

KEYNOTE INTERVIEW

Making the case for Japan's multifamily market



*Residential real estate remains resilient despite the Bank of Japan's recent rate hikes, says PIMCO Prime Real Estate's **Scott Kim***

Favorable demographic trends, strong rental growth and affordability relative to other APAC markets continue to drive demand for Japanese multifamily, particularly for smaller rental units in major cities. Scott Kim, CEO, Asia-Pacific with PIMCO Prime Real Estate sees investors increasingly looking to the country's multifamily sector as a resilient asset class amid shifting macroeconomic conditions.

With the Bank of Japan gradually tightening policy, rental growth and net operating income in key cities are expected to outpace rising interest rates. The sector benefits from strong urban migration, changing demographics and a growing preference for renting over homeownership across

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the country. Smaller units in particular offer attractive entry points for investors due to high demand from young professionals and students.

As Japan's economic landscape evolves, multifamily properties remain a compelling opportunity for stable, long-term returns.

Q How does the Bank of Japan's rate hike in January 2025 affect the residential market, and what should investors know about the multifamily sector across

Japan in this context?

The Bank of Japan raised its policy rate by another 25 bps to 0.5 percent in January this year. For us at PIMCO, this suggested a cautious approach to policy normalization, given sustained evidence of wage-growth-driven inflation. Despite rises in both BOJ policy rates and Japanese government bond yields, investment sentiment towards the multifamily sector in Japan remains optimistic. Transactions in 2024 matched those of 2023 at around \$7.4 billion, and cap rates broadly remained intact, according to MSCI Real Capital Analytics data from February.

In a "higher for longer" inflationary environment, there is an opportunity for strong returns through a strategic

shift towards Japan's multifamily sector - particularly small and micro apartments. These apartments provide accommodations needed by graduates during their first three to five years of working in Japan's largest cities, which provides a constant flow of tenants for investors.

Q Does this macroeconomic impact require a shift in investment strategy toward areas like Japan's multifamily market, where rents and NOI are expected to rise faster than interest rates?

The anticipated rises in rents and net operating income are likely to help mitigate the adverse impact of rising interest rates and cap rate expansion.

At the same time, Japan's multifamily sector is expected to capitalize on economic growth, surging corporate profitability and labor shortages. In 2024, these factors led to high wage growth and rental growth, with Tokyo seeing a 6.5 percent increase, well outpacing the BOJ rate hikes, according to a Savills report on Japan.

Historically, Japanese multifamily properties have provided stable income returns, compelling yield spreads and attractive risk-adjusted returns. The secular demand drivers, including urban migration, shifting demographics, deteriorating homeownership affordability and high levels of rental penetration, should all contribute to a "rent for longer" environment, and are expected to sustain demand for multifamily dwellings.

Q Why should investors consider allocating to Japan's multifamily market, particularly smaller apartments?

Japan has a relatively high renter penetration ratio. Market data from Statista reveals that 39 percent of the Japanese population resides in multifamily rental housing. This is comparable to other markets like Switzerland and Germany.



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The six-story Season Flats multifamily tower was completed in 2022 within the Takadanobaba neighborhood in the Shinjuku City ward of Tokyo, Japan

Q What does the future hold for the Japan multifamily sector in terms of growth and development?

Japan has finally ended its decades-long deflationary macroenvironment - we have seen strong wage growth boost inflation. Thanks to this positive trend, we anticipate the residential sector will benefit from positive rental reversion over the coming years.

There are, of course, some headwinds to navigate. For instance, rising construction and land costs in Japan have made it more difficult for developers to start new projects.

In terms of capital markets, investors have become more cautious and selective following a series of BOJ rate hikes. However, it is important to note that cap rate expansion has not been observed yet. Looking ahead, should cap rates move out in the medium term, the quality of the building and its location will be key in mitigating any potential negative impact on asset values.

“Japan’s multifamily sector is expected to capitalize on economic growth”

Based on transaction volumes between 2015 and 2024, Japan's institutional-grade residential market is the most established and the largest in Asia, and the fourth largest in the world, following only the US, UK and Germany.

This high level of renting is likely to increase due to demographic shifts, such as delayed marriage and childbirth trends, as well as rising housing prices which make it difficult for potential home buyers to acquire one. Given delayed family formation in the country, single-person households have increased considerably as well.

Smaller units have lower entry costs, appealing to a broader tenant base such as students, young professionals and

new families. The shortage of new rental housing due to high construction and land costs has further driven rental growth, particularly for smaller units that are more affordable.

Q What does the data suggest, and what is the investment case from an investor's perspective?

Japan multifamily rents are much more affordable than other major APAC markets, with rent-to-income ratios at 15-20 percent, compared to 30-50 percent in other large Asia-Pacific cities like Beijing, Singapore and Sydney.

This affordability supports a mild rental upside trajectory in the medium to long term, based on the Urban Land Institute's Asia-Pacific Home Attainability Index, which was published in mid-2024.

Q What are the key macro and social drivers underpinning the development of the Japan multifamily sector?

The combination of urbanization, demographics and economic resilience is fostering an attractive investment case for Japan's multifamily sector across the "Big 4" cities, namely: Tokyo, Osaka, Nagoya and Fukuoka.

While Japan's overall population is aging and shrinking, these cities are expected to continue growing, primarily due to a young demographic aged 20-29 looking for better education and employment, as well as better health-care opportunities.

Q How do factors like younger professionals moving to key cities and trends such as urbanization support this investment case?

These cities have remained resilient, with average market rents continuing to grow and occupancy holding firm above 94 percent, according to Savills. This comes amid strong demand and positive net migration. In addition,

“With limited new supply and strong rental demand, particularly for smaller and micro apartments, we believe the multifamily sector is well positioned for sustained rental growth”

the rise of single-person households and a shrinking household size, fueled by evolving socio-economic norms, is increasing demand for smaller units in these growing cities.

Turning to key economic factors, price increases in the housing market are affecting potential home buyers, resulting in a shift to rental markets for cheaper housing alternatives. Japan's labor market also remains structurally undersupplied, leading to high wage growth. This strong wage growth is expected to translate into higher rental growth and improved rental affordability, making multifamily investments more attractive for investors.

Q With long-term challenges like ageing and shrinking demographics in Japan, how can investors effectively navigate these issues while investing in the multifamily sector?

There are several factors to consider. First, targeting smaller units can be advantageous due to the increasing number of single-person households and the overall decline in household size, which drives demand for affordable apartments. Second, adapting to changing consumer preferences is crucial; properties that offer short-term flexible living and user-friendly amenities like self-storage and Wi-Fi can attract a broader tenant base.

Connectivity is another significant driver of value, particularly in Japan, where households prefer living near city centers. Our strategy includes compact-type housing close to major stations, providing quick access to the Central Business District.

In addition, affordability is a vital consideration, as rising housing prices have made multifamily rental housing more appealing, potentially unlocking rental uplifts. Last, Japan's chronic undersupply of rental housing, especially in metropolitan areas, due to high construction and land costs, along with regulatory challenges, can lead to upward pressure on rents and occupancy rates, presenting a strategic investment opportunity.

Q How might trends and market conditions shape the sector's trajectory in the coming years?

Our view remains that the multifamily sector in Japan offers stable and resilient rental income. Historically, it has offered compelling risk-adjusted returns, outperforming most other asset classes. Favorable borrowing conditions have further enhanced the investment case for multifamily properties, allowing for better cash-on-cash returns compared to global peers.

With limited new supply and strong rental demand, particularly for smaller and micro apartments, we believe the multifamily sector is well positioned for sustained rental growth, making it an appealing option for investors looking for long-term returns. ■

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