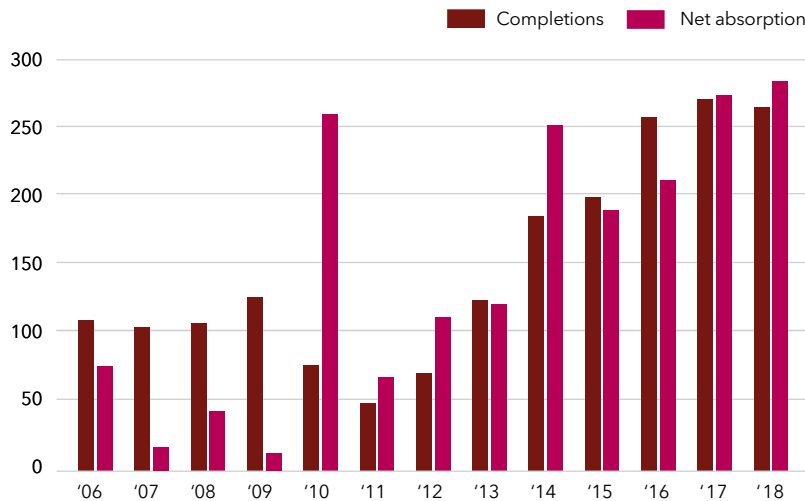
### **New concepts**

While traditional multifamily is still the bread-and-butter of the residential investment sector, recent years have seen the emergence of a variety of sub-sectors like student accommodation, various forms of senior living, co-living, micro-living and serviced apartments.

For some managers, specialization is a key element of their approach to the sector. Thomas Landschreiber, founder and chief investment officer of Luxembourg-based manager Corestate Capital, says his firm’s range of strategies seeks to satisfy customers’ needs for rental accommodation at various stages of their lives: “We try to follow the demographics and our tenants – from student homes, to apartments for young professionals, normal residential, serviced apartments for when they travel for business, and lastly, we will develop a silver-age product for when people want to leave their big family house and move back into the city.”

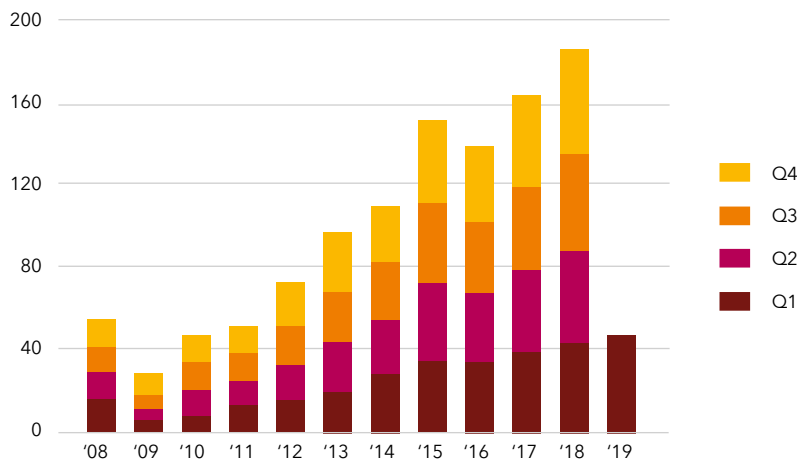
Co-working is the office market’s hottest trend, but while co-living –

The risk of oversupply in US multifamily remains low despite a high level of development (units 000s)



Source: CBRE Research

European residential investment shows an upward trend since the financial crisis (€bn)



Source: Real Capital Analytics and Patrizia. Note: data based on rolling annual levels

smaller apartments with more extensive communal spaces for socializing - has received plenty of publicity, so far there have been relatively few such developments. Nevertheless, Landschreiber "strongly believes" in the concept. "In two to three years I am pretty sure it will become an asset class on its own," he predicts. "As that happens, we will see cap rate compression in that sector just as we did in student housing when it became established."

Other observers are less convinced of the scope such sub-sectors provide for

long-term growth. "Student housing will remain an important part of the residential universe, but a less important one than many people expect because in European countries outside the UK, a lot of students will go into the general rental market when there is accommodation available," argues Cieleback. "New concepts like co-living might be interesting for students and young professionals in some cities, but it is an add-on to an existing market and not something I expect to be hugely important going forward." However, he adds that he too thinks that early movers

may be able to capture some capital growth in emerging niche markets.

### Bubbles of supply

Residential real estate has become established on many investors' wish lists, but could anything derail that enthusiasm for the space? Investors must always keep a watchful eye on political developments that might drive regulatory change, suggests Bill Hughes, global head of real estate research and strategy at the real estate and private markets division of Swiss investment bank UBS. "In the late 90s, the policy to make capital more available for homeowners in the US diminished the multifamily sector for a decade," he recalls.

Robust tenant demand for rented accommodation does not guarantee a profitable investment, cautions Andrew Allen, head of global property research at asset manager Aberdeen Standard Investments. "Investors need to be clear they have the entry price right because the yields are relatively tight. Quality of design, services and layouts are incredibly important in terms of long-term investment performance. If you get that right, it can really improve the gross-to-net efficiency of your assets. Get it wrong, overpay, and it could run away from you."

Meanwhile, old buildings may be at risk of obsolescence due to evolving tenant demand, says Tom Shapiro, founder of US investment manager GTIS Partners. "People are willing to sacrifice unit size for more common spaces, and it is very hard to adapt some of the older multifamily buildings to what is wanted today."

Faith warns that "bubbles of supply" have developed and are outstripping demand in some sub-markets where development has been rife. "There are also markets like the San Francisco Bay Area where affordability is starting to become an issue. Even if there is not much supply, rents cannot continue to grow without incomes also growing," he adds.

Most market observers will agree those are relatively modest caveats, however. Everyone needs a roof over their head, and fewer people can afford to buy, so residential real estate in growing urban areas around the world looks certain to exercise a powerful fascination on real estate investors for years to come. ■

## Watch list **Four** trends that could define the global residential market in 2019



### European markets mature

Multifamily markets in countries like the UK and Ireland are close to reaching the stage at which the first generation of fully stabilized assets is sold into the institutional investment market. "We may have the evolution of a whole new sector in the UK," says Bill Hughes, global head of real estate research and strategy at the real estate and private markets division of UBS.

"It is one thing to build a new idea and establish it, but another thing to stabilize it and transact. We could see real tests of that market over the next 12-24 months that define where pricing will be."

Jeremy Plummer, global chief investment officer at CBRE Global Investors, adds: "Appetite from institutional investors will increase as it becomes more proven and clearer where the long-term demand will be and for what kind of private rented sector product."

### Opportunity zones drive activity in the US

Established under the Tax Cuts and Jobs Act 2017, the opportunity zones program offers tax breaks for investors willing to invest capital gains in the country's distressed areas. Tim Wang, head of investment research at Clarion Partners, says 8,700 zones have been certified by the US Treasury Department, with investors awaiting the final guidelines. "Of those zones, one third look very appealing from a real estate developer's standpoint. We believe that will incentivize the development of multifamily in underserved communities."

GTIS Partners is also focused on opportunity zone-related developments, says its founder Tom Shapiro. "We are doing several projects now. Plenty of areas like the boroughs of New York City make a lot of sense, and we have a large project in Mesa, Arizona, that is in an opportunity zone and will work very well for build-to-rent."

### China opens up

China lacks a purpose-built PRS sector, but that could soon change: "The Chinese government realized a couple of years ago it was missing a large component of the market and began to aggressively create a regulatory framework for rental housing," says Bob Faith, founder of Greystar Real Estate Partners, which achieved a \$450 million first close in February for a China-focused fund.

In July 2018, CPPIB also announced it would enter the multifamily market, providing \$817 million to back developer Longfor Group.

### Affordable housing investment

Some cities already have an oversupply of luxury apartments, but there is enormous unsatisfied demand for more modest accommodation. In March, UBS Asset Management recapitalized the Avanath Affordable Housing I fund, which invests in US affordable housing developed under tax incentive programs. "Initially they have a slightly better yield and in a well-balanced market they have good growth potential," says UBS's Bill Hughes.

CBRE Global Investors raised £250 million (\$323 million; €289 million) for a UK affordable housing fund last year: "There is potentially a good synergy between the affordable housing sector and UK pension funds that are interested in an income yield with some sort of inflation connection and that want to make a social impact investment while being willing to accept a low return," explains Jeremy Plummer.

# Year in residential Multifamily still attracts the lion's share of institutional capital, but single family and other strategies are gaining ground

## Pretium bucked single-family consolidation trend

The manager raised \$1 billion for the strategy for its Pretium Residential Real Estate Fund II and two separate accounts. The fund, which attracted \$700 million from institutional investors and high-net-worth individuals, targets homes in areas of high employment and population growth in Phoenix, Houston, Dallas, Las Vegas, Indianapolis and the US south-east. The firm has acquired 5,000 homes so far through the fund. Pretium is now the largest private owner of single-family rental homes in the US.

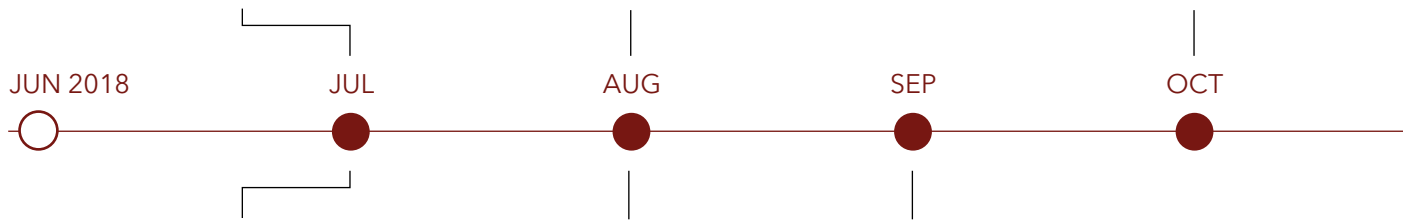


## Single-family rentals in fundraising 'second wind'

Cerberus Capital Management and Amherst Holdings were seeking to raise capital for single-family-rental-focused funds. The former was reportedly seeking \$500 million to expand its single-family rental portfolio, while Amherst held an initial close on its fund of \$600 million, according to an SEC filing.

## CapitaLand grew overseas with US multifamily debut

Pushing to diversify its investments outside Singapore and China, CapitaLand International entered the US multifamily sector by buying 16 assets for \$835 million. Gerald Yong, the firm's chief executive, said: "Besides diversification, we want growth and [to] tap into new businesses and income streams. US multifamily meets these criteria."



## Bouwinvest made its debut Asia-Pacific multifamily deal

The Netherlands' Bouwinvest was the cornerstone investor - with a \$90 million commitment - for Nuveen's ERES APAC III fund, which will invest in Tokyo multifamily assets. This marked the Dutch investor's Asia-Pacific debut, betting on the defensive attributes of the multifamily sector and the growing institutionalization of the asset class in Japan.

## Tricon Capital Group launched a \$750m JV

The firm formed a \$750 million joint venture to buy 10,000-12,000 single-family rental homes. Tricon and its partners, an Asian sovereign wealth fund and a large US pension, each committed \$250 million for a one-third stake. It will follow a core or core-plus investment strategy and target homes primarily in the southern US geared toward households earning an average of \$75,000 annually.

## First State Super in US multifamily entrance

Australian superannuation fund First State Super and developer Lendlease teamed up to acquire \$2 billion in US multifamily properties. Each committed \$500 million of equity for the multifamily venture - their first outside of Australia - and will match the equity with an equal amount of debt. The pension fund will use the US venture to learn more about development, said Damien Webb, the fund's head of fixed income and real assets. The partnership includes two seed assets that the developer is completing: Chicago's Southbank and Boston's Clippership Wharf, which are together valued at \$400 million.

## Trion launched second multifamily fund

The California-based firm is using a crowdfunding platform to help raise capital for the vehicle, Trion Multifamily Opportunity Fund II, which has a value-add strategy targeting apartments on the West Coast. The Los Angeles-based firm aims to raise \$50 million for the fund from an investor base of family offices and high-net-worth individuals. Fund II's investment strategy will be similar to that of its predecessor: buying underperforming multifamily properties that were built around the 1970s and are in need of physical renovations or management restructuring. However, Trion is also eyeing acquisitions in Seattle, Denver and Salt Lake City for the fund, in addition to markets like Los Angeles, San Diego and Portland.







**Ex-APG exec bet on Asian co-living with Warburg Pincus money**

Weave Co-Living, a Hong Kong-based co-living rental accommodation platform, received a major cash boost from Warburg Pincus. The \$181 million investment gives it a majority stake in the company, which was set up in 2017 by Sachin Doshi, formerly head of Asia-Pacific private real estate at APG Asset Management. The deal marked Warburg's first investment in a rental accommodation platform in Asia-Pacific outside of mainland China.

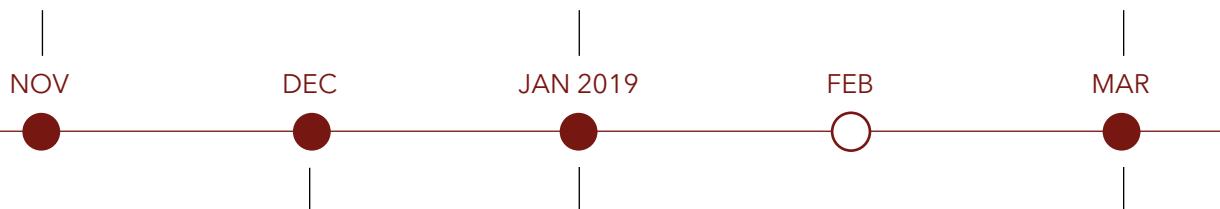
**Carmel Partners closed multifamily fund on \$1.28bn**

The San Francisco-based investment manager surpassed its \$1 billion target for Investment Fund VII and hit its hard-cap of \$1.25 billion. The multifamily specialist contributed \$30 million of its own capital to the vehicle, which will focus on ground-up development in major US markets. A strong contingent of re-ups led the charge for Carmel's latest capital raise, which reached its first close in August 2018. Ninety-five percent of the investors from Investment Fund VI returned for the seventh installation, accounting for \$950 million.



**UBS in affordable housing debut via fund recap**

The multi-manager business of the bank's real assets management arm, Real Estate & Private Markets Multi-Managers, acquired the bulk of the assets in Avanath Capital Management's debut real estate fund, Avanath Affordable Housing I. The investment was made on behalf of a consortium of investors from Europe, Asia-Pacific and North America. UBS bought out all of the fund's existing investors through a tender offer process while Irvine, California-based Avanath maintained its equity stake.



**UBS Asset Management turned to multifamily in Japan**

The firm raised \$175 million in equity from APG Asset Management in the first close of its debut Japan multifamily real estate investment strategy. Including the cornerstone investment that came from APG and UBS-AM's own equity commitment, the firm is targeting \$330 million in total equity for the club vehicle, after further commitments from one to two other investors. The capital is being corralled for a build-to-core investment strategy, with some allocation for positioning income-producing operating assets in Tokyo and Osaka. UBS is targeting a low double-digit leveraged return from this strategy. UBS-AM will be implementing the multifamily strategy locally through its fully-owned real estate management platform, called UBS Japan Advisors.

**Lone Star offloaded senior housing in European exit spree**

The Dallas-based fund manager sold a portfolio of 93 UK senior housing facilities for £450 million (\$567 million; €500 million), the latest in a string of exits. Lone Star was one of several US private equity groups that swept into Europe after the global financial crisis to scoop up distressed, non-core assets. That cohort is now ready to sell and find willing buyers from Asia and, more recently, Europe, where fund operators are savvier and less risk averse than a decade ago. Lone Star exited more than £2.6 billion of investments on the continent during a nearly two-year period. The firm has not abandoned Europe altogether, however. In December, it purchased a portfolio of foreclosed real estate and troubled bank notes from Spain's state-run Bankia for €3.1 billion.



**JEN Partners closed its largest residential land fund**

The firm hit its \$360 million hard-cap for JEN Partners VI, its third institutional fund. The vehicle will deploy capital to finance and develop new housing throughout the southern and western US, focusing on growing metropolitan areas in Maryland, Virginia, North Carolina, Georgia, Florida, Texas, Colorado, Arizona and California. JEN VI is JEN Partners' largest fund since launching the series in 2006. More than 80 percent of the commitments for JEN VI came from repeat investors, most of which were endowments and family offices.

## Editor's letter

# A safe house for uncertain times



**Helen Lewer**

[helen.l@peimedia.com](mailto:helen.l@peimedia.com)

Somewhere to call home. It is a basic human necessity. And for many investors, this is the attraction of the residential asset class. Simply, need creates demand, and that translates into stable returns over the long-term.

The experts opining on the state of the market in this year's report convey that message boldly. Residential, the multifamily rental segment in particular, is considered resilient, a safe house for capital, at this late-stage of the cycle and, at a time of growing concerns of an economic downturn, "recession-resistant."

Demographic trends – urbanization and population growth – underpin the demand. While these factors exist – let's face it, they are unlikely to disappear soon – the market will need to supply more homes. And investors will look to support the asset class with capital.

PERE's historical fundraising data depicts the story well. Multifamily/residential is consistently at, or near, the top of investors' hit lists. In 2018, it was beaten by a whisker to the top spot by that other asset of the moment, logistics – \$11.2 billion to \$11.5 billion, respectively – but was well ahead of retail, office and hospitality in attracting institutional capital.

Investors and managers cannot rest on their laurels, though. For another message emanating from within these pages is that property is no longer just an asset. It is a product, and the provision of that product a service. A building must stand out to attract occupiers through the door.

Nowhere is this more in evidence than residential. Tenants are discerning. They want more from a home, seeking add-ons like communal living areas and concierge-type services; and evidence that property is environmentally friendly. It is incumbent on owners to actively manage assets to ensure they remain relevant, fully leased and making money. That is where the real challenge lies.

Enjoy the report

Helen Lewer

**“ Property is no longer just an asset. It is a product, and the provision of that product a service ”**



**New York**  
130 West 42<sup>nd</sup> Street,  
Suite 450,  
New York,  
NY 10036  
T: +1 212 633 1919

**London**  
100 Wood Street,  
London,  
EC2V 7AN  
T: +44 20 7566 5444

**Hong Kong**  
19F On Hing Building,  
1 On Hing Terrace Central,  
Hong Kong  
T: +852 2153 3240

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# Short-term lets, long-term gains



Expert comment by **Guy Westlake**

*The growing demand for flexible living presents attractive opportunities for real estate investors, says Lavanda's founder*

Mounting competition between real estate investors has been putting pressure on yields, resulting in landlords sweating assets at tenants' expense. Tenants are therefore increasingly turning to illegitimate subletting to offset increased living costs. The professional short-term rental sector can eliminate this issue, allowing landlords and tenants to benefit, legitimately and transparently, from slack capacity.

Remote, flexible working is fast becoming the norm, and there is demand for the residential sector to adapt accordingly. Landlords are realizing it is impossible to ban Airbnb-style subletting completely and are embracing short- and medium-term rentals across portfolios to offer greater flexibility and value to tenants, eliminate structural voids and drive incremental revenue streams.

Consequently, rented communities are set to become a more fluid blend of short-, medium- and long-term residents. This is a fundamental market shift, enabled by technology that unlocks the short- and medium-term rental market to the benefit of residents and the local community alike while putting full transparency, control and flexibility into landlords' hands.

Developers have a new toolkit for bringing innovative rental options to market, which are more attuned to the needs of "generation rent." Pay-as-you-go living is becoming a reality, unlocking new value for all stakeholders in the value chain. Imagine a world where you rent an apartment, your home, in perpetuity; it is your home whenever you need it, but you have the flexibility of being able to sublet it securely and effortlessly whenever you wish to spend time elsewhere.

## The investment case

Funds adopting a more diversified tenant acquisition strategy will achieve higher IRRs. A 10 percent uplift on net operating income can be transformational for leveraged fund returns, allowing them to be more competitive in acquiring new sites and outbidding competitors struggling to embrace innovation; to reduce the cost of underwriting the lease-up period; and to recapitalize assets faster by reducing the stabilization period and shortening capital investment cycles.

These uplifts are realized through harnessing short- and medium-term rental demand in order to solve inefficiencies in the asset. Here are some examples:

- **Lease up:** Occupying newly developed residential blocks from day one with high-yielding, short-term guests will unlock positive cashflow as long-term tenants are phased in and the scheme is stabilized.
- **Resident hosting:** Long-term residents can opt into a controlled building program permitting them to sublet legitimately in exchange for sharing a percentage of the short-term rental income with the landlord.
- **Void filling:** Monetizing vacant units between long-term tenancies with high-yielding, short-term guests eliminates void periods while optimizing revenues.
- **Mixed-use schemes:** Allocating a percentage of each scheme to dedicated short-term rentals, such as serviced apartments and guest suites, can enhance long-term yield potential. This introduces transient, high-spending footfall, which benefits local businesses.

Build-to-rent (BTR)/multifamily and purpose-built student accommodation (PBSA) are in the best position to benefit from the trend. As more BTR schemes come to market, filling void periods and optimizing cash generation during the initial lease-up period is a burning issue for investors. BTR landlords are also turning to short-term rentals and home-sharing to engage premium tenants by offering a value-add 'resident-hosting' amenity. This eliminates the growing problem of illegitimate 'Airbnb-ing' by ensuring all activity is transparent, secure, insured and professionally managed, while unlocking a meaningful new revenue stream.

PBSA is often well located in or near city centers, and in high demand from short-term guests seeking an affordable alternative to a local hotel. Students always seek new ways to reduce their cost base and supplement incomes, and are an established community of hosts and Airbnb users. Alongside the natural void periods that exist during holiday periods, there is untapped potential to enhance the yield performance of PBSA assets while offering better value to student tenants. Equally, if student landlords refuse to embrace home sharing holistically and leave it unaddressed, it is set to become a priority issue that threatens the security of student communities.

Short-term rentals benefit tenants and landlords alike and are core to creating long-term economic and strategic value for investors. This is a market with the potential to shape the future of the private rented sector. ■

# Investing in thriving communities

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# KEYNOTE INTERVIEW

## An asset for all times



*Clarion Partners' Evans Anderson and Sue Ansel of Gables Residential discuss the resiliency of US multifamily and why it is a good defensive play for investors in this late-stage cycle*

Multifamily has had the best risk-adjusted returns of all core real estate property sectors since 1990, explains Evans Anderson, managing director at Clarion Partners, which is why his firm has conviction around the attractiveness of this asset class through cycles. He talks to Sue Ansel, president and chief executive of apartment owner, developer and manager, Gables Residential, about the trends they are currently seeing in this segment of the US residential market and why they focus on development in high-growth and high-demand neighborhoods. PERE's Marine Cole listens in on their conversation.

### Fulfilling a need

**Evans Anderson:** As we progress further through this US expansion cycle, multifamily continues to look attractive, especially given the underlying demand fundamentals that exist and the long-term investment performance the sector has delivered.

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**Sue Ansel:** Housing is a necessity. Multifamily is unique because it reflects a need that does not fundamentally change in different economic cycles. In the hospitality real estate sector, for example, demand and performance fluctuate based on changes in business travel and consumer discretionary spending.

The underlying demographics for US multifamily continue to be strong. Reviewing our portfolio, we see demand coming from two key groups. First, from young people starting their lives outside the family home or graduating college and moving into the rental pool. This population segment is made up of the millennials – the 23 to 38 year olds – which is 72 million-strong, and in the next few years, Generation Z – the 4 to 22 year olds – which is about 86 million strong. Second, we are seeing demand from

the Baby Boomers, defined as those aged 53 to 73, of which there are 73 million in the US now and they are reaching a point in life where they are considering downsizing and moving to a community that gives them more flexibility.

Within the millennial group, there is huge pent up demand, as there are 23 million young adults currently living at home with their parents. In many cases, they left college, possess some student debt and are unable to obtain credit or the down payment required for home ownership, particularly in hot job markets. Coupled with that, there continues to be strong annual household formation across the US and rising home prices. These factors support strong future demand for multifamily rental units.

**EA:** There are many headlines about supply in the multifamily sector and, since the global financial crisis, there has been an increase in new development in most markets.





Lifestyle living: Gables Villa Rosa in Dallas, Texas, caters to the needs of modern renters

An important takeaway is that absorption has been strong too – the supply has, for the most part, met with commensurate demand driven by the factors mentioned. Multifamily is a sub-market-by sub-market and street corner-by-street corner business, so across the US markets there are varying supply and demand dynamics that must be evaluated when making an investment and operating a portfolio.

**Offensive and defensive**

**SA:** There is continued job growth in the US and we are also beginning to see improved wage growth. Those trends also drive favorable demand for multifamily. The asset class ultimately has both an offensive and defensive nature, performing well through all cycles, which is attractive to investors.

Our portfolio performance during the last downturn, for example, remained at 93 percent occupancy or above. When investors look at various real estate investment

*“The key to driving long-term investment success is building flexible and sustainable portfolios that can adapt quickly to the latest trends and resident needs”*

**SUE ANSEL**  
**Gables Residential**

opportunities, they recognize multifamily has compelling characteristics, regardless of the economy.

**EA:** At Clarion, we have seen a number of institutional investors seeking to increase allocations to multifamily recently. A key lesson learned from the global financial crisis (GFC) is that multifamily remains well occupied during downturns as compared to other asset types that have historically experienced greater declines. There is always a degree of occupancy and cashflow in a stabilized multifamily portfolio. Multifamily is one of the building blocks to achieving durable cashflows across all cycles.

**Development and disruption**

**EA:** As we look across the landscape of opportunities in the multifamily sector, we are developing new assets in high growth markets, acquiring value-add assets and renovating assets within our existing portfolio. For

## Catering to a lifestyle

### Multifamily property must meet the ever more granular demands and movements of today's residents

**SA:** Gables Residential is now focusing its efforts on catering to the demand for live, work, play neighborhoods. Residents of all ages want to rent apartments in lifestyle locations – that means in areas where they can walk to dinner, to the theater and to work. We are developing assets in markets that have high job growth, which is the most important driver of demand for residential property.

The Seaport district in Boston is an example of an area that has turned into a very vibrant, high job growth, high demand, live, work, play neighborhood in the last 10 years. Other markets in which we are investing today, and which exhibit these conditions include the greater Washington DC area, the greater Atlanta area, South Florida, Houston, Austin and Dallas in Texas, Denver and Southern California. In Denver, for example, we are focusing our efforts in two neighborhoods: the Cherry Creek neighborhood and the Golden Triangle neighborhood, which both meet the live, work, play lifestyle.

**EA:** In Washington DC, Gables has two new developments, which are very close to the new Amazon headquarters. There is also a lot of migration to southern US states where the cost of living and level of job growth have outpaced some of the northern markets. In addition, millennial renters are more mobile than previous generations; they are willing to move for jobs and they generally rent because they incur less frictional cost when moving for a new opportunity.

*“Multifamily is one of the building blocks to achieving durable cash flows across all cycles”*

**EVANS ANDERSON**  
Clarion Partners

many new multifamily deals, Clarion Partners has been focusing on development of new product that we want to own for a very long time as we believe multifamily development offers attractive risk-adjusted returns.

**SA:** I agree that a great opportunity to create value-add returns can be manufactured through development in the current climate and an experienced team is critical to success. The cost of labor is going up, and so too is the cost of commodities and land, and expertise is required to maximize value.

Technological disruption is another trend that is impacting all commercial real estate sectors. The most visible example is in the retail area with the growing impact of online shopping on the retail brick and mortar stores as compared to the inverse positive impact on the industrial sector. The office building sector is being disrupted as a result of an increasing demand for flexibility from the workforce, whether it be flexible work hours and work locations, home office or co-working spaces. New technology is influencing all of our businesses and smart owners, operators and investors are paying time and attention to the changing trends.

Specifically, in the multifamily sector, the most immediate disruptive change has been a reduced demand for parking spaces in urban locations. The advent and accessibility of ridesharing has impacted the demand for parking spaces. New developments that are intended to have a multiple decade life need to carefully evaluate the costs of and demand for parking solutions.

Disruptive technologies will continue to influence all property sectors, so the key to driving long-term investment success is building flexible and sustainable portfolios that can adapt quickly to the latest trends and tenant needs. ■



Southern hospitality: the Ashley apartments in Atlanta caters to the rising multifamily desire for services and spaces that meet individual needs

# Moving into multihousing



Expert comment by **Roberto Casas**

## *HFF's co-head of multi-housing on why the sector is a preferred asset in the US*

Multi-housing has always enjoyed a favored position in most asset managers' portfolios because leases mark to market every 12 months along with the comparatively low capital expenditure nature. Investors that overweighed their portfolio compositions with multi-housing during this economic cycle have enjoyed outperforming returns relative to other asset classes. With a record amount of capital raised for real estate – and more than \$210 billion of dry powder – multi-housing continues to be a preferred asset class.

### Record-breaking numbers

The multi-housing market entered 2019 with continued strong fundamentals and rent growth fueled by both Class B and C asset classes. Data provided by Axiometrics shows rent growth in 2018 at 3.3 percent – surpassing the 2.5 percent rent growth registered in 2017 – and occupancy remains tight, having reached 95.4 percent in 2018.

According to Real Capital Analytics, 2018 saw record-breaking multi-housing volume and transaction activity – the market finished the year up 12 percent and with deal volume at \$173 billion.

Supply concerns remain elevated, however. But most markets have absorbed the supply and remain in balance. The current supply issues in specific submarkets could be short-term headwinds – in 2018, annual completions registered at 287,000 units and are projected to reach 318,840 units in 2019. This is expected to retreat slightly in 2020 to 284,122 units and 224,581 in 2021, according to Axiometrics data.

Supply is expected to outpace absorptions in 2019 and in 2020. However, it is

### Investment tips

#### Here are three ways to maximize opportunity

1. A core-plus strategy for new products will present many opportunities to acquire assets at attractive price-per-pound metrics – if an investor can hold through short-term oversupply headwinds.
2. Invest in niche property, like manufactured housing, student housing and senior housing.
3. Pursue recently-renovated assets. This will provide current yield without taking the risk of completing a deep value-add strategy at the property level.

expected that the supply pipeline will begin to moderate toward the end of 2020 and into 2021, and the Class A space will see increasing rent growth as demand outweighs supply.

All this said, demand remains a bright spot for the sector, as demographics and housing data strongly support a sustained, long-term need for apartments. The economy added 2.6 million jobs in 2018 with the unemployment rate at 3.9 percent. The tight US labor market is supporting higher wages, and the country is experiencing robust household formations. According to the February BLS Employment Situation Report, nominal average hourly earnings have risen by 3.4 percent over the past 12 months. Prior to 2018, wage gains had not reached 3 percent since 2009.

### Expectations for 2019

The major underlying theme for 2019 is that the multi-housing industry will continue to provide investors with safe returns and resilient cashflow. Given the current state of the market, there are no signs of slowing transaction volume. Capital will be prevalent in 2019 and assets will continue to be underwritten based on current performance as capital is expected to remain disciplined.

Sellers also remain patient and are looking at other capitalization options for their assets, including refinancing or resetting promote structures with current partners. Merchant builders will likewise continue to look to harvest profits in 2019 as assets stabilize. Investors for recently stabilized assets in oversupplied submarkets with artificially low rents will benchmark pricing to current replacement cost, which is expected to also compress going-in yields.

Investors will look for yield in alternative assets and niche property types within multi-housing: student housing, senior housing and manufactured housing, for example. Furthermore, institutional capital for workforce housing continues to increase as more funds are raised to focus on that specific niche.

The most plentiful capital in the market continues to be for value-add opportunities and, given the dearth of value-add opportunities relative to historical norms, it is expected that capital will lower return thresholds in order to deploy into the space. The market is also experiencing cross-border capital entrants into the US multi-housing market through portfolio acquisition or by investing in vertically-integrated platforms. ■



# KEYNOTE INTERVIEW

## Meeting demand for US single and multifamily housing



*Tricon Capital's Gary Berman explains why his firm is pursuing a two-pronged strategy in the rental housing sector*

By the end of June, Tricon Capital is poised to close a \$1.4 billion deal to acquire the Starlight portfolio of 23 US multifamily properties totaling more than 7,000 units mainly located in the US Sun Belt. The publicly quoted residential property company is also a leading operator within the US single-family rental (SFR) sector, signing a \$2 billion joint venture with two institutional investors in June 2018. Tricon Capital has 30 years of residential investment experience spanning single and multi-family rental, and for-sale housing. President and CEO Gary Berman tells *PERE's* Stuart Watson how common factors are driving demand within the different sub-asset classes.

**Q Tricon has made a big bet on the US single-family rental market, building up a portfolio of 18,000 units. Why is that asset class appealing to investors?**

The SFR industry was created out of the

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foreclosure crisis in the late-2000s, which allowed institutional investors like Tricon to buy homes at scale. In the meantime, the development of new technology has allowed us to manage them efficiently. It is really a tech and logistics business first, rather than a real estate business. It has been propelled by the same confluence of technologies that has allowed Uber, Amazon and Airbnb to succeed: cellular mobility/broadband, cloud computing and artificial intelligence. The combination of these technologies has allowed us to manage a complex set of activities and turn this into an institutional business.

The increased efficiencies also help us to provide an affordable housing option to our residents. In our portfolio, the average rent represents around 22 percent of resi-

dents' household income. By contrast, mortgage payments are typically underwritten to 30 to 40 percent of household income. The larger gap between income and expenditure attracts SFR residents by providing them with a healthy financial cushion of disposable income every month, which is particularly appealing in a downturn.

The sector has resonated with public institutional investors. Single-family rents generate a predictable, recurring income and cash-flow stream, which is attractive to pensioners, retirees and public shareholders. On the private side, we announced a joint venture last year with a sovereign wealth fund investor and a US state pension plan. That will provide \$750 million of equity leveraged to buy 10,000 homes at a cap rate of around 6 percent with a value of \$2 billion. We are about a third of the way through that and expect to be fully invested over the next two years.

Most importantly, we are providing a

Settling in the Sun Belt: a Tricon single-family rental home in Charlotte, North Carolina



*“We are still in the early days of institutionalization of the single-family asset class, and there is a tremendous consolidation opportunity”*

**GARY BERMAN**  
Tricon Capital Group

very compelling value proposition to the consumer and that, in turn, drives the economic opportunity for investors. Our residents get to move into what feels like a new home that is ‘hotel ready’ and then live a maintenance-free lifestyle without going through the hassle of obtaining a mortgage. Instead of spending their weekends repairing their home, our residents are afforded more time to be with their families.

### **Q How do you differentiate your single-family strategy from that of competitors?**

It is very much focused on the Sun Belt and what we call middle-market housing. Across our portfolio, the people living in these homes are families with children and pets with household income between \$50,000 and \$95,000 paying about \$1,350 a month in rent on average. We believe middle-market residents are generally longer-term residents. They may not necessarily have the credit score or down payment to buy a home, as is more prevalent at higher rent levels. Conversely, in a downturn, their relatively low ratio of rent to income makes it easier for them to withstand economic hardships and ultimately remain in their home. This is apparent in our industry-low resident turnover metrics and makes for a very defensive strategy.

Our Sun Belt theme is driven by demographics. Around 40 percent of the US pop-

## Pioneer in PropTech

### **Technology is an essential enabler for large-scale investment in SFR homes, observes Tricon’s Berman**

Tricon utilizes computerized systems to buy single-family homes, acquire customers and support the management of its properties. A proprietary software package scans online residential real estate listing services every few minutes, using an algorithm to screen homes against 90 different acquisitions criteria, including location, school ratings and crime statistics. It looks for properties at yields of around 6 percent and seeks to gather data on how much renovation will be needed.

“Our software and algorithms look at hundreds of thousands of homes every quarter and we are able to write an offer in four minutes,” claims Berman. “At that point we send someone to inspect the home and make sure that the renovation scope is what we thought it was, then we decide whether to proceed. In our key markets, we might put in offers on up to 2,000 homes each quarter and we are looking to buy roughly 700 to 800 homes per quarter.”

Tricon and its industry peers also use technology to enable “self-showing” for potential customers. A lock-box is put on the home, so that prospective residents can contact a call center, pay a nominal deposit and receive a code that allows them to access the property for viewing at their convenience. Application and credit vetting processes are then handled online via an automated system.

The company also uses home mapping technology to create realistic virtual walk-throughs of all of its homes and uses similar technology to capture key attributes of major home components, such as appliances and water heaters. This data can later be mined to determine how much will need to be spent on repairs each year. In addition, Tricon tracks all components used for ongoing repair and maintenance, and uses sophisticated inventory management tools to make sure its maintenance vehicles are always stocked with the most frequently used components, saving itself both time and money.

## Analysis

ulation lives in the Sun Belt and it is going to get 60 percent of the growth going forward. Americans are moving from north to south in search of jobs, lower taxes and better weather – that trend is going to continue. The Sun Belt states have had higher population growth, household formation and job growth than the national average.

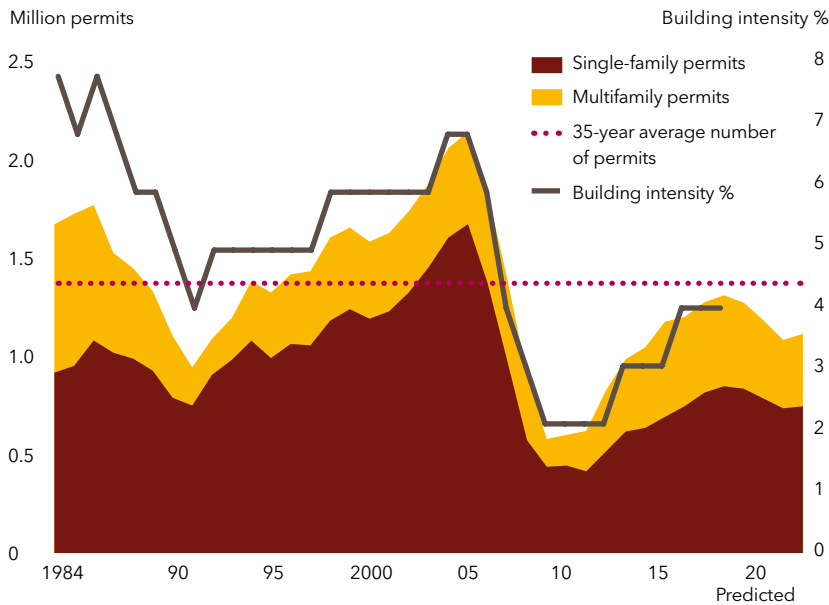
### Q Is there much scope for further institutional investment in the single-family sector?

Around 16 million American families rent single-family homes. It is a \$4 trillion market. We are the third-largest publicly traded company focused on single-family in the US, and probably the fourth largest overall, but all in-

stitutional investors combined own only 1 to 2 percent of the industry. The average owner owns something like one-and-a-half homes. We are still in the early days of institutionalization of the single-family asset class, and there is a tremendous consolidation opportunity, both within the institutional sector and of the properties owned by ‘mom and pop’ landlords. Morgan Stanley recently published a report that said the industry could grow quickly to ten times its current scale.

Total US residential permits remain well below the long-term average, while building intensity is still less than it was during the early 1990s housing recession

Note: building intensity measured as annualized housing starts per 1,000 persons



Source: US Census Bureau for historical data - John Burns Real Estate Consulting for forecast data

### Q You also invest in mid-market multifamily housing in the Sun Belt. Why combine the two strategies?

We are one of the first companies to go into both sectors in the US, and the two businesses are very compatible. There are definite back office synergies available on the property management side. Call center, accounting, legal, IT, procurement and resident underwriting can be done from one centralized office so that as you buy an additional single-family home or multifamily property, management expenses are spread over a relatively fixed-cost base. We are working toward this. From a procurement perspective, we can have the same team and suppliers provide materials to both businesses. There are also learnings between the two product types as we start to understand the overall housing market better. Finally, there are potential long-term synergies over the lifetime of the resident, so if someone is renting one of our apartments and decides to have children and form a family, we can rent them a single-family home without them leaving our company.

The common factor driving our decision-making in both US multifamily and single-family is the dearth of new housing. We use the building intensity metric to measure starts and permits per 1,000 population. Ten years after the financial crisis, the building intensity in the US is less than it was in 1982 and 1991, two of the worst real estate recessions on record. The US is not supplying enough affordable housing because of land economics and major issues with labor and material cost pressures, which is why everything we do is relatively affordable. In that environment, when the US economy is growing as much as it is, particularly in the Sun Belt, you really want to own the existing stock, whether it is single-family or multifamily, so you can provide that growing workforce with a high-quality, affordable place to live. ■

## Asset case study: The Selby

### In addition to buying existing rental homes and apartments in the US, Tricon is pursuing a build-to-core multi-family development strategy focused on its home market of Toronto

Supply in the Canadian city is “very constrained” says Berman, with vacancy standing at just 0.3 percent and a predicted annual shortfall of 10,000 units of rented housing through 2021. In November, Tricon completed construction of The Selby, which Berman describes as “one of the first US-style multi-family developments in Toronto.” The 50-story building is one of seven rented residential projects Tricon is developing in the city.

The Selby was funded by Tricon together with a Canadian pension fund, which owns an 85 percent share. Its 502 units are priced to appeal primarily to professionals with rents of C\$3.70 (\$2.76) per square foot per month on average. Amenities include a state of the art 3,500 square foot fitness center, wellness spa, outdoor terrace and pool, integrated co-working spaces, and pet grooming facilities. There is also an on-site restaurant in the historic red-brick mansion house that serves as the property’s front door, and which was rebuilt as part of the development.



# Why US multifamily remains attractive to lenders



Expert comment by **Justin Kennedy** and **Jack Cohen**

## *3650 REIT's managing partners explain where the market is heading and the factors they consider when examining origination opportunities*

**M**ultifamily renters' tastes and requirements are shifting rapidly – they prioritize high-end amenities, storage, shorter commutes, walkable neighborhoods and access to transit. The classic affordability limitation remains, however, straining the resources of developers, owners and renters.

Beginning in 2012, pent-up, post-crisis demand combined with changing demographics and consumer tastes moved US multifamily markets into high gear. Federal data show that, since 2012, annual multifamily deliveries, at 30-year highs, have been easily absorbed. Nationwide vacancies have recently declined below 7 percent, something not seen since 1986. The Consumer Price Index estimates urban rent has increased nationwide since 2012 by 27.1 percent, with Dallas, Denver, San Francisco and Seattle all showing increases over 40 percent.

Given this, multifamily development costs have risen sharply since 2012. Urban land prices eclipse pre-crisis levels, and Turner Construction data show a 38 percent increase in costs, driven primarily by a skilled labor shortage. Municipal impact fees and other costs linked to entitlements and permitting are markedly higher across the US.

These factors paint a concerning picture. While rent growth and rising property values have positive connotations, these trends are not sustainable. Despite stronger economic and wage growth in recent quarters, incomes have not and will not keep pace with rents rising at these rates. Yet, to justify new con-

struction, revenue must grow to cover the even faster rise in development costs. We are not aware of any major market without aggressively trending rents where development yields are above 5.75 to 6.5 percent; some are lower. Nor do we hear many operators pleased with the recent Class A rent growth.

While the multifamily industry has seen too much Class A product and too few cost-based innovations, clever renters, developers and owners are addressing the situation. Smart first-adapters are testing new solutions to make properties and the renter experience more attractive and efficient in delivering quality housing at attainable rents.

### **Investment takeaways**

These trends point to four conclusions. First, despite new supply – and oversupply of Class A in certain markets – continued demand in growing urban areas will keep the market stable. Second, expect more renovations and rehabilitations as higher costs enhance relative value and prompt the need for these projects. Third, in most localities, rent growth has outpaced middle and lower-middle class incomes. And finally, in many cases, existing

properties at lower costs will be more appealing to renters than new product that is less affordable due to higher development costs.

Many US cities have not entitled enough supply to housing in urban areas with high job growth. This applies to product types attainable for middle- and lower income renters. Urban districts are high cost and constrained by site affordability. If this product can be priced attainably, we believe walkable, transit-oriented locations will outlast the trend of robust tenant amenities at less attractive locations. As the ability of renters to pay for Class A products nears capacity, they will want a short commute with transit access, walkable urban districts and Class A amenities. Accordingly, we believe developers' priorities will be cost efficiency, increased density where permitted, smaller units and mandatory amenities.

New residence types such as micro units, co-living and net leases for highly capitalized groups, which manage homes in a similar manner to hotels, will accelerate in taking market share. As costs rise, and individuals are forced to operate within their monthly rental caps, they will continue to seek opportunities that are well-located, amenity-rich and employ a hostel-like approach to living.

Undeniably, there continues to be a need for purpose-built rental housing, and specifically attainable housing. If well-capitalized and sophisticated sponsors with sound business plans bring opportunities that meet today's market dynamics, multi-family rental assets will remain attractive to lenders. ■

# 7%

**Since 2012, nationwide multifamily vacancy rates have fallen below this level for the first time since 1986**

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# KEYNOTE INTERVIEW

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## Finding a home in Europe's fastest-growing region



*With demand growing for multifamily rental in the Nordics, NREP's Mikko Räsänen believes there is an opportunity for investors to find both value uplift and shelter from future storms*

The strongest population growth in Europe combined with a millennial generation ever keener to live and work in large cities, but lacking the income to buy their own homes, mean the Nordic countries are facing high demand for rental apartments. But currently, there is a lack of supply to fulfill the need. For investors, this signals opportunity, and NREP, as one of the regions leading developers and investors in real estate with €4.3 billion of assets under management, is aiming to plug the gap by capitalizing and developing a new generation of modern rental homes.

PERE talks to the firm's Helsinki-based partner Mikko Räsänen about the intricacies of the Nordic markets and the growing

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importance of adopting a tenant-focused approach to property investing.

### **Q** What factors are driving demand for rental apartments?

The Nordic region has stronger population growth than any other region in Europe, and is also experiencing strong urbanization rates. Stockholm, Copenhagen, Oslo and Helsinki are four of the five fastest growing capitals in Europe.

On top of the population growth, an increasing number of people living and

working in our capital cities cannot afford to buy an apartment, so they are turning to the rental market. This is especially the case among the younger generation, whose incomes are typically lower. Furthermore, as much of the added incremental rental population live as singles or couples rather than as families, more apartments are needed to house the same amount of people.

This demand growth should be seen against a general supply that is hampered due to very slow and iterative zoning processes. In addition, regulation of rents further hampers the supply of rentals, thus causing a significant supply-demand imbalance.

**Q How would you describe the current residential real estate market in the Nordic region?**

While the demand growth is a common characteristic, each of the Nordic countries are indeed local markets and differ in many important ways, such as regulatory, structural and cyclical factors. Starting with regulation, the residential-to-let segment is partly regulated across all Nordic countries, but Sweden is unique due to all-encompassing rent-control legislation limiting what landlords can charge for rental apartments, thus limiting income return potential, especially in the largest cities. Strictly regulated rent levels in Sweden mean that tenant demand overwhelmingly exceeds apartment supply and tenants often queue for several years to get one. In Denmark and Finland, regulation relates to older assets. Copenhagen and Oslo also have rules around average apartment sizes in new buildings, which limits the supply of smaller and affordable rental apartments. Against that backdrop it is not surprising there is literally no vacancy in the capitals and growing cities in the Nordics.

Structurally, ownership is highly favored in the Norwegian market, while Denmark is a rental market. Finland and Sweden are somewhere in between. From an investment perspective, because Norway is so ownership-focused, a proper liquid investment market for multifamily rental buildings is largely absent whereas Denmark, Sweden and Finland offer a highly liquid market for investors.

Cyclically, the markets are also at different points. Stockholm's residential market is the furthest along in the cycle and after years of increasing prices, the develop-to-sell market recently experienced a slowdown with apartment prices declining by 10 percent. That has led to many developers facing financial problems, and an increase in the supply of rental apartments as a result of a growing number of developers converting develop-to-sell projects into rental projects.

Copenhagen and Oslo also have rules around average apartment sizes in new buildings, which limits the amount of smaller and affordable apartments that can be brought to market, so while demand is growing in this segment, supply is constrained, and rents for small apartments has been growing fast.

To make the right decisions, investors need to be familiar with the local subtleties.

**Q In terms of strategy, how are investors approaching the sector?**

The Nordic markets provide opportunities for investors across the spectrum, from core to opportunistic.

Large amounts of capital are competing to buy core residential rental assets in the large cities, which is considered by local institutions and banks as one of the safest assets you could own. Supply is limited and there is significant competition every time there is a large portfolio or significant asset for sale. Hence, in addition to struggling to get sufficient volume, many institutional core investors are struggling with historically low yields.

One way for value-add investors to improve yields and returns is to do forward purchasing or forward funding of residential-to-let projects from local developers. Investors can push away many development risks to other market participants, and the reward, if done successfully, is to obtain access to a high-quality rental building at a price point that is well below the market value of similar standing assets.

A smaller number of opportunistic investors are pursuing a strategy of buying regulated older assets, refurbishing those assets and

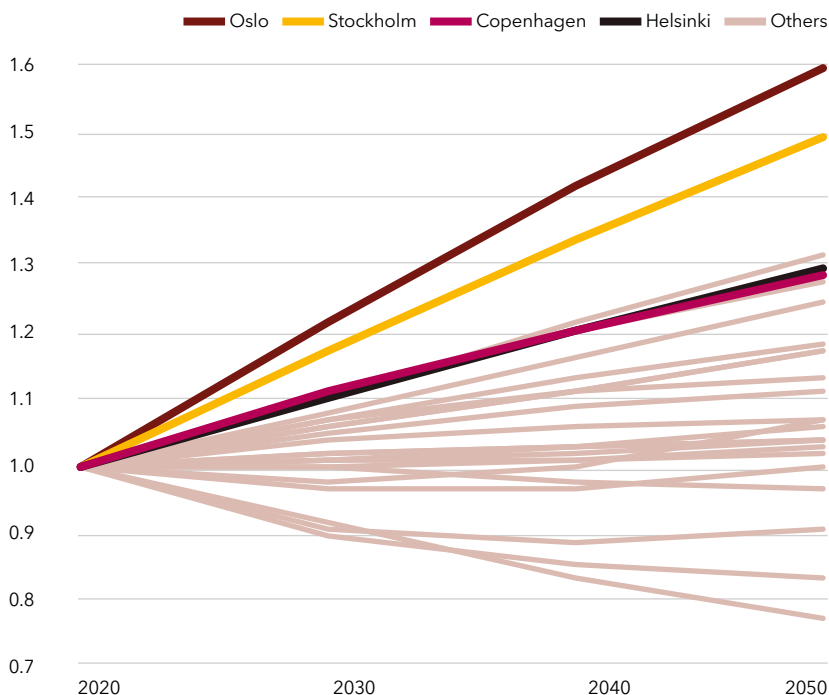
then trying to increase rents. This is a strategy that certain investors have pursued in the Swedish market in particular. The other strategy that certain opportunistic investors have been embracing is buying assets of various quality in the smaller regional cities where the general outlook is not as positive compared to the larger cities. This allows these investors to purchase assets at higher yields, but on the other hand liquidity risk is clearly higher and the rental market outlook is not that positive.

Another opportunity in the Nordics, as many of the segments are less mature compared to, for example, the UK or Germany, is to improve initial and long-term rental yields by developing multifamily rental residential that is more tailored to consumer demand and needs than the typical standard existing product offering. And this is a space that NREP finds particularly interesting and is very active in.

**Q How important is it to have a tenant-focused approach to residential developing and investing these days?**

Both old and new rental stock tend to be of lower quality than in the for-sale space. But because demand has outstripped supply in

Population of Nordic capital cities is forecast to grow higher than other EU cities (index)



Source: Eurostat 2017



most Nordic markets, owners have been able to let their apartments regardless. As a result, there has been no competition between owners to adopt differentiated products and services. That is likely going to change going forward.

To ensure portfolios are fit-for-purpose in the long-term, it is increasingly important to have customer- or tenant-focused investment approach. While the pace of change differs between the Nordic markets, we are seeing a general trend of tenant expectations growing in terms of what they want from a rental property. They seek flexibility and convenience from their homes, and they demand better quality and with a price tag attached that is reasonable to their incomes. For example, tenants are now showing a preference for modern and good quality smaller apartments; single people and couples without children are a growing demographic, and they have less need for large living spaces. Owners need to be attuned to these subtle dynamics at play and respond.

And certainly differentiation is something NREP is very focused on achieving. We have already developed more consumer-focused concepts for student housing, serviced living for young professionals as well as for active seniors and families with children. Each of these concepts are tailored for a specific customer group and bring something new to the Nordic markets. Noli Studios,

*“The Nordic markets provide opportunities for investors across the strategy spectrum, from core to opportunistic”*

**MIKKO RÄSÄNEN**  
NREP

for example offers affordable yet hassle-free flexible living for young professionals with various services such as cleaning, gym and communal facilities on the ground floor. Our Plushusene concept in Denmark offers communal spaces where residents can have dinner together and spend time with neighbors. We also see significant untapped potential to provide more consumer-focused concepts for the general residential rental market in the Nordics, improving the quality of life for residents without increasing costs.

A living environment that promotes health and well-being is fast becoming a key consideration for the modern tenant. Poor air quality has been a topic of debate across the region, so we can expect to see demand for residential property to have better air quality and ventilation. The younger generation in the Nordics is also more concerned about energy efficiency and the environmental impact of property. Property owners and investors must also respond to these types of sustainability considerations. You can no longer get away with selecting the cheapest option or the easiest route when developing a new rental property. We are beginning to see more renewable energy being installed in properties and more low-carbon building material being used. And wooden construction is finally picking up in the Nordic region, and modular construction techniques where buildings are assembled in factories.

### Case study: Plushusene

**NREP’s co-living concept is deliberately customer-focused, designed to enrich the lives of young families and active seniors, and bring the two demographics together**

Currently, NREP has two sites in development with 220 units and a total of 215,280 square feet, and a further pipeline of 1.07 million square feet planned for the near future. Here are some facts that support co-living as a long-term opportunity for investors, while also delivering value for its tenants.

- By 2030, seniors above 55 years will account for 35 percent of the population in Denmark (Statistics Denmark);
- 104,000 seniors in Denmark feel lonely (RealDania);
- 74 percent of people aged 55-80 prefer living together or close to families with children (NREP study);
- 89 percent of families with children prefer living close to people aged 55-80 (NREP study);
- 91 percent of people in co-living residential have experienced an increase in their quality of life (SFI, 2016);
- There is a demand gap of 100,000 co-living units in Denmark (NREP survey).

### **Q** What is your outlook for the next year?

Multifamily rental in the Nordic capitals and growing cities is underpinned by demographic growth trends that are projected to continue for the coming decades and supply constraints that are unlikely to disappear in the short term. Hence, part of the attraction of owning a high-quality rental product is that as a long-term investor focused on your rental income you do not need to worry about the outlook for the next year.

That said, to answer your question with regards to opportunities for new investments over the coming year, we expect the residential rental markets in Copenhagen and Helsinki to continue offering the most attractive risk-reward balance, but potentially the recent slowdown of the development-to-sell market in Stockholm may open a new window of opportunity to buy land or completed projects from distressed local developers. ■

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# From office space to living room

*The shifting dynamics of China's property market makes converting older commercial assets to residential a viable investment, writes Mark Cooper*

China's housing market conjures up images of brand-new apartment blocks on the fringes of cities, but some investors are finding value in converting older commercial premises to residential uses.

Several factors are driving this. The government is keen to build more rental housing to provide better quality homes for young professionals who cannot afford to buy. Those young professionals – China has 400 million millennials – want to live closer to work and enjoy the dynamism of city living. China's maturing property market means there is a growing stock of older buildings which can be converted to new uses.

Yvonne Siew, executive director, global capital markets, APAC, at CBRE says: "China's rental sector is known to be underdeveloped. Only one-fifth of the housing stock in Beijing, Shanghai and Shenzhen is used for leasing, compared with 50 percent in Tokyo and more than 60 percent in San Francisco and New York. At the same time, urbanization continues to drive residential demand in China's first-tier and larger second tier cities, as more people move to find work."

## Matching the millennial taste

China's millennials are more mobile than the average citizen and are flocking to first tier cities like Beijing. While they are keen to buy in the longer term, most will need to rent first. The co-living concept – smaller apartments with shared space – seems attractive to them and this type of rental offer suits former commercial buildings.

While much of the for-rental residen-

tial stock under development is new-build, carried out by state-owned enterprises, which can obtain land more cheaply, a few companies specialize in conversions. Nova, launched in 2015 by Qian Wang and Warburg Pincus is one of them. The company acquires buildings in first-tier cities for refurbishment or conversion to residential. It has more than 40 projects operating or under construction, with a total investment value of nearly 12 billion yuan (\$1.8 billion; €1.6 billion) and a total project area of nearly 400,000 square meters.

Wang says: "We look for underperforming assets, older or undermanaged buildings where we can add value through conversion to residential. Typically, we are pretty open about what type of buildings we convert, because we have a strong renovation capability, however we prefer to convert hotel and office buildings because the floorplates are easier to convert to residential."

*"One of the biggest challenges is getting the current owner to sell at a reasonable price"*

**JAMES MACDONALD**  
Savills

"We also convert shopping malls, but this is more challenging, as you often need to bring in more daylight, for example. We also tend to stay away from converting industrial buildings because of the potential environmental liability."

Last year, Nova teamed up with Infrared Capital Partners to buy the Hongkou Bailian shopping mall in Shanghai, which will be refurbished to provide 400 rental apartments and retail space.

## Mixing it up

Most of Nova's projects have a mixed-use element, says Wang. "We need to be creative in working with the existing structure in order to maximize value; key to this is a mix of uses. Each of our buildings is like a vertical mixed-use development. We might put retail on the ground floor, to serve both our residents and the local community."

Including retail space is not just a matter of using the building's ground floor, as often the areas Nova purchases in lack neighborhood retail. Office space is also in the mix, says Wang. "A podium floor might be too large to convert to residential so we might convert to office space. For example, we recently leased the podium floor in a Shanghai building to WeWork."

In 2017, Nova joined forces with car manufacturer BMW's Mini brand to launch a co-living project in Shanghai's Jing'An district, where it converted a former paint factory to a co-living facility.

Investors looking to convert commercial to residential also need to consider title and zoning, the number of years left to run on a building's lease and the configuration of the building.





Leaving work behind: Nova's conversion project in Shanghai's Pusan district created 128 apartments with communal areas

Siew says: "There are also structural concerns such as building depth, ceiling height, lighting ventilation."

So far Nova has mainly focused on Shanghai and Beijing; "firstly because we need depth of rental demand and both cities are growing as people move there to find work," says Wang. "There is also a lot of building stock of varying ages and replacement costs are very high."

Key to residential conversion is to buy at below replacement cost, but sellers have become increasingly demanding.

James Macdonald, head of China research at Savills, says: "One of the biggest challenges is getting the current owner to sell to you at a reasonable price. Anecdotal evidence suggests many are not willing to sell at the current usage value but on the up-graded value of the asset – they do not want to leave the buyer with much upside."

Wang adds: "It is becoming more competitive to find suitable buildings, which is why we need to be able to maximize value each time." It is also important for buyers to establish credibility as a company that can execute deals, which reassures sellers.

Some rental residential companies are, therefore, trying to be asset light. "They take relatively inexpensive long-term leases,

convert the asset and hope the returns over the lease duration cover the costs of the re-fit," says Macdonald.

For example, rental housing firm Ziroom works directly with developers to secure buildings for its co-living project and requires a 10-year lease to justify the fit out.

### Engage locally

As is often the case, a potentially difficult part of the process is dealing with local government. China's government is promoting rental residential, which means city authorities are more likely to support conversions, but attitudes can vary. Macdonald says: "Some city governments are less accommodating when it comes to change of use or redevelopment in certain districts. The opportunity also depends on how many greenfield development opportunities exist in a particular city."

Another complication, Wang says, is that China lacks an established planning regime for conversions, "so there is a requirement for lots of discussion with the local authorities to prove the value of converting, and dialogue is also needed to develop regulations and permits for converted buildings."

CBRE's Siew adds: "We always advise

early engagement with the authorities on the intended change of use in order to gain a smoother process on the conversion, which is essential to make the renovation works cost-effective."

Warburg Pincus is not the only investor taking an interest in China residential conversions. GIC has invested in Nova and in a new fund which will acquire and renovate residential projects in first tier cities. Meanwhile, Chinese insurer Ping An has invested alongside developer Landsea Group in a \$1.5 billion rental residential fund, which will convert a Shanghai apart-hotel into rental apartments.

A key part of the strategy for Ping An and Landsea is their intent to exit mature properties via a real estate investment trust. China still does not have formal REIT legislation, but has trialed a number of REIT-style structures. Some China observers believe multifamily housing could be the sector that enables a true China REIT to get off the ground.

It would be a little ironic if such a significant development in China's capital markets had converted hotels and office buildings as its catalyst, rather than the soaring apartment blocks usually associated with China's cities. ■

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KEYNOTE INTERVIEW

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# At home with China's residential market



*AP1's Johan Temse and White Peak Real Estate Investment's Jesper Jos Olsson discuss the opportunity of investing in the country's Tier 2 and 3 cities, and how to do it the 'right way'*

For many investors, developing residential property in China's second and third-tier cities sounds like a risky proposition, however a structured and data-driven approach takes a lot of risk out of the process says Johan Temse, investment manager real estate at AP1, a Swedish pension fund with total assets under management of SKr340 billion (\$35 billion; €31 billion) and a 13 percent real estate allocation, and Jesper Jos Olsson, chief executive of Swedish investment manager White Peak Real Estate Investment. Together, they have been investing in this sector for close to a decade. Here they discuss how they make it work, with PERE's Mark Cooper listening in.

## Playing to themes

**Jesper Jos Olsson:** White Peak has been

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investing in China for 13 years now and we follow a hybrid model where we are the investment manager of a number of real estate funds catering to predominantly Swedish institutional investors and uniquely we also have a 400-plus employees strong in-house development platform. Our focus is to build middle-income residential housing for sale. Currently, we develop and invest in around 20 projects in 11 cities, which are often defined as second and third tier, across three provinces – Shandong, Hebei and Liaoning – primarily in northern and eastern China.

**Johan Temse:** China is obviously one of the world's fastest growing economies. It is a huge market with very well-developed infrastructure. From a macro view, we like that. When we invest in property, we always try to identify themes, and one very strong theme we like right now is urbanization. This is a global trend, but one I believe is particularly strong in China. At the same time, we are also seeing a rise in the middle-income class in China together with strong GDP growth. These fundamentals are attractive for AP1 as a long-term investor, particularly as population movement to large cities will continue for the foreseeable future.

Housing affordability is also stronger in China compared to some markets in Europe. Household debt is relatively low and

*“When we invest in property, we always try to identify themes, and one very strong theme we like right now is urbanization .... one I believe is particularly strong in China”*

**JOHAN TEMSE**  
AP1

there is a desire among the middle-income class to achieve a higher life quality in terms of improved housing conditions in more convenient locations and closer, for example, to better schools for their children. This is creating high demand in the residential space, and as investors we are well positioned to take advantage of these shifts going forward.

**JJO:** If you look at China just a decade ago, it was only 46 percent urban. Today, it is close to 60 percent and we can expect that to increase to 70 percent or more over the next decades. And this is the reason White Peak started looking at the market 15 years ago. We spotted this trend already 15 years ago and continue to see urbanization as a long-term opportunity.

**JT:** Although there are still some doubts whether Asia generally could be regarded as an institutional market, AP1's view is that China is one of the markets in the region where there is very good transparency as well as a legal system that functions very



## Case study: Building a Scandinavian-style eco city in China

In December 2018, White Peak acquired two land parcels of the Yantai Hammarby Eco City Project, which aims to integrate Scandinavian innovation, lifestyle and sustainability in China's rapid urban developments. Jesper Jos Olsson comments: “White Peak is working with our international and Chinese partners to build a sustainable, high-quality project, which will display advanced environmental technology, and contribute to creating a healthy, green, connected and smarter environment for future generations.”

- **Location:** Yantai City, Shandong Province, China
- **Developer:** White Peak
- **Investor:** White Peak Fund IV
- **Lead designer:** Sweco International AB
- **Acquired land size:** 92,000 square meters
- **Number of apartments:** 1,870 units
- **First-phase product mix:** Residential, loft, retail and sports stadium



well when it comes to making property investments. This is another reason why we like the market.

### Data-driven decisions

**JJO:** There is a misconception that China is extremely complicated, irrational and opaque. In fact, it is pretty straightforward and open. Something we learned early on is that in China, data is readily available for the whole supply and demand of land, including inventory and the production pipeline of property. This makes China unique. I do not think there is anywhere else in the world where every piece of land that is auctioned already has designated planning in place, and the certainty that it will start construction according to a pre-agreed time schedule. And every apartment sold is registered in a database. When the data is available, the next step is to analyze and validate the data. It then requires the deep understanding of the local market and buyer behavior, which we have developed gradually over the last decade.

So basically, it is possible to build very sophisticated data models around supply and demand. This allows us to have quite specific data underwriting of these different local markets and base our investment decisions on supply and demand. We can run modelling based on, for example, what kind of products people like and what purchase price sells the most. These are some unique features of the Chinese residential property market that most foreign investors might not be familiar with.

### Top priorities

**JT:** Governance, sustainability and corporate social responsibility are also rapidly becoming top agenda items now. And it is not just a box-ticking exercise for us. We believe a focus on these issues is resulting in better returns from our investments in China's residential market. We push all our managers to participate in the GRESB survey, and we benefit from White Peak's dedicated approach to these issues – we can demonstrate good returns and a good GRESB score.

Looking at Asia generally, real estate investors and managers are a little bit behind the curve on these issues, but White Peak has, naturally, taken a Swedish approach to ESG in China. Strong ESG performance helps when bidding for land plots and also we are finding the end customer is now

keener to buy from developers that take the responsible environmental approach to residential projects.

**JJO:** We partner with cities that value good urban development and because of our focus on doing things the right way, for example by having fewer accidents on our work sites, we experience fewer lawsuits from customers; we pay more tax; we train our people better and we are more transparent. This makes us a better partner for institutional investors like API. The key in China today is really to be a low risk partner. And that is not complicated. You can push for an extra percentage point of IRR, but we have been generating opportunistic returns and this is while using minimal debt, so there is no need to take unnecessary risks.

**JT:** And from the investor perspective, one of the attractions of China is the sort of the risk-adjusted return we can generate from the residential sector in the second and third-tier cities. The combination of low operational risk and low financial risk continues to provide us with high returns making the market attractive for us.

**JJO:** And our data-driven approach, which as I mentioned before is so critical to our development and investment decision-making, also really helps us to drive those returns for API in China. To give you an example, in terms of location, our strategy is to develop residential real estate in the least urban districts of the biggest cities in our markets. So in Shandong province, for instance, that means the less urbanized areas of Qingdao and Yantai. We think this is where most growth will take place. You put a large amount of supply and demand metrics into a database and then you can figure out quite quickly what works. In most of these cities, income growth has outpaced property prices over the past 10 years and continues to do so.

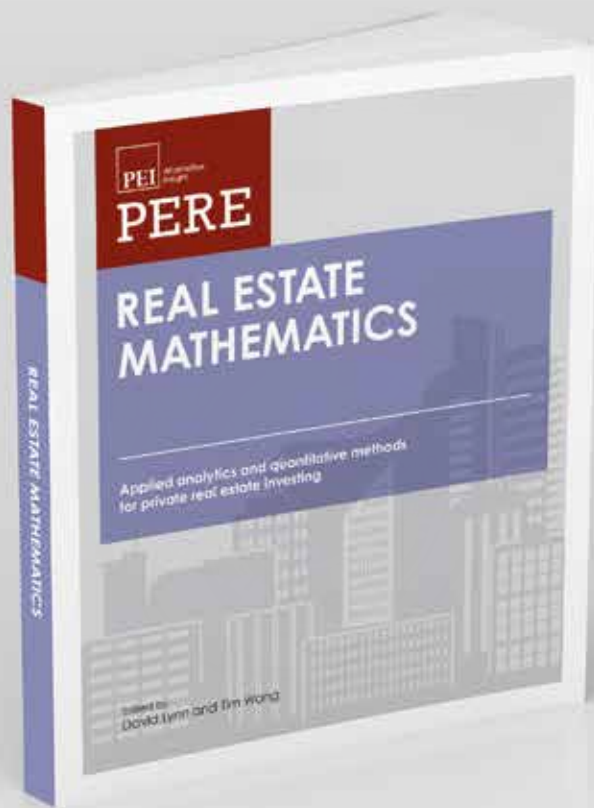
This increased affordability is very positive for us. In contrast, it is difficult to find development sites in China's Tier 1 cities like Beijing and Shanghai. There is a real misperception about city tiers in China. We do not consider a second or third-tier city as a secondary market. These are cities with populations of five to 10 million and in a region similar to the size of Europe. That means almost any city market in China offers attractive investment potential. ■

*“We do not consider a second or third-tier city as a secondary market. These are cities with populations of five to 10 million and in a region similar to the size of Europe. That means almost any city market in China offers attractive investment potential”*

**JESPER JOS OLSSON**  
White Peak Real Estate Investment

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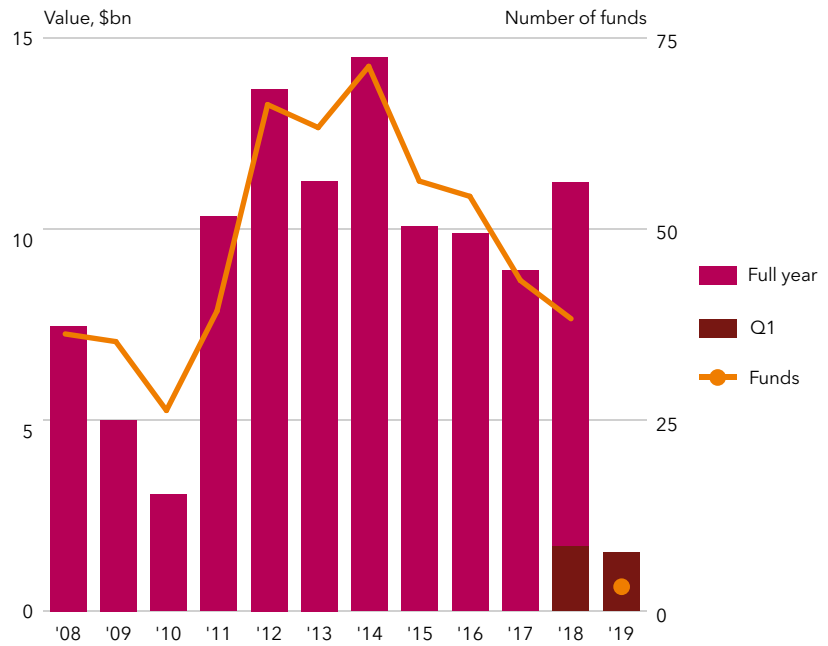
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**Déjà vu?**  
**Residential-focused fundraising was slow in Q1 2019; but 2018 kicked off in the same vein before ending on a three-year high. Is a similar rebound in the cards again?**

Fundraising for residential-focused funds in 2018 reached its highest point since 2015, but the number of funds has dropped sharply since 2014



**\$31.2bn**  
 Total capital targeted by residential funds in market as of March 31, 2019

**\$1.54bn**  
 Value of residential-focused funds in market in Q1 2019

**2**  
 Number of residential-focused funds in market in Q1 2019

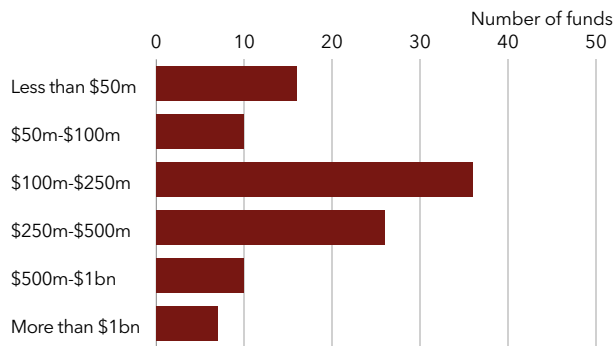
Value-add is the strategy of choice for six of the top 10 residential-focused funds in market, with five looking to place capital in North America

Fund name	Fund manager	Target size (\$bn)	Fund strategy	Regional focus
AIG US Real Estate Fund III	AIG Global Real Estate	2.00	Value-add	North America
Greystar Equity Partners X	Greystar Real Estate Partners	2.00	Value-add	North America
US Single Family Housing V	Man Global Private Markets	1.50	Core-plus	North America
Secure Income Property Unit Trust - SIPUT	Henley Investments	1.28	Value-add	Western Europe
ArthVeda Affordable Housing Fund	ArthVeda Fund Management	1.00	Opportunity	Asia-Pacific
Bridge Multifamily Fund IV	Bridge Investment Group	1.00	Value-add	North America
Edelweiss Residential Credit Fund	Edelweiss Group	1.00	Mezzanine/debt	Asia-Pacific
County Garden NPL Fund I	Country Garden	0.87	Mezzanine/debt	Asia-Pacific
Residential Land V	Residential Land	0.83	Value-add	Western Europe
Bridge Workforce & Affordable Housing Fund	Bridge Investment Group	0.75	Value-add	North America

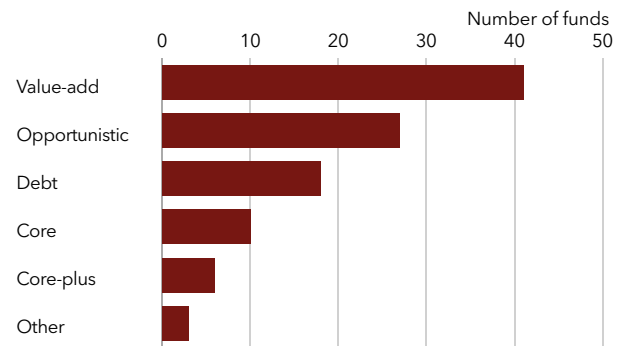
Source: PERE. Figures are correct as of March 31, 2019



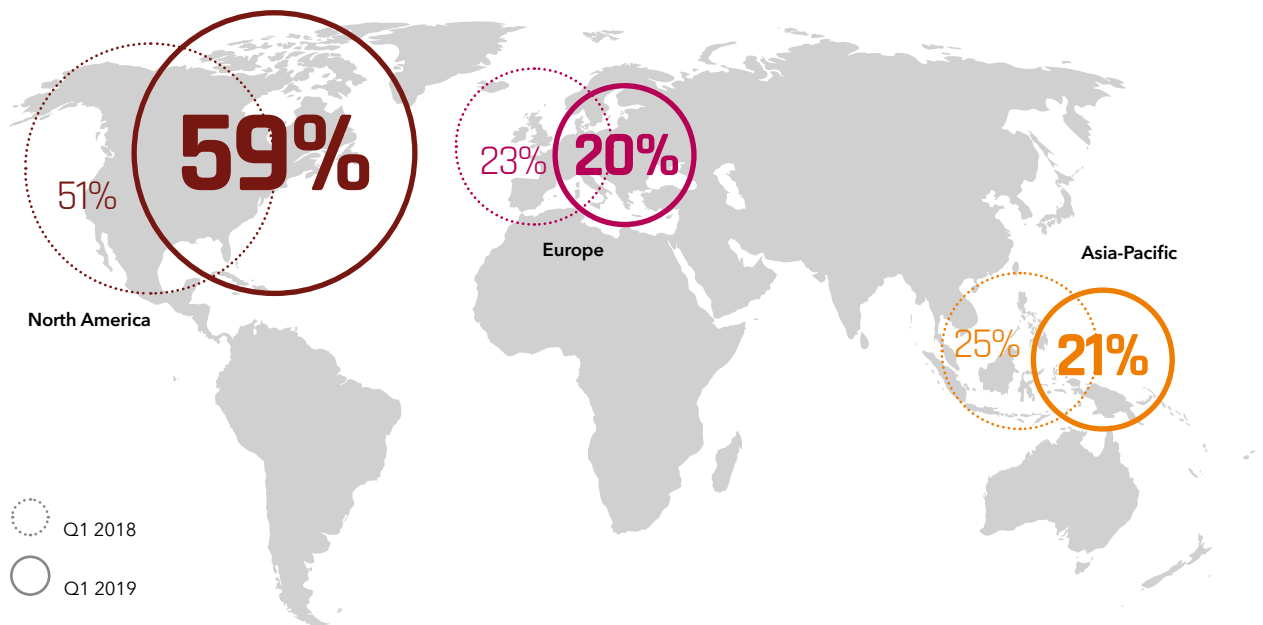
Funds in market are most likely to target a capital raise of between \$100m and \$500m



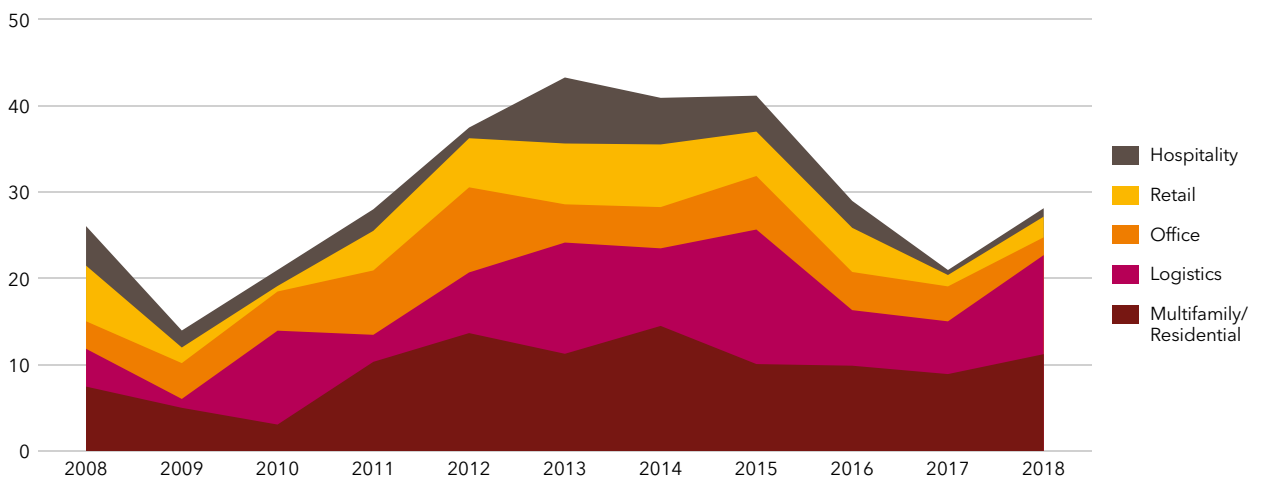
Funds in market show a preference for pursuing value-add



Residential funds in market show a greater propensity for North American capital in 2019 compared with 2018



Multifamily/residential was investors' second most popular capital destination in 2018 by capital raised, edged out by logistics (\$bn)



Source: PERE. Figures are correct as of March 31, 2019

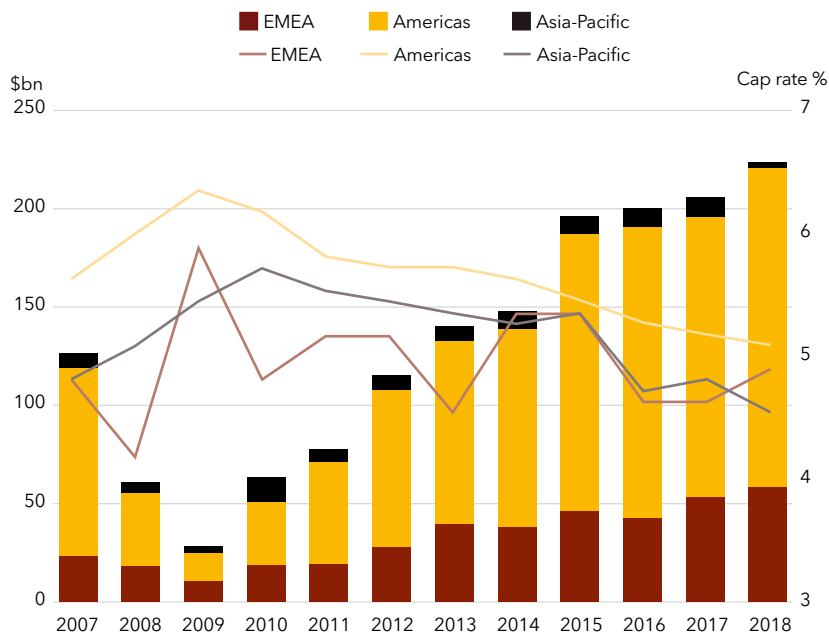
**W**hile activity in the Americas is a big part of this story, other regions are contributing to the growth of the rental apartment sector, writes *RCA's Jim Costello*.

In the EMEA region, for example, apartment deal activity came in at \$57.9 billion in 2018, which is 18 percent of deal volume across all property types there for the year. By contrast, in 2007, the sector represented only 5 percent of deal activity in the region. This means that apartment sector transactions in EMEA are now at the scale reached in the Americas back in 2007, when it had a 17 percent share stateside. The relative share of deal activity shows this sector is catching up with the experiences of investors in the Americas.

Of interest to investors globally is the lower volatility of the sector in the Americas. The RCA CPPI, a same-store measure of building prices, posted a shallower peak-to-trough movement for the apartment sector in the US in the aftermath of the global financial crisis. Additionally, price growth for the apartment sector in the US recovered more quickly than prices for other property types - up to 10 percent year-on-year growth by 2011 versus ongoing declines for many other property sectors. ■

## Deal data The Americas dominated multi-housing transactions in 2018, according to Real Capital Analytics

EMEA contributes to sector growth in 2018, but APAC sees activity slow down



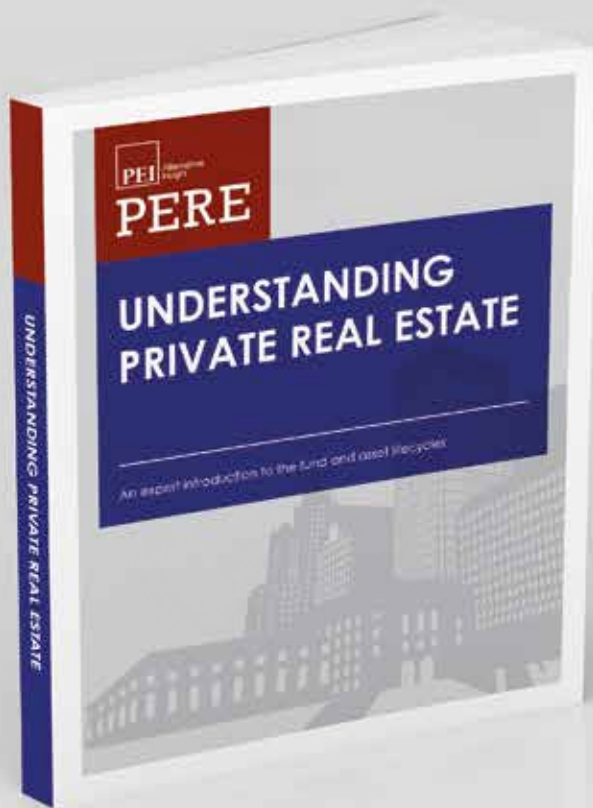
Data correct as of March 21, 2019  
Source: Real Capital Analytics

The US - and New York especially - accounted for nine of the top 10 global apartment transactions

Property name	Location	Number of units	Buyer	Seller	Price paid
Spring Creek Towers	Brooklyn, NY	5,581	Brooksville Company, Rockpoint Group	Disque Deane Estate, Donald Trump	\$905m
Park Towers	Queens, NY	1,327	Blackstone	Jack Parker Corp	\$475m
Archstone 101 West End	Manhattan, NY	506	Dermot Co, USAA Real Estate, PGGM	Equity Residential	\$416.1m
El Rancho Verde	San Jose, California	700	WNC & Associates Inc	Clark Realty Capital (CRC)	\$370m
The Vogue	Manhattan, NY	320	Vanbarton Group	Harry Karten	\$316m
ALTA LIC	Queens, NY	467	SBDG, Square Mile Capital	Quadrum Global	\$313.2m
Portal West	Ealing, London	578	Not provided	City & Docklands	\$303.8m
Riverside Center Tower	Manhattan, NY	616	PGGM	Carlyle Group, Greenfield Acq Partners	\$195m
One North Fourth Place	Brooklyn, NY, US	509	Douglaston Development, American International Group	Macfarlane Partners	\$167.6m
Waterside Plaza	Manhattan, NY, US	1,470	Brookfield Property Partners	Richard Ravitch, UBS Realty Advisors	\$162.5m

Source: Real Capital Analytics

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- AXA Real Estate
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