Aligned interests: the case for long-term institutional investment in multifamily residential rental in South Africa

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DIVERCITY URBAN PROPERTY GROUP

SAMRRA South African Multifamily Residential Rental Association

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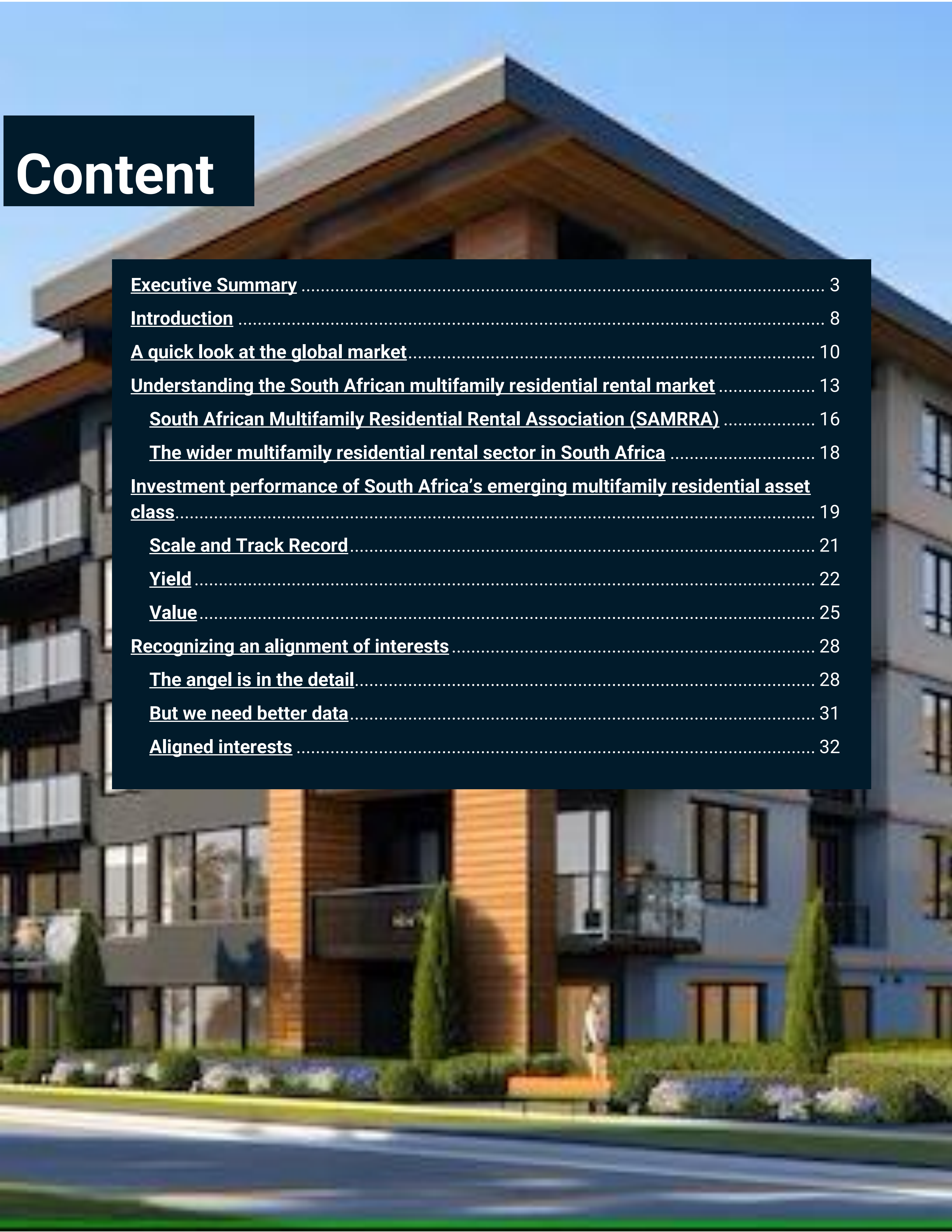
CAHF Centre for Affordable Housing Finance in Africa



Content

Executive Summary

South Africa's multifamily residential rental sector is an increasingly robust, demonstrably resilient, and qualitatively rewarding sector bringing positive, stable returns to investors and promising a pipeline of developments that surpass ESG expectations while delivering high quality accommodation to a market that is currently underserved. The offering has shifted in recent years from simple accommodation for rent to a full lifestyle concept known as 'convenience living' with access to a suite of additional amenities. The market has responded such that vacancies and arrears are moderate and manageable. At the local level, these developments are contributing to urban regeneration and a positive fiscal benefit to their local authorities, supporting good urban management and changing the face of South African cities.

According to StatsSA, 4.5 million households (23% of South Africa's population) rent the homes they live in. Of this population, 15% (about 685,000) households rent their home in a block of flats – an effective 3.5% of the total South African population.[1] This [flats / apartments] segment is used as a proxy for multifamily residential rental in this report (*note: flat living also includes student housing and housing for senior citizens, neither of which fall into the multifamily rental definition*). The figure for 2023 is up 9% on the 631,000 households who reported renting their flats in 2018, suggesting the delivery of 54,000 new rental units in blocks of flats, in the five-year period.

With thirteen members owning and operating over 75,000 units in South Africa, the South African Multifamily Residential Rental Association ('SAMRRA') represents an estimated 11% of the multifamily rental market, across close to 550 separate properties. Like their counterparts in the UK, multifamily residential rental or 'build-to-rent' developers are particular about the market they are developing – well-located, amenity-rich, solidly managed, good value for money. This housing type is unique in the wider private rental sector, and historically, has not been well-tracked by analysts.

There are at least five reasons for investors to diversify and grow their portfolios by investing in this asset class:

1. **Demand:** The units attract quality demand with low levels of default and low vacancies that are themselves easily filled with an established waiting list.
2. **Supply:** Multifamily residential developers and landlords are trailblazing a new form of rental that has been gaining popularity in the United States, Australia, Europe and the UK – leveraging off the latent value in South Africa's wider real estate market and the improved performance of residential over office and commercial property.

[1] Statistics South Africa (2023) Statistical Survey P0318, General Household Survey 2023. The total rental population of 4.5m households includes informal and formal structures in backyards, as well as formal rental accommodation of various kinds, including government-subsidized social housing. See https://www.statssa.gov.za/publications/P0318/P03182023.pdf. Accessed 25 July 2024.

3. **ESG:** Multifamily scores high across all ESG metrics both in terms of risk management and impact, offering investors comfort that they will be able to themselves fulfill their ESG goals.
4. **Experience:** With over 75,000 units currently under management among the SAMRRA membership, property management expertise is developing, leveraging the benefits of evolving technology, and maximizing on economies of scale.
5. **Quality, track record and pipeline:** MSCI reports that the multifamily residential rental sector consistently outperforms office and commercial real estate and is second only to industrial real estate primarily on a risk relative return basis. In 2022, residential property was the only sector to record improved NOI yield, raising its performance above retail and on par with the all-property figure. While cap rates are somewhat higher than for other asset classes, MSCI believes this suggests the need for a re-pricing, offering further opportunities for new investors. A pipeline of developments suggests that the sub-sector is only growing, honing its experience and building a new style of urban living across South Africa.

A significant barrier to investment in the multifamily residential rental sector, however, is the very limited availability of data on size, character and track record of performance, and segmented by quality, type, and target. Various data sources that do exist offer market data in the aggregate, but do not isolate the multifamily residential market specifically, and do not distinguish between sub-segments of the private rental sector overall. International experience has demonstrated real differences in performance between sub-markets that warrants a more detailed tracking and analysis. Investing in this as a collective, the multifamily sector in South Africa could substantiate the case for investment and attract needed capital into its plans for growth, which the demand-side of the market could readily absorb.

SAMRRA Members and examples of their portfolios

AFHCO / SA Corporate | https://afhco.co.za/ Affordable residential and commercial rental property company established in 1996, operating predominantly in the Johannesburg inner-city. Afhco's portfolio presently has approximately 16,000 residential apartments (split equally between inner city and suburban properties), 4,500 student beds and 90,000m^2 retail space, located throughout Gauteng. The Afhco Group was acquired by SA Corporate Real Estate Limited in July 2014, a REIT listed on the JSE. ***Stuttafords Building*** *Inner city conversion office to residential rental.* *Johannesburg CBD, Gauteng*	
Africrest | https://www.africrest.co.za/ Owns more than 4,200 apartments with a portfolio value of over R3billion – set to expand to over 7,000 apartments within the next 18 months. Africrest's residential estates appeals to a high LSM tenant. The company specializes in both greenfield developments as well as converting office buildings into residential apartments, with resort-style facilities and amenities. ***The Maverick*** *Conversion of office to residential rental* *Sandton, Johannesburg, Gauteng*	
Alleyroads | https://www.alleyroads.co.za/ Award winning residential real estate developer and landlord established in 2009, now with more than 4,000 units under rental and a further 1,153 units nearing completion in Gauteng and Western Cape. The portfolio has a disclosed asset value of R5billion. ***Eagle Heights*** *EDGE-certified greenfields new build, suburban* *Delmas, Mpumalanga*	
Octodec | https://www.octodec.co.za/ A listed REIT and one of the largest property owners in the Tshwane and Johannesburg areas. Owns a diversified portfolio which includes residential properties. Its residential portfolio consists of 65 properties and 9,241 residential apartments. City Property, a private company with over 50 years of expertise in the management of inner-city properties, performs the fund's property management function. ***Sharon's Place*** *Inner city mixed-use residential with retail* *Pretoria CBD, Gauteng*	

Communicare | https://communicare.co.za/ Social enterprise property company established in 1929 with market-related and social housing divisions. Portfolio now includes more than 3,000 units and a disclosed asset value of R2billion. Group includes Goodfind Properties, Mother City Housing Company, and Shared Future Rentals ***Bothasig Gardens Phase 3*** *Urban infill newbuild* *Cape Town, Western Cape*	
Cosmopolitan / Central Developments | https://www.centraldevelopments.co.za/ Specialises in developing affordable housing, apartment complexes, secure lifestyle estates, and retirement estates. Established in 1992, it has delivered more than 80,000 units to own or rent. ***East on 82*** *Urban infill newbuild* *Johannesburg, Gauteng*	
Divercity | https://www.divercity.co.za Property investor, developer and property manager established in 2017, specializing in well-located, amenity rich affordable rental. Portfolio comprises more than over 9,000 residential units and a disclosed asset value of R4.5billion. ***Jewel City*** *Inner city urban infill newbuild and conversion* *Johannesburg CBD, Gauteng*	
First Mile Properties | https://www.firstmileproperties.com/ Property developer, investor and asset management company established in 2004, specializing in creating affordable living spaces in mixed-use spaces. Portfolio comprises around 4,000 units. ***Greaterman****, 220 Commissioner Street* *Inner city refurbishment* *Johannesburg CBD, Gauteng*	

Houss Rentals/Century | https://houss.co.za/ Residential property manager established in 2019, specializing in rental lifestyle estates. Portfolio comprises over 9,000 units. ***The Parks*** *Greenfields new build estate living* *Lifestyle apartments at Riversands, Gauteng*	
IHS | https://www.ihsinvestments.co.za/ Affordable Housing fund, asset and property manager, established in 2005, with a focus on financing and delivering sustainable, climate-friendly and affordable homes. Portfolio comprises over 12,000 units and over R7billion in AUM. ***Erand Creek Ext 14*** *Greenfields newbuild, EDGE-certified* *Midrand, Gauteng*	
Live Easy | https://liveeasy.co.za/ Affordable housing developer, landlord and manager established in 2014, now with 19 buildings located in across Gauteng: Specialist in “nano units” with lifestyle amenities. ***Fourways Boulevard*** *Suburban conversion from office to residential* *Fourways, Gauteng*	
Transcend Residential Property Fund | https://transcendproperty.co.za/ A residential property fund established in 2016 and now wholly owned by Emira Property Fund. Portfolio comprises over 3,500 units, predominantly located in Gauteng. ***Birchwood Village*** *Suburban greenfields new build* *Chartwell, Gauteng*	
TwinCity | https://twincity.co.za/ Property Manager and Developer established in 1984. Portfolio comprises 1,606 units with another 700 under construction. ***Urban Quarter South, 304 units*** *Urban infill newbuild* *Hatfield, Gauteng*	

Introduction

The residential property market is a major contributor to the South African economy, playing a pivotal role in supporting economic growth and job creation, while also addressing the evolving housing needs of a growing and diversifying population. Over the past few decades, the sector has transformed significantly – new players are delivering new products with increasing effectiveness to new niche markets; technological developments coupled with experience have transformed the approach to and success of property management; and in the context of wider socio-economic shifts, rental has become a substantial and desirable tenure form. This is “commercial” real estate with a residential outcome: delivered by increasingly experienced landlords, the South African multifamily residential rental sector in particular is growing its track record and demonstrating stable and attractive yields, surpassing other real estate asset classes.

Some investors are still wary. The notion of residential comes with associations of unmanageable, non-commercial risks, inner city concentrations, low-income tenants with fickle tenancy that together combine to deliver low returns and low values, especially sensitive to wider macro-economic and city factors that ultimately affect the entire investment market. These concerns are often misguided, however, and not borne out by the data emerging from MSCI, which since 2018 has been tracking 338 residential properties comprising around 45,000 units and valued at R20.6billion, as part of the MSCI South Africa Annual Property Index.[2] They are also not replicated internationally, where residential property is a more mature, well-invested, major asset class, accounting for 21% of global investment property by value, equal in size to industrial property and delivering stable, attractive returns. The MSCI analysis found that “South African [multifamily] residential property had a significantly lower inter-asset volatility of net operating income per square meter compared to other main property sectors. The consistently lower inter-asset volatility for residential “build-to-rent” property implies more stable forecastable returns for international investors.”

Of course, the South African market is still small, and nowhere near, yet the size and significance of multifamily residential in other economies. It is not surprising, therefore, that misconceptions continue to exist. This is ultimately where the opportunity is – as this asset class grows and deepens its reach into the residential market in South Africa, it promises investors first mover advantage, providing the opportunity for early market share and the ability to set the standards for the asset class as it develops. Institutional investors coming in now can leverage this experience and the emerging track record, while also being part of something new with real growth potential.

This paper sets out the current status of the multifamily residential rental (or build-to-rent (‘BTR’)) asset class in South Africa, with a brief reference to the global market. Drawing on data from MSCI as well as from the landlords and asset owners themselves (including the newly formed South Africa Multifamily Residential Rental Association, or SAMRRA), as well as insights from several investors in the market, this paper provides an insight into the investment opportunity, and engages with some of the arguments maintained against it. In a market where investors are all sitting at the edges of their seats, calculating the relative merits and demerits of the range of investment targets within the context of the current political and socio-economic climate, the multifamily residential rental market

[2] These figures are as of December 2022. See MSCI (2024) Residential Property: Quantitative Analysis of an Emerging Asset Class. Analysis of residential property investment and fundamental performance in a Global and South African context. https://samrra.co.za/wp-content/uploads/2024/03/MSCI-Residential-Final-Print.pdf (Accessed 14 August 2024).

is showing confident growth and return prospects that make it a realistic target for investors seeking to grow and diversify their portfolios.

A quick look at the global market

MSCI tracks institutional property investments across 27 countries and publishes their analysis in the MSCI Global Annual Property Index. The index includes over 20 years of data, comprising at the end of 2022 just under 60,000 properties, valued at USD2.1trillion. By value, the United States accounted for 27% of the overall index, followed by France and the United Kingdom. While offices (at 35% of overall capital value) were the largest sector in the index at end 2022, residential comprised 21% of overall invested capital. This ranking of residential reflected tremendous growth in the twenty years previous: rising from only 11% of the index's total capital value in 2001. The United States market is the dominant player in the residential sector, accounting for 39% of capital value, followed by Switzerland and the Netherlands. By number of units, however, the distribution is more even, with European countries having more residential properties than the United States.

According to the MSCI research[3], residential real estate has been the second best performing real estate asset class globally after industrial and since the inception of the index in 2001. Notably, residential has shown more stable performance than industrial.[4] Within residential, MSCI finds a distinction between multifamily rental and single-family rental, with multifamily showing lower annualized total returns than single-family, but also a much lower standard deviation of total return, indicating that it is the more stable asset class. Taking this over 20 years, while single-family returns were found to be 120 basis points (bps) above multifamily, this was at two and a half times the risk. The relative risk, measured as the standard deviation of returns achieved between periods, remained constant between 2.3 to 2.8 times that for multifamily, no matter the term, meaning that **ultimately, multifamily residential has a much stronger risk / return profile than single-family.** Stripping out single-family from the broader residential dataset, MSCI found that this improved the residential sector's position relative to the other main property sectors even further.

This nuance has not been lost on American institutional investors. In 2022, the Pension Real Estate Association Intentions Survey in the US found that 31% of planned capital deployments were targeting multifamily, ahead of the 28% that were targeting industrial. S&P Global Market Intelligence reported a significant increase in pension funds' investments in US REITs specializing in multifamily, office and industrial properties. Between 2019 – 2022, residential investments increased by 47.2%, bringing investment in residential ahead of office and communications real estate and maintaining its position ahead of industrial[5].

[3] This report draws heavily on a report published by MSCI, commissioned by SAMRRA and sponsored by Divercity Urban Property Group and Absa. See MSCI (2024) Residential Property: Quantitative Analysis of an Emerging Asset Class: Analysis of residential property investment and fundamental performance in a Global and South African context. https://samrra.co.za/wp-content/uploads/2024/03/MSCI-Residential-Final-Print.pdf Accessed on 14 August 2024.

[4] The MSCI report notes that (page 9) "for the twenty years ended December 2022, industrial assets in the MSCI Global Annual Property Index had the highest annualized total return, bot also the highest standard deviation. This means that the performance of industrial assets was more volatile, but they also generated higher returns." Residential, on the other hand, had a lower annualized total return than industrial (still higher than all other asset classes - retail, hotel, office, other) but also a lower standard deviation (i.e. less volatility) than industrial, retail and hotel.

[5] Moffat, C and C Hudgins (2022) Pension funds boost investments in multifamily, industrial, office REITs. S&P Global Market Intelligence. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/pension-funds-boost-investments-in-multifamily-industrial-office-reits-70019051 Accessed 22 February 2024.

In the UK, the BTR market has been the subject of similarly enthusiastic interest, also with a focus on multifamily over single-family rental. In 2024, the market segment hit the 100,000-unit mark across 542 apartment schemes, with investors having invested GBP35billion over the course of eleven years. Savills reports that 50% of investment in BTR in 2023 was from new entrants to the market, up from 20% in 2018. As the market matures, a wider pool of global capital is being attracted into the asset class.[6] Multifamily rental comprises 89% of the pipeline of 112,500 additional BTR units expected, now in 200 local authorities across the country. Investors have been rewarded: in the context of a very real under-supply as they have been enjoying rapid rent increases with double-digit growth for almost two years to the end of 2023.[7] A significant part of this relates to the level of amenity that is particular to BTR, so much so that BTR schemes in the UK have achieved a rent return that is 24% higher than rental on a building originally planned for private sale and then rented[8].

In both cases, growth in the residential rental market has been supported by a growing demand for high-quality rental properties that are otherwise out of reach for first time potential home-buyers. With house prices and interest rates rising, and with tougher mortgage lending criteria, first time buyers struggle to secure the capital they need to buy a home. At the same time, changing work and lifestyle patterns have created a demand for multifamily living environments in a work-live-play arrangement. The profile of the rental tenant, therefore, is not only those who *cannot* access ownership housing, but increasingly, it is also those who *choose not* to own.

It is worth considering MSCI's observations over 20 years of data, during which time two economic shocks created challenging conditions for all investment sectors. The impact of both the Global Economic Crisis of 2008-2009 and the COVID-19 pandemic in 2020-2021 is visible in the MSCI Global Annual Property Index graphs. MSCI has found that globally, residential recovered on par with other property asset classes following the 2008-09 crisis second to retail and survived the 2020-21 crisis with far less loss. MSCI writes "the residential [multifamily] segment showed the value of the strong fundamentals underpinning demand and performance, as its stable income stream, essential housing need, diversification benefits and the support of government measures all contributed to the sector's ability to weather storms and emerge stronger."

The argument for institutional investment in residential rental in Europe and North America is clear and increasingly accepted. With demand for multifamily rental being driven by demographic shifts, demand for new kinds of convenience living, affordability constraints with respect to ownership, limitations on supply and improved property management capacities, investors have found that the asset class offers strong and stable yields as well as long-term appreciation. A trend in whole-community developments has meant that the rental offering extends beyond accommodation to include access to amenities that are attractive to younger, urban tenants, and new entrants to the labour and housing markets. As a result, occupancy rates are consistently high, and vacancies quickly managed. Investments are easily scalable, especially in the context of trusted developers, landlords and property managers. Professional property asset management reduces the burden of day-to-day

[6] De Winton, P, et al (2024) Investment in UK Operational BTR: The Next Phase of Evolution. Savills Research: https://www.savills.co.uk/research_articles/229130/363755-0 Accessed 10 August 2024.

[7] Daly, J et al (2023) Record growth in UK Build to Rent. The third quarter of 2023 witnessed a record 59,043 BtR homes under construction, while completed BtR homes surged by 11%. https://www.savills.co.uk/research_articles/229130/353636-0 Accessed 22 February 2024.

[8] De Winton, P, et al (2024) Investment in UK Operational BTR: The Next Phase of Evolution. Savills Research: https://www.savills.co.uk/research_articles/229130/363755-0 Accessed 10 August 2024.

responsibilities for investors, while the multifamily nature of the asset class also diversifies the risks and reduces the costs associated with residential rental. In these ways, the multifamily / BTR segment performs more like commercial property than what investors classically understand to be 'residential'. The key difference is in the shape and character of risk: in multifamily rental, household-level risks associated with traditional, private rental are aggregated within a solid property and asset management framework – there is one landlord. Turnover may be high, but it is rapid, and vacancies are kept low given the demand. With scale, assets can be valued on a portfolio basis. In addition, many BTR schemes in the UK have diversified their income beyond the rent-roll, and are moving towards more dynamic pricing models that respond to their tenants' needs.

It is this promise of growing demand, especially significant off a low supply base, that the emerging South African multifamily residential rental sector is anticipating. Indeed, as they build a track record that is now over a decade old with an underlying database of just over five years of data, there is increasing evidence that their expectations are realistic. Compared with international markets, MSCI finds that South Africa had the highest NOI yield[9] for residential – at 7.6% in December 2022, more than double the NOI for the next highest country, the United States, at 3.7%. Globally, NOI yields for residential range from 1.7% (Italy) through to 3.5% (Finland), 3.6% (United Kingdom) and 3.7% in the US. The South African numbers are therefore particularly interesting, although likely influenced (and obviously demanded) by the high inflation environment.

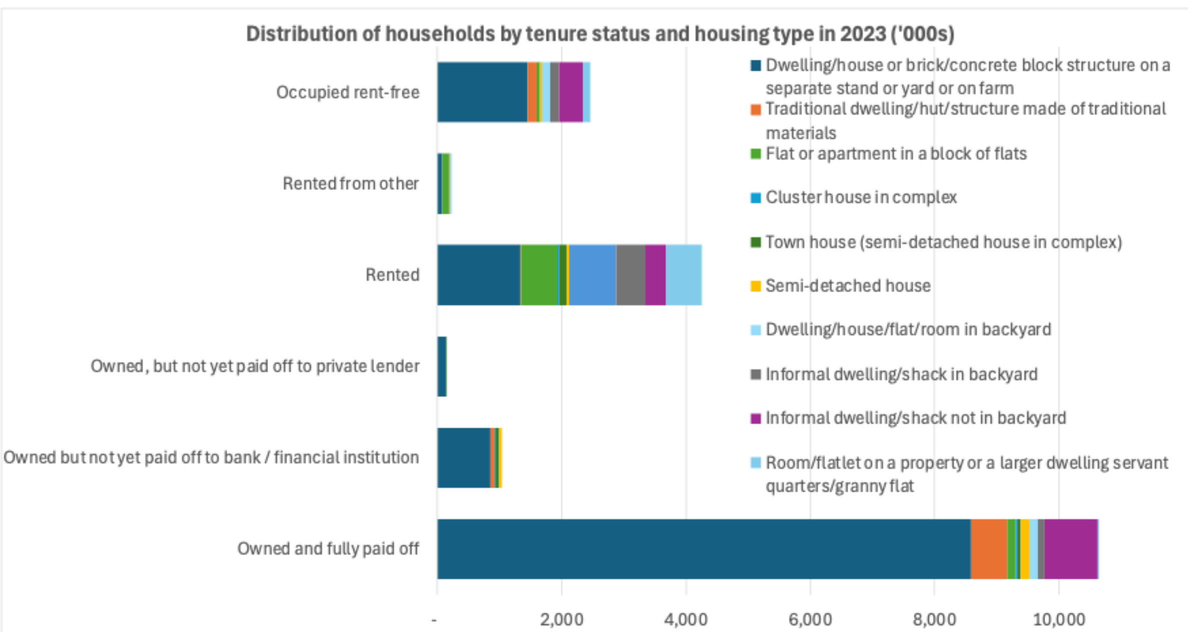
Analysts agree that South African property market performance typically lags the international market, and so they are anticipating similar growth and yields even in their hesitation. A key gap undermining their ability to act on this is a lack of data on the particular experiences and performance in the sector, and a lack of familiarity with the asset class.

[9] NOI yield is net operating income divided by the end capital value of the stock.

Understanding the South African multifamily residential rental market

The lack of data exists in part, because of limitations in our national data framework. Deeds registry data tells us that as of December 2023, there were 7.73 million registered properties in South Africa with a total value of R9.63trillion. Of the total number, 6.91 million were residential properties, and comprised a total value of R6.79trillion.[10] While deeds registry data classifies properties as freehold or sectional title, it is not possible to determine from a deeds record whether a property is available for rent, or if it comprises multifamily rental units.

Proxy information comes rather from the demand side. According to StatsSA, just over a fifth (23%) of the 19 million households that together comprise the South African population rent their homes (4.5 million households).[11] These households live in a diversity of unit types, from single-family dwellings through to flats or apartments, cluster houses, townhouses, and rooms (whether formal or informal and including so-called "granny"-flats) in backyards. The graph below shows the distribution of households by tenure status, segmented further by the type of housing they live in, in each of those tenures.



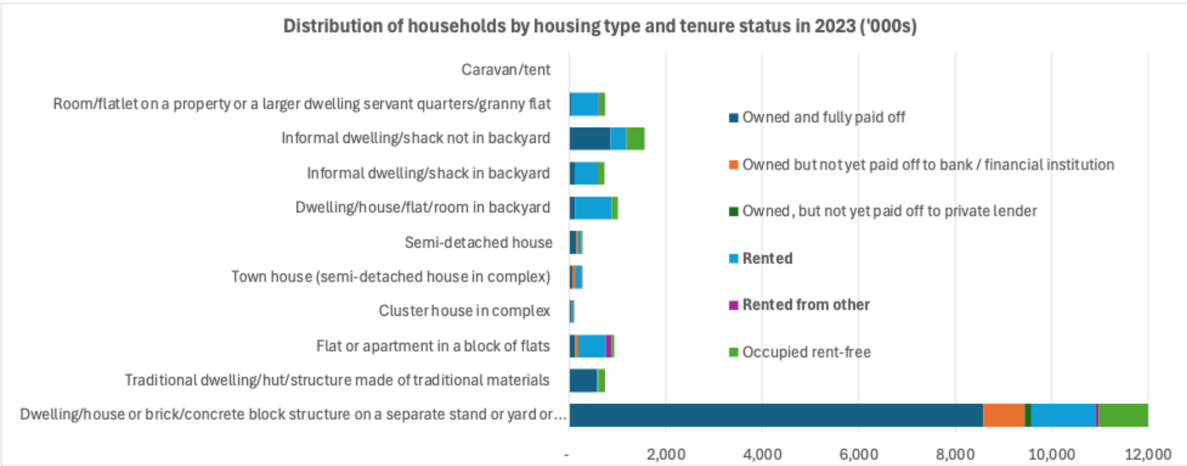
Source: Own analysis with data from Stats SA GHS 2023

Looking at the data from the other direction, first by housing type, and then segmenting by tenure, the most common form of home is a single-family dwelling – about 12.5 million households live in this, of which about 77% (9.56 million households) own and 11% rent. For flats and apartments, the ratio

[10] CAHF Citymark data obtained from Lightstone for the year ending 31 December 2023.

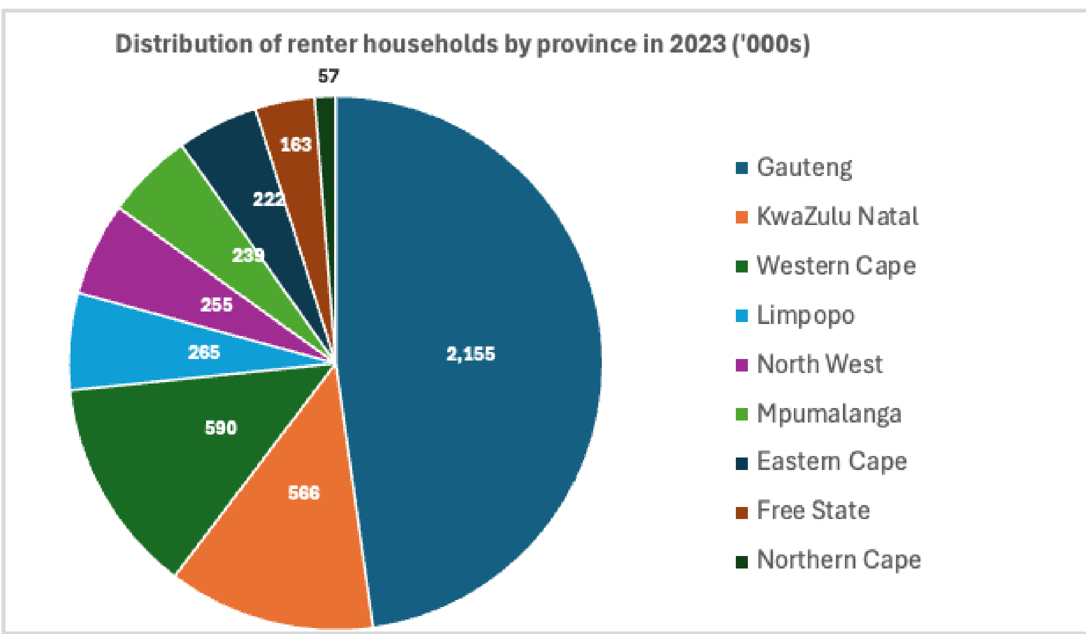
[11] Statistics South Africa (2023) Statistical Survey P0318, General Household Survey 2023. https://www.statssa.gov.za/publications/P0318/P03182023.pdf. Accessed 25 July 2024.

is reversed, with 20% owning and 73% renting (685,000 households, or 15% of the wider rental market of 4.5 million households). Rental is also significant in cluster houses in a complex, and in townhouses, with 37% and 46% respectively renting, comprising together about 166,000 households.



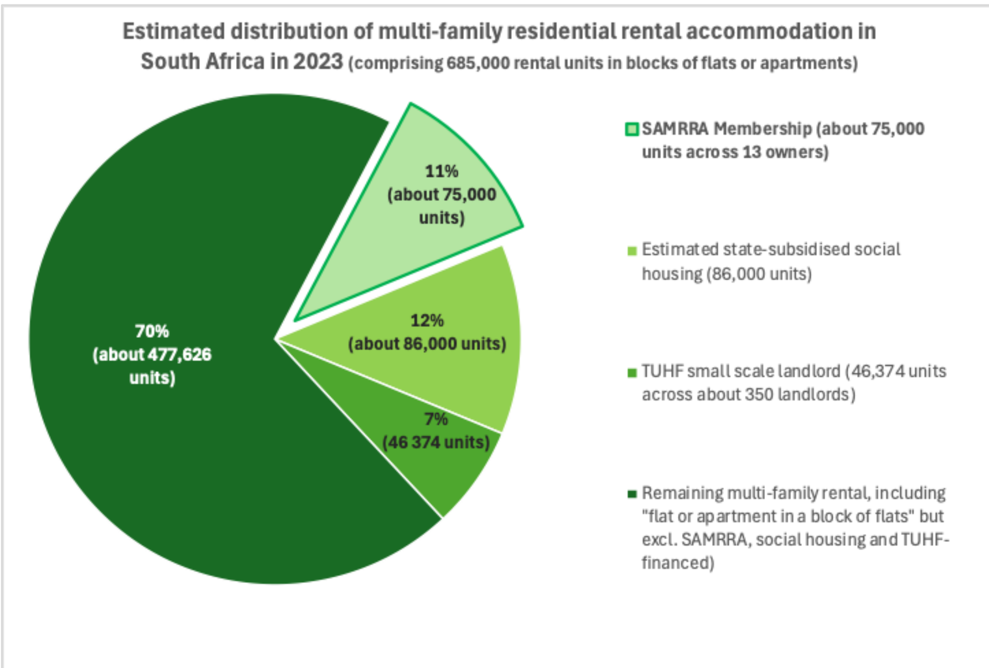
Source: Own analysis with data from Stats SA GHS 2023

Renter households are not evenly distributed across South Africa. Just under half of all rental households live in Gauteng, followed by 13% in KwaZulu Natal and another 13% in the Western Cape. Within Gauteng, over a third (37.3%) of households rent, while just under a third (27.6%) of households rent in the Western Cape.



Source: Own analysis with data from Stats SA GHS 2023 – note this data is based on survey responses from self-defined tenants and does not necessarily correlate with the number of units that exist.

Thinking just about the 685,000 households who say they rent their homes in a block of flats or apartments: this is likely to comprise South Africa's multifamily residential rental market segment, and it comprises about 15% of the total rental market in South Africa. Among this would be the units offered by SAMRRA membership and households living in the various rental buildings that are owned by small scale landlords (for example, TUHF reports that they've financed over 46,000 units across South Africa), and about 86,000[12] state-subsidized social housing units. The category of rental households living in a block of flats or apartments likely also includes populations that are not part of the SAMRRA definition of multifamily residential: the growing numbers of households renting student accommodation and housing for seniors.



Source: Own analysis with data from Stats SA GHS 2023, SAMRRA, SHRA, TUHF

Of course, what this doesn't show is the relative rate of growth of each sub-segment of the rental market, or the growth of the rental market overall in relation to ownership. Today, StatsSA suggests that 23% of the population rents. This is significantly lower than some countries – in Switzerland, 57% of the population rents. In Germany, just over half (52%) rent, and in Austria and South Korea, about 44% of the population rents. In Canada and the United States, just over a third of the population (33% and 36% respectively) rent. The ratio of renting to ownership in South Africa more closely matches Greece (24.9%), Slovenia (23.8%), and the Czech Republic (22%).[13]

[12] This number is an approximation. According to the Community Survey of 2016, there were 76,617 social housing units in South Africa. Added to this is the 9,764 units reported by the Social Housing Regulatory Authority in their 2023-24 Annual Performance Plan, as having been delivered between 2019 and 2023. We can reconsider the number with the release of the 2021 Census data,

[13] See Bogdan (2018) International Study: Renting Landscape in 30 Countries Around the World https://www.rentcafe.com/blog/rental-market/renting-landscape-30-countries-around-world/ and OECD (2022) HM1.3 Housing Tenures https://www.oecd.org/els/family/HM1-3-Housing-tenures.pdf.

Nevertheless, in South Africa, the newbuild of, and conversion of offices into, multifamily residential is a relatively new phenomenon. Aside from the development of high-rise residential rental buildings in the 1970's and 1980's along the Atlantic seaboard in Cape Town, the Durban coastline, and Hillbrow in Johannesburg, there was historically very little development of multifamily residential relative to the total stock of housing delivered. Then, in the 1990's and early 2000's much of what was multifamily rental was converted into Sectional Title, reducing the rental market even further. StatsSA data from 2018 and 2023 shows an increase of 54,000 households in the five years, reporting that they live in a rented flat or apartment in a block of flats – a growth of 9% in the period, significantly higher than single family rental which decreased in number.

South African Multifamily Residential Rental Association (SAMRRA)

The newly formed SAMRRA reports that its thirteen founding members together own and manage a total of over 75,000 units to a combined portfolio worth around R42billion. Expressed as a percentage of the StatsSA figure of households estimated in this analysis as multifamily rental (685,000 households), the founding SAMRRA membership holds around 11% of the total stock of possible multifamily residential rental. Those institutions reporting their data to MSCI (some of which are SAMRRA members) represent about 6.5% units rented by households living in a block of flats.

It is worth noting that StatsSA says nothing about the landlords associated with the various unit types. This is an important part of the SAMRRA definition[14]:

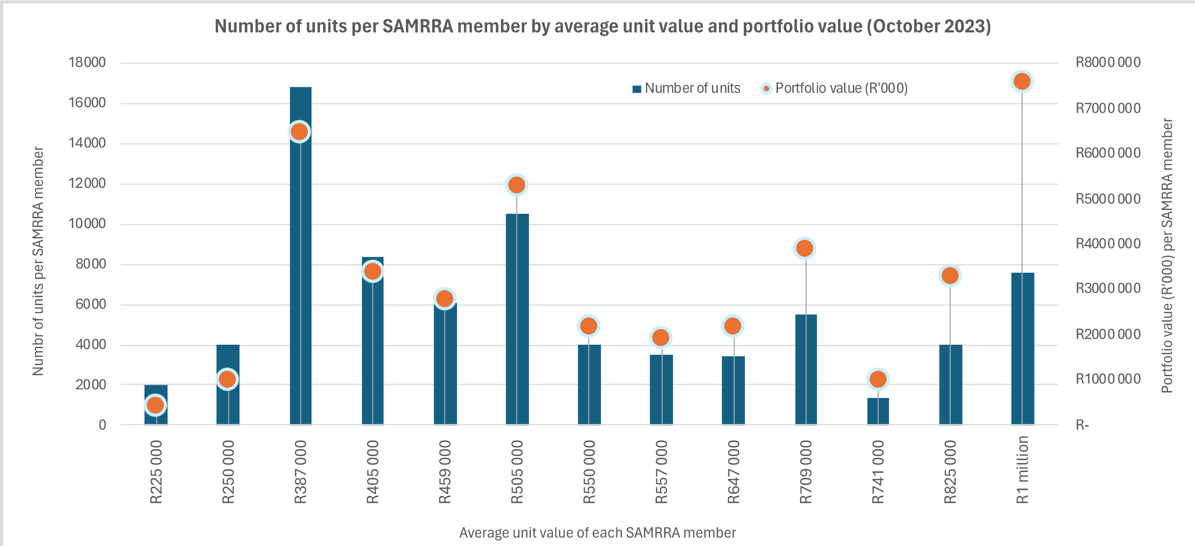
Multifamily Residential property represents privately owned residential stock, designed specifically for renting rather than for sale. Properties are typically owned by institutional investors and managed by specialist operators. This asset class is a property classification characterized by large-scale residential property rental supply, which provides consistent long-term income for investors.

Multifamily Residential assets commonly include apartment buildings: multiple separate housing units for residential inhabitants, contained within one or several buildings within a single complex/estate. Units can be next to each other (side-by-side units) or stacked on top of each other (top and bottom units).

SAMRRA's membership offers a diverse range of multifamily rental unit types, provided within a diverse range of living environments. Across the 13 members, the majority operate portfolios between 3,500 and about 10,000 units each with units valued between about R350,000 and R1million.[15] Unit values show different market targeting strategies: the member with the most units (over 16,000) has a total portfolio of R6billion with an average unit value of R375,000. By comparison, the member with the largest portfolio by value manages nearly half that number of units (9,000) at an average value of R1million.

[14] See SAMRRA's definition here: https://samrra.co.za/about-us/ Accessed 28 February 2024.

[15] A few members do have units valued at below this range - these would be rooms or very old (and impossible to replicate) small studios, probably accounting for a very small (less than 5%) of their portfolio.



Source: CAHFanalysis with data from SAMRRA members

The stock owned and managed by SAMRRA members is a mix of new-build (such as The Parks, offered by Houss / Century), office-to-residential conversions (such as Africrest's The Apollo), and residential refurbishments (such as First Mile Properties' Greatermans Building, or Afhco's Stuttaford's House, both in the Johannesburg CBD). Developments are increasingly mixed use – for example, Octodec's Sharon's Place in the Tshwane CBD, which includes 399 residential units together with ground floor retail. Some members specialize in lifestyle offerings, presenting affordable developments that emit a sense of luxury and opportunity. While some of the portfolio is found in the inner cities of South African metros, much is found in urban or suburban nodes (such as Sunninghill, in the north of Johannesburg and Halfway House (Midrand); or Kempton Park and Boksburg in Ekhuruleni), often in transport hubs (such as Ferndale in Randburg), or regenerating areas where lower property values and existing infrastructure offer an investment opportunity for significant growth. There are some places of surprise: the emphasis on high value, amenity-rich, well-located residential rental has seen impressive precinct developments like Divercity's Jewel City, come up in the Maboneng Precinct of Johannesburg's CBD – raising eyebrows in terms of the potential of investments coming off a low base.

SAMRRA members are equally diverse – the oldest, Communicare, was founded over a hundred years ago; a few have foreign development finance institutions among their shareholders, and most were initially capitalized in some way with their founders' own equity. Some members focus on more affordable rental (LiveEasy, Afhco, Communicare and others), while some focus on higher income or alternate rental markets (Central Developments, for example, which also specializes in retirement estates). SAMRRA members include institutional landlords, property managers, and investors. The requirement of members is that they "own significant multifamily residential portfolios of apartments, located in South Africa; be actively involved in the South African multifamily residential rental sector; are best in class operators and have a good industry standing". Partners and affiliates can include "non-member organizations which promote asset class impact and network reach".[16]

[16] See https://samrra.co.za/partnerships/

The wider multifamily residential rental sector in South Africa

Beyond SAMRRA, there are other industry bodies with overlapping membership, but where the central organizing principle is not strictly multifamily or rental. JPOMA is the Johannesburg Property Owners and Managers Association. Established in 2003, JPOMA represents inner-city property investors and managing agents in Johannesburg, "who are active in the rejuvenation of the inner-city through building upgrades, conversions and effective urban and building management." JPOMA members have "a combined property portfolio of over R18billion and provide over 70,000 affordable housing units accommodating around of 350,000 tenants and 600,000m^2 of retail, commercial and light industrial space"[17].

The National Association of Managing Agents is an industry body representing the interests of managing agents and community scheme management in South Africa. They have more than 500 members that operate across the country. They engage with the National Property Practitioners Council, the Property Sector Charter Council, the Property Practitioners Regulatory Authority, and the Community Schemes Ombud Service.

Among the managing agents engaged in the multifamily residential rental sector, are older players such as Trafalgar Property Management, established in 1971 with 85,000 units under management. Zulberg Estates is even older, established in 1683 with 340 properties under management. More recent operators such as Live the City, iThemba and IHS Property Management have carved specific niches for themselves, focusing on the affordable, entry-level rental market. They have been part of the technological wave that professionalized South Africa's residential property sector with tenant specific biometrics, fingerprint or eye-retina building access, individual water metering, the provision of lifestyle amenities, and so on.

While some multifamily residential rental operators have attracted foreign investment capital (for example, British International Investments (BII), the International Finance Corporation (IFC), and Proparco have all made investments), the domestic investor market is growing, with funds and REITs enabling the flow of capital into the asset class. Dipula Income Fund, for example, is a JSE-listed REIT with a diverse real estate portfolio that includes 716 residential units spread across four properties, all in Gauteng. As of 31 August 2023, these were worth R409million. Emira Property Fund (incorporating Transcend Residential Property Fund) has exposure to a residential portfolio of over 3,500 units, worth an estimated R2billion. Amongst others, Futuregrowth, Fairvest Property Holdings, Growthpoint, Hosken Consolidated Investments (HCI), Octodec Investments, Redefine, SA Corporate and Vantage Capital are all involved in the residential rental sector in one way or another.

Pension funds like the Public Investment Corporation (PIC) and Eskom Pension and Provident Fund (EPPF) are increasingly investing in the space and providing important long-term capital. Their interest is responsive to the demand for this housing, but also to the growing track record of management that is being demonstrated.

[17] See https://www.jpoma.co.za/about/

Investment performance of South Africa's emerging multifamily residential asset class

MSCI has been tracking the performance of multifamily residential rental in South Africa for five years since 2018, as part of the MSCI South Africa Annual Property Index. As of December 2022, it was tracking 338 properties valued at R20.6billion and comprising about 45,000 units. Owned by eight funds, the 338 properties vary widely in value – at the 5th and 95th percentiles, capital values ranged from R3.9million to R213million per property.

Looking at the past five years of data, MSCI shows that the total return on residential property in the SA index (annualized since 2017) was 6.1%, just under the 6.7% all property average. While the dominant performer was industrial, at 9.1%, residential was ahead of the 5% growth that was achieved in the office sector – albeit at significantly lower overall risk, as measured in standard deviation of returns. The residential return of 6.1% was only 70bps below the global average, even though it showed negative capital growth.

Perhaps more interesting is performance around the risk event of the global pandemic. The MSCI data shows that in South Africa, the residential portfolio fell by less than retail during the pandemic and bounced back more quickly than office. According to the MSCI South Africa Bi-Annual Property Index to June 2023, "net operating income in the residential sector grew by 19% year on year, putting the sector's NOI just 5% below" pre-COVID levels, while "the office sector's NOI was still 17.8% below pre-COVID levels".

That this was possible over the COVID-19 period is of interest and suggests perhaps something particular about the multifamily rental asset class itself. MSCI notes that "multifamily residential is set apart by the fact that its income stream is more diversified, and its tenants typically offer differentiation across lease terms, income levels and employment sectors. This diversification helps to reduce the risk of income loss if one tenant or group of tenants moves out or defaults on their lease."

This performance is also despite a strong proportion of rental units in the index being located in the inner city and targeted at households in the low-middle income range. MSCI reports that as at the end of 2022, just under half (44%) of the residential assets by capital value in their index, were in the CBDs of the major metros. The remainder were primarily in suburban areas in the metros, while about 4% were outside the metros. Over the five years to December 2022, suburban assets performed better than inner cities – 6.3% versus 5.4%.

The rents charged by landlords providing data to MSCI range from about R2,200 per month to R11,500 per month. As set out below, half of the units tracked by MSCI rent for less than R5,600 per month.

MSCI Residential owners: gross rental range per unit by NOI quartile[18]:

NOI Quartile	NOI m^2	Gross Rental Range per unit #
Top quartile	94	R8,800-R11,500
Second quartile	64	R6,200-R7,600
Third Quartile	44	R4,300-R5,600
Bottom quartile	23	R2,200-R3,432
Total	**60**	

In terms of the global numbers, stable and consistent performance and the special nature of the residential asset class is well known and reflected in confident cap rates that are lower than those for other real estate assets. Not so in South Africa, where valuers express hesitation in the underlying value of property overall, and in residential in particular, with much higher cap rates. SAPOA's recent Valuations Report, with results to the end of June 2023, shows a median cap rate for all property of 9.5%. The cap rate is slightly higher for residential with a 9.6% weighted average (ranging from 9.5% at the 25th percentile to 10.3% at the 75th percentile). Meanwhile residential hardly features in the SAPOA outlook for future rental growth – with no shifts expected in either the discount rate or expected rental growth. It is ahead of office and industrial, and close to retail, but behind neighbourhood, small and regional shopping centers, with no commentary at all.

MSCI suggests that the surprisingly high cap rates and lackluster investment interest might be because of a mispricing – noting that the discount may be due to how young the multifamily or BTR market is compared to "more mature and better-understood" property sectors in South Africa. Still, in 2022, residential property was the only sector to record improved NOI yield, raising its performance above retail and on par with the all property figure.

A particularly interesting observation is in the spread of the cap rate over the net operating income yield per sector. These two numbers can be different for a given asset because, while they both measure the relationship of net operating income to capital value, the cap rate also includes adjustments based on valuer expectations regarding income and costs, while it also normalizes for vacancy. MSCI finds that across the rental, office and industrial sectors, the average spread of the cap rate over NOI yield was between 40-50bps, in the five-year period to December 2022. In that same period, the average spread for residential was three times that figure at 160bps, trending upwards since 2018 to a spread of 200bps at the end of 2022. MSCI suggests that "this implies that valuers are still attaching a larger risk to the sector's medium term cashflow, relative to the other sectors."

Why?

Analysts and investors aren't shy about their hesitation, and unfortunately, MSCI data aside, there is very little information to help them change their minds. In discussions with several asset managers

[18] See page 25 of MSCI (2024) Residential Property: Quantitative Analysis of an Emerging Asset Class. Analysis of residential property investment and fundamental performance in a Global and South African context. https://samrra.co.za/wp-content/uploads/2024/03/MSCI-Residential-Final-Print.pdf (Accessed 14 August 2024).

and investment analysts in South Africa over the course of 2024, three main issues were raised as to why the multifamily residential rental sector is less favoured than the more familiar property sectors: perceptions of scale & track record, yield, and value. These arguments are summarized and countered in the tables below, together with suggestions for how they might be overcome.

Scale and Track Record

Investors look for scale to diversify and strengthen their investments so that they can weather market shocks or niche market fluctuations. To make such large investments, investors need evidence of the opportunity. Institutional investors seek investment opportunities that have already proven their potential with verifiable metrics.

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
Investors say….	***Experience in South Africa demonstrates rather…***
There is insufficient scale to attract large-scale capital • Too few landlords, and limited track records mean that this sub-market is negligible in the scope of SA's investable property market. Even landlords with sizeable portfolios offer relatively small investment opportunities by comparison. A number of analysts said the players in the residential rental sector needed to consolidate, to create a single, investable opportunity. • In terms of the MSCI data, investors noted that residential property is only 1-2% of the MSCI sample and has only been collected for five years. While the data is interesting, it is not necessarily representative of the entire asset class.	• The multifamily residential rental sector is growing, and the industry is already consolidating, creating quality investment opportunities with the stock, tenant base and management capacity to prove it. Across the SAMRRA membership, thirteen property owners / operators hold 75,000 units with a combined value of R41.6billion. • Although this is still a fraction of the overall rental market, it is estimated at 11% of the estimated current multifamily residential sector which is growing fast. Within the scope of the affordable housing market, it is a critical and still under-supplied market segment. • There is more in the pipeline – with numerous large-scale developments currently underway – SAMRRA aims to hit the 100,000-unit mark with its members by 2026-27. Investors coming in now have the opportunity of riding this wave as the sector grows from strength to strength.
International evidence is not relevant • Investors argue that South Africa's residential property market is different than the residential property markets in other countries. They argued, for example, that rental stock in Germany and the US is of a much higher quality than in South Africa, and so therefore not comparable. • On the demand side, it is understood that in some countries, rental tenure is not only	• We've seen that the performance of SA markets tracks the performance of international markets – and this is supported by the MSCI data. Multifamily rental is newly established in the United States, Australia, and the UK and has shown a shift in market preferences for amenity-rich urban living so that demand is responsive to supply. This shift is also evident in South Africa, as evidenced in the demand and tenant profiles of SAMRRA members who are attracted to the locational and neighbourhood advantages of multifamily rental.

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
acceptable but also desirable. Some analysts argue that in South Africa, this is not the case. • The regulatory framework in other countries is also considered to be more stable than in South Africa, given their longer history with the tenure form. There is anxiety that the South African regulatory framework for rental is not reliable from an investment perspective.	• South Africa has a strong Rental Act that does not allow rent control. Operators of multifamily residential rental have developed a long track record in navigating the legislation while managing the risk of non-payment of rent.
Property markets are themselves not stable investments • Some analysts have argued that local listed property has been more volatile than other asset classes – over ten or 20 years, volatility in the listed property sector has been higher than in other asset classes.	• Globally, and locally, the multifamily residential market is the least volatile of all the property sectors. Current levels of demand, and the very important shift in consumer interest with a focus on well-located, amenity-rich, lock-up-and-go living environments create an opportunity that, coupled with a deficit in stock, bodes very well for property.

The data available in South Africa's residential market does not offer the detail necessary for investors to comfortably define their risk. In other economies, globally, multifamily rental properties are classified according to their condition, quality, amenities, and rent levels, with Class A, B, and C representing increasing tiers of luxury and affordability. An industry body such as SAMRRA should introduce market classifications aligned with these international data tracking efforts, according to building or property quality, available amenities and rent levels. Further metrics could include data on occupancy rates, average rent growth, lease terms, typical rental terms, performance in times of risk and bounce-back potential, portfolio efficiency, etc. This will create a level of market confidence as the data is increasingly trusted as reflective of the actual opportunity.

While investors were encouraged with the potential of MSCI's residential portfolio, they were also aware that it represents a fraction of the industry. SAMRRA members should be encouraged to all report data to MSCI so that richer analyses can be undertaken over time.

Yield

Yield refers specifically to the rental yield, which represents the annual rental income received from a property divided by the property's value. Yield provides insight into the immediate return on investment from renting out a property.

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
Investors say….	***Experience in South Africa demonstrates rather…***
The residential rental market is not a commercial opportunity	• The multifamily rental sector behaves like commercial property, albeit for residential rental use. Owned by professional landlords with strong and tight management

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
• Many investors argued that the rental market is really only targeted at the affordable market, and suggested that by definition, this was a riskier market. One investor suggested that under normal circumstances, this should be a market that the government serves because the risk is not commercially manageable.	capacity, multifamily rental units perform from an investment perspective as a diversified portfolio. The breadth of tenants creates a stability across the portfolio such that the perceived volatility of individual tenant decisions is smoothed. • The Tenant Profile Network's ('TPN') Residential Rental Report for Q2 in 2024 highlights improved rental payments, up significantly from the pandemic, notwithstanding the difficult economic environment. The number of tenants in good standing improved between Q1 and Q2 with the national average being 83%. The R7,000-R12,000 rental band is the best performer with 88.58% of tenants in good standing. The highest rental value band (rentals above R25,000) performed below the national average, with 82.29% of tenants in good standing.[19]
The cost base of managing residential properties is higher than the cost of managing commercial properties • Investors argued that while increased management costs can be easily passed on to commercial tenants, residential tenants have affordability thresholds that make this difficult. • One investor was worried that the quality of tenants is not assured, and that affordability constraints mean that densities are difficult to control as tenants overcrowd to pay the rent. • This creates further pressures on property management that cannot be funded from the tenant base.	• Within the multifamily rental sector, landlords and property agents have been consolidating to realize economies of scale in management. Developments in technology have further enhanced management capacity and reduced the overall cost per user. • IHS Property Management reports [20] that excluding provision for vacancy and bad debt, the cost to income ratio for rental in 2023 was 27.02% with 26.7% projected for 2024. Vacancies (lease-up excluded) were at 4% for 2023 and projected at 3.5% for 2024.
Costs have been rising faster than rent, putting pressure on yield • Statutory costs such as rates and taxes, infrastructure costs such as water and electricity, overall management costs such as maintenance and security, and	• This is supported by the data in terms of the past few years since 2021, but it is an issue that has been experienced across all property sub-sectors. PayProp reports that towards the end of 2023, the numbers for residential have come closer together, with year-on-year inflation sitting at 5.1% at the end of 2022 while the YoY weighted average national rental growth rate was 4.9%.[21]

[19] TPN (2024) Q2 of 2024 Residential Rental Report Monitor Report. See https://mrisoftware.tpn.co.za/wp-content/uploads/2024/10/TPN-Residential-Rental-Monitor-Report-2024-Q2.pdf Accessed 9 November 2024.

[20] Email correspondence from Bernard De Jongh, Senior Asset Manager, International Housing Solutions, on 28 February 2024.

[21] PayProp Rental Index, Q4 2023

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
the cost of additional facilities are greater than what tenants can afford to pay. • One investor said they hadn't seen an increase in residential rentals in the past five years. Another said that while rents had gone up 4.5%, his costs had gone up 26% since COVID. This was squeezing landlord margins in a way that wouldn't happen in a higher income market.	• JPOMA usefully reports that its biggest trading partner is the City of Johannesburg, noting that 40% of its members' operational costs are paid to the City. This data is critical for negotiating with the city to deliver services for this income received. • Meanwhile, MSCI data shows that residential property was the only sector to record improved NOI yield in 2022. MSCI argues that this "highlights how South African residential fundamentals and performance reacted faster than other property sectors, similar to the trend observed across other global markets".
Landlords suffer a low "security of lease" - tenants can easily leave for a cheaper product • The one investor who raised this said that while vacancies had been fairly low and coming down since COVID, the only data available in this regard was TPN, which segmented only by rental and province, but not by other factors. • Another investor suggested that in the context of rising rentals, tenants were co-habitating to afford their rent. This practice was increasing densities beyond what the unit was designed for, putting pressure on management and decreasing margins. By comparison, commercial rental tenants happily sign multi-year leases on which landlords and their investors can rely.	• Vacancy rates that are available suggest that this is much less of an issue than investors might think. As noted, vacancies for SAMRRA members have been consistently below 5%, with very short turnovers between leases. MSCI makes the point that tenants in multifamily residential rentals differ across lease terms, income levels and employment sectors, which helps to reduce the risk of income loss if one tenant or group of tenants moves out or defaults. • In its Vacancy Report for Q2 of 2024, TPN reports that residential vacancies are at their lowest level since 2016, at 5.57% in the first half of 2024, significantly down from the double digits during the COVID pandemic.[22] An uptick in Q2 of 2024 was expected given the expiration of short term leases after the festive season, but vacancies in student housing were also evident. Vacancies in the R4,500-R7,000 and R7,000-R12,000 rental bands were lower than the national average. TPN reports that in the R7,000-R12,000 band, demand is still strong and there is less supply available compared to previous years.
The legislative framework over-protects the tenant: Consumer Protection Act, Rental Housing Act, PIE Act • Investors highlighted the difficulty with evicting in the event of default and that the legislative framework is biased against the landlord. This creates risk for yield, with no security in income. By contrast, in retail property, national	• Two factors help mitigate the risk of not being able to evict: first, institutional landlords have become excellent property managers, with regular and insistent reminders for payment, implemented together with sanctions limiting access. Reliable and transparent billing also assists in getting tenants to prioritize their rental payment. Second, the demand for quality rental is so high, tenants in good properties are loathe to put their tenure at risk by not paying. In terms of well-managed rental, the landlord is in the stronger position.

[22] TPN Vacancy Survey, Q2 2024. https://mrisoftware.tpn.co.za/wp-content/uploads/2024/09/TPN-Residential-Vacancy-Survey-Report-Q2-2024_Final.pdf Accessed on 9 November 2024.

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
chains are seen as more stable and reliable tenants.	
Residential in South Africa that is yielding sufficiently is associated with inner city CBD – and this neighbourhood comes with too many other risk associations • Investors argued that the residential rental sector has a high-risk profile, based on experiences from the early 2000's. At that time, CBD assets yielded the highest values, but the risk of these investments was such that investors were shy. • At the same time, investors argued for the notion of "quality of yield" – a yield of 7% in an area like Rosebank in Johannesburg is better than a yield of 7% in the CBD.	• Multifamily residential rental doesn't only happen in the CBD. Increasingly there are investments in suburban markets that are showing real potential: in Johannesburg, Linden, Randburg, Glenwood, and Morningside all offer opportunities. SAMRRA's members have flagship assets in desirable areas such as Sandton, Sunninghill and Halfway House (Midrand). • MSCI data shows that NOI yield is actually higher in the suburbs than in the CBD, delivering a 6.3% return over the five years to December 2022 versus 5.4% for the CBD. With more than half of units in the suburbs, this strength can be realized by investors. • It is also worth noting that well managed stock in the CBD has also been performing. TUHF has two securitizations worth R2.3billion which went through the pandemic without triggering any covenant or priority of payments clause. TUHF's new securitization, Urban Ubomi 2, launched in September 2023, attracted two new investors.

There is clearly insufficient data on yield, and none of the available data distinguish between landlord and rental type. TPN's Residential Rental Report does not yet distinguish between single and multifamily rental, or between SAMRRA members and the rest of the market. In contrast, the UK market which is only a few years ahead of the SA market and comparable in terms of scale, is able to produce detailed analyses that get into the character and other influencing factors that impact on yield, so that investors can make more targeted investment choices when considering real estate. This is an important gap that SAMRRA could fill on behalf of its members drawing on their data. Together with the data that MSCI is now collecting and sharing, it would be a useful contribution to overall sector development and to investor understanding of the asset class.

Value

Value in real estate, pertains to what a buyer would agree to pay for a property. It is shaped by factors such as location, improvements, economic conditions, and underpinned by management. An assessment of value considers the potential for capital growth or capital appreciation; as well as the income profile the property generates.

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
Investors say….	***Experience in South Africa demonstrates rather…***

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
Asset quality is poor in the multifamily residential rental sector • Investors expressed concern that building quality is poor, and that they suspected that some buildings were falling apart. Investors are wary that their investment will have to carry the maintenance and refurbishment requirement, undermining the potential for yield.	• There is a significant difference in the quality of assets available for investment. Investors need to (and can) choose well. The asset class is not just old stock and building refurbishments – a significant proportion involves new-build and conversions that are well-located and outside the inner city i.e. suburban based. Upmarket options are creating R/m^2 returns that are high as landlords seek tenants who can absorb higher margins in exchange for good value. UK analysts argue, however, that vacant possession valuation is increasingly irrelevant as multifamily residential rental schemes respond to market demand and diversify their income streams beyond the rent roll. In these instances, value is seen as a secondary reference point rather than a primary commercial metric.
Asset values are undermined by area-based risks, especially in the inner city • Building quality and sustainability is substantially affected by poor infrastructure provision and maintenance, and the increased pressures that come with densities in the inner city. Poor and failing municipal service delivery makes landlords particularly vulnerable, especially as property rates rise, challenging tenant affordability.	• While the MSCI data agrees that suburban rental performs better than inner city rental, the difference is slight and not yet sufficiently tracked to be a reliable indicator. Still, area-based risks affect all real estate, not just rental, and neighbourhood matters. • It is also worth noting that the inner city is a multi-sector economy with highly diversified sources of income, so the reliability of cashflows is very stable. High rates of urbanisation indicate a growth potential, and the better location in inner cities improves affordability by decreasing the cost of transport. Cities can be confident that inner city rental makes much better (and therefore more sustainable) use of existing infrastructure.
The wide gap between listing prices and Net Asset Value (NAV) demonstrates the risk inherent in the asset class and offers investors reason to look elsewhere. • Analysts cite the delisting of IndluPlace and Transcend. The offer price for IndluPlace was R3.4 per share – this was 47% below the net asset value. For Transcend, with a NAV of R8.23, per share the offer price was at R6.3. Delisting was therefore at a discount of 24% of its NAV.	• Independent property analyst Keillen Ndlovu explains that at that time, that the market believed that cap rates should be 75bps to 100bps higher and that valuations were 10%-15% overstated. As a result, the market applied a big discount to NAV to manage the perceived risk around liquidity, size, income and quality and location of assets. Part of this big discount related to the size and liquidity of these stocks and therefore the residential sector was seen as insignificant. Lack of industry data, performance, history and trends also aided to the pricing gap. • However, there was an improvement in market conditions in 2024, and therefore, the delistings, although they benefited Emira and SA Corporate (who clearly spotted an opportunity), happened too early and the sector lost specialist residential funds. The

Challenge: what investors and analysts argue against the asset class	Counter: evidence from South Africa's multifamily residential property market
	other option could have been to merge these funds and, therefore, address the size and liquidity concerns that fund managers/institutional investors had and still have. The launch of SAMRRA and MSCI reporting on the residential market is a positive response going forward.
The listed sector is much easier to access and offers better liquidity than the unlisted sector • Residential property faces same headwinds and economic factors as listed properties, and total returns are similar. • Given this, some investors argue that it is easier and safer to invest in the asset class through listed assets where there may be greater diversification and certainly more information on the quality of the investment.	• In December 2023, the listed property sector was trading at 36% below net asset value. By end December 2024, share prices had rallied such that it was trading at about 18% below net asset value. Meanwhile, market awareness and data on the residential property (unlisted) sector have improved, and greater market activity is expected to further improve the relationship of listed prices to NAV. • In terms of market performance, as information and experience improve, the difference between listed and unlisted residential property is however, less relevant. Further, the portfolio approach adopted by the main providers of multi-family residential rental offers the diversification otherwise sought in funds.

Institutional landlords make the point that building management models address asset risk – but this needs to be better confirmed and demonstrated. At the same time, there is a need for increased transparency over property valuations. This point is echoed in the UK where Savills argues that Vacant Possessions Value is increasingly irrelevant to the BTR model. However, the ability to shift from this metric depends on the availability of other information: transaction values and the ancillary income realized by multifamily residential rental operators that does not depend on the rent roll. [23]

As demonstrated internationally, the stability and certainty associated with the listed property market is achievable by unlisted portfolios, through better reporting with established, standardized metrics on which landlords report regularly over time. This is something that the new association, SAMRRA, can facilitate. It is also a function of scale which allows for better risk diversification. SAMRRA is offering the market an important opportunity to aggregate the asset class in such a way that investors can see the wider portfolio of opportunities. As the South African sector grows, contained by evolving experience that encourages good practice, the economies of scale that can be achieved on property management create a real opportunity for multifamily residential rental to become a significant asset class, much like it is in other geographies.

[23] The Savills report provides an excellent example of the type of reporting that SAMRRA could champion in South Africa. See https://pdf.euro.savills.co.uk/uk/residential---other/savills-spotlight-investment-in-uk-operational-btr.pdf Accessed 16 November 2024.

Recognizing an alignment of interests

Ultimately, the first indicator that analysts look at is the spread between the cap rate and NOI yield in residential rental. At 200bps, three times the spread of the other property asset classes, investors are more than wary. But in truth, such a spread is also not particularly unique – this has been the case in every other property sector at one time or another. MSCI reports that in the late 1990’s the retail sector had a similar spread of about 200bps, largely because of the combination of high interest rates and poor business and consumer confidence. In the early 2000’s, the office sector also experienced a wide spread – 300bps as the shift to work-from-home and other factors undermined confidence in the office sector. It was in part because of this, that office to residential conversions were possible, after which the office sector rebalanced. The spread in the industrial sector hit 150bps in 2007/8 after which shifts in the structure of that sector stimulated investor interest such that the sector’s income risk was re-priced. By the end of 2022, industrial property had the tightest spread among the main property sectors. Looking at how the residential spread has been trending, MSCI suggests that a similar re-pricing is due.[24]

Of course, with only five years of data and a view of only about 3.3% of the formal (excluding backyard) rental market (or 6.5% of the multifamily residential rental sector), the MSCI data may well seem too high-level to support an argument for large scale institutional investment. On the other hand, some might understand that we are sitting at the beginning of a run, and that early investors stand to make good returns on the strength of their insights.

When this happens, the wider community of institutional investors will see the asset class for what it really is – an investment opportunity that is set for growth and well aligned with their long-term interests for stability and yield.

The angel is in the detail

Five key factors, evident in the existing multifamily rental sector in South Africa point to this:

1. High levels of demand, and niche-market specialty

Vacancy rates are low across all of the SAMRRA members, while turnover is well managed. TPN has been showing a general decline in vacancies since before the pandemic, particularly in the R4,500-R12,000 rental range – and this is largely due to there still being insufficient supply. Focused on convenience living, multifamily and BTR developments are very quickly attracting tenants who are experienced renters – young, urban professionals who move to these developments to benefit from increased amenity. This is likely to increase, as South Africa moves towards 71% of its population being urbanized by 2030 and as its young population finds its way out of student housing and into the workforce.

[24] Drawing on BTR performance data from the past ten years, analysts in the UK have also suggested the need for an evolving valuation methodology. Specifically, they argue that vacant possessions valuations are increasingly less relevant where rents are rising faster than residential sales value, as has been the case for the past three years. See De Winton, P, et al (2024) Investment in UK Operational BTR: The Next Phase of Evolution. Savills Research: https://www.savills.co.uk/research_articles/229130/363755-0 Accessed 10 August 2024.

2. Innovative delivery models and product offerings

Multifamily investors and operators are each building their market share with innovations that are identifiable to their brand.

Africrest is known for office conversions. Co-founder, Justin Blend describes the strategy of finding under-performing office and commercial real estate and converting this into the much better performing multifamily / BTR residential sector that attracts young professionals with a full suite of lifestyle amenities – from laundry and gym facilities through to a local cinema, convenience store and braai area.[25] When the Apollo was converted from the offices of a large accounting firm into residential accommodation in Sunninghill, Johannesburg, it was the largest office to residential conversion ever undertaken in South Africa. Its origins as an office park created the opportunity for a residential estate that is consistently let. Similarly, LiveEasy has also undertaken office to residential conversions, focusing on the opportunity of delivering so-called "nano units", 15m^2 units with their own kitchenette and bathroom, targeted at lower income earners while providing a full lifestyle offering in well-located areas, close to transportation nodes and business hubs. The Batho Pele development in Pretoria offers a gym, work-spaces, a laundromat, salon, braai facilities and a convenience store.

Other SAMRRA members focus on the delivery of new build, but on brownfield sites, maximizing the locational advantage of existing infrastructure, while creating affordable rental opportunities that fundamentally change the character and local property economy in profound ways. The Barlow Park development (Divercity) in Sandton turns investor expectations on their head by providing affordable, entry-level rental for new professionals working in that upmarket area.

Communicare, similarly, is focused on the delivery of high quality, affordable rental accommodation in good locations – their Woodstock development is also turning the energy in that neighbourhood around in favour of strong property performance and better governance.

Houss and IHS both develop new-build in urban infill areas: in choice locations and focused on creating a lifestyle estate with a clubhouse and social calendar as well as all of the other amenities, exclusively for rent.

Across all of the SAMRRA members, in different ways, there is an element of experimentation leading to innovation that is fundamentally changing the face of South Africa's rental market.

3. ESG on all fronts

The realization of Environmental, Social, Governance (ESG) metrics for investments is increasingly standard, with investors singling out strong ESG performing investments for their attention. Ultimately a risk management framework, ESG is also used as a framework for impact investing. An investment in multifamily residential rental performs well on all three fronts, delivering a truly sustainable asset class:

- **Environmental:** aside from explicit attention to green building construction and the efficient use of water & electricity services prioritized by good property management, multifamily units are generally also well-located as they respond to local labour market dynamics, while the inclusion

[25] Naidoo, S (2023) The Property Pod: Office-to-residential conversions on the up. See https://www.moneyweb.co.za/investing/property/office-to-residential-conversions-on-the-up/ Accessed 15 July 2024.

of amenities in the overall development limits the need for transportation even further. As a result, the overall carbon footprint and impact on the environment by both the building and its tenants is minimized. A study undertaken by the Green Building Council of South Africa, Divercity, and Arup quantifies the impact of the better locations and localized amenities that multifamily schemes have and argues that it is only through this housing form that climate targets in South Africa can be met.[26] Research undertaken by BuildChange has also found that building conversions, retrofits and upgrades are more carbon efficient than even just green building, with dramatic savings in embodied carbon.[27] Increasingly, multifamily residential rental developments are EDGE certified – for example Alleyroads, a specialist developer and landlord focusing on affordable residential rental stock, has more than 4,000 units across South Africa that are certified as EDGE compliant. This has opened up access to green finance – Alleyroads is among other multifamily residential rental operators who have secured IFC finance on the back of their alignment with EDGE requirements. Another worthy mention includes IHS, who certified around 6,500 units since launch of EDGE in South Africa in 2014/15 and have been catalytic to the delivery of green housing on the continent.

- **Social:** Multifamily in South Africa is meeting a very real and currently under-served need, that is, affordable housing for the entry-level working-class market. Across the various multifamily residential rental estates, the emphasis on extended amenities and security provide an added benefit, especially important for young professionals and single people. Beyond their immediate residents, some multifamily developments have an impact on social metrics in the wider neighbourhood: Jewel City, for example, attracted a Shoprite to the Maboneng precinct area, the first national chain grocery store in that part of the Johannesburg CBD.
- **Governance:** Multifamily developments operate at the micro local level, managing their own tenant populations to ensure payment for rates and services charges, and adherence to the local rules of the development and by extension, local bylaws. This is fundamental to the management strategy which needs to be able to cope with significant residential densities. In the context of municipal capacity constraints, the additional capacity offered by such targeted property management is valuable and contributes towards overall governance of the local area. The affordable housing outcome has a positive micro-economic impact in the neighbourhood and a positive fiscal impact for the city. Within the development, multifamily operators are themselves held accountable by their institutional investors who hold high standards for transparent and sustainable operations – especially critical if they are going to attract further investment.

4. Solid and experienced portfolio risk management, based on a growing track record of operation

As reported by MSCI, the multifamily residential rental operations it tracks are solid businesses performing ahead of office and commercial real estate despite higher levels of risk. This is a demonstration of solid management which itself has improved as the market has developed. While some multifamily operators run their entire operation in-house, owning, developing, letting and managing their developments themselves, others such as IHS have developed separate businesses

[26] Green Building Council South Africa, Divercity, Arup (2021) Does location matter? A quantitative study on impact of housing development location on carbon emissions in Johannesburg, South Africa.

[27] BuildChange (2023) Saving Embodied Carbon Through Strengthening Existing Housing. https://embodiedcarbon.climateresilienthousing.org

to focus on the particulars of management. As digital solutions become more integrated into property management, they are enhancing efficiency and tenant engagement.

5. Size, scale, liquidity and stability – and due for a repricing

Multifamily residential rental, owned and operated by investors, developers and landlords who build explicitly to rent, leveraging local real estate dynamics and riding property investment cycles, is the perfect opportunity for dynamic investment focused on growth. South Africa's multifamily sector is new and learning fast from its own experience and international precedent. Comparable in size with the UK market's BTR sector, it has been developing the systems, processes, and product offerings to respond to a new, young urban population that is changing the face of South African cities. With over 75,000 units under management across 542 developments, SAMRRA's membership is significant. Within its membership are companies with established track records – Central Developments Property group has, for example, delivered more than 80,000 units since it was established in 2002 and is achieving an average delivery rate of 3,500-plus units per annum. The collective pipeline across SAMRRA membership therefore offers even further opportunity as the market comes to expect this type of offering.

The MSCI data demonstrates strong, stable performance that has weathered the global pandemic and other economic challenges well, bouncing back faster than other asset classes. Relatively high tenant turnover is mediated by the diversity of tenants and high demand for this particular type of accommodation which keeps vacancy rates low. The high cap rates suggest, however, that investors don't recognize this performance as relevant to their assessments. MSCI has pointed out that similar rates and spreads existed in other real estate categories, highlighting a misunderstanding or inexperience with valuing the investment potential. Industrial property, however, has the tightest spread between the cap rate and NOI yield as investors understand the asset class and what drives performance. In the residential sector, valuers are still attaching a larger risk to medium term cashflow, relative to the other sectors.

Given this, and the growing track record that is developing, MSCI suggests that a repricing similar to what has been seen in the other real estate sectors, is due for residential. When this happens, investors who have already put their skin in the game stand to benefit substantially.

<u>But we need better data</u>

Possibly the most significant constraint undermining increased institutional investment into the multifamily residential rental sector is that there is so little data – so investors don't know that the opportunity exists. The MSCI data, offering a five year track record, is very good and useful too when compared against international experience – but investors are skeptical given how small its sample is, representing at most half of the multifamily residential rental sector, and only about 6.5% of units included in blocks of flats. Plus, the data lacks texture – who are these multifamily residential operators? What does the housing they deliver look like and who does it serve? SAMRRA offers an important opportunity to broaden understanding of the asset class by collecting data from and sharing the track records and experience of its membership. Incorporating among its membership an estimated 11% of all units in blocks of flats, it represents a sizable sample that should be tracked.

Not all multifamily residential rental developments, landlords, investors, and managers are the same, however – and the differences between them, and the specialties understood about each – must also be tracked if investors are to understand the investment opportunity.

There is an important opportunity to segment residential rental market in South Africa as it is segmented in analyses in other countries:

- By single-family vs. multifamily
- By inner city vs. suburban
- By metro vs. non-metro
- By development approach: new build, conversion, refurbishment, etc.
- By management approach, and so on

To this end, SAMRRA could develop a classification mechanism to distinguish between landlord and building types on the basis of various factors: location; building quality; management quality, tenant profile, etc. Data on payment trends, incidence, time and cost of eviction and so could then be collected on the basis of that classification. As noted by UK analysts, the BTR market is special because it is explicitly built to rent, and not simply converted to rental following a failed sales process. This has resulted in the development of better targeted offerings, putting BTR rentals in the UK 24% higher than units built for sale and then rented. Tracking the particular character of the multifamily residential BTR market would be a critical contribution that SAMRRA could make to the industry.

A further area relates to cost data – disclosing this on a per unit basis would be useful for benchmarking and would help investors familiarize themselves with the asset class. Data on costs should also be segmented in terms of statutory, infrastructure, overall management, facilities, and the impact on yields, as this would assist SAMRRA in lobbying efforts against municipal cost increases.

Investors would find case studies of management arrangements useful, so they could understand in detail how the management of multifamily rental by institutional landlords is different from single family rental, or commercial rental. The portfolio management approach is a key factor in mitigating risk of vacancies – this is already borne out by the data but must be better communicated.

Aligned interests

South Africa's multifamily residential rental sector is poised to grow into the potential demonstrated by the asset class in other markets. For this, it needs institutional investment to support the scale that institutional investors seek – it is their capital that will build their own success. Off a low base, the opportunity for scale is significant. For its part, the multifamily rental sector needs to develop robust and transparent performance tracking mechanisms and metrics, the results of which it must share and communicate publicly. And then of course there's the enabling environment – most critically at municipal level to enable good building management and cost control, support rezoning applications in favour of residential, and reduce the area-based risk that plagues so many buildings in the current environment.

Whether any of these enabling conditions are realized, however, is perhaps less relevant to the investment opportunity than the drive of the multifamily developers and landlords themselves: the multifamily / BTR approach is to control the entire environment, from development, to letting, to property management, to the sustainability of the entire area's ecosystem. These institutional landlords are making better housing in better cities. It is here where the interests align: BTR developers and landlords of multifamily residential rentals are in this market for the long haul. They are personally committed with their own equity and while they manage their own developments they are also working collectively to manage and improve the wider ecosystem in which they operate. They take the long view, just like institutional investors. By working together, they stand to change the face of South African cities while realizing their own corporate goals for growth, return and impact.

REPORT AUTHOR: CAHF

The Centre for Affordable Housing Finance in Africa (CAHF) has been operating as an independent think tank in South Africa since May 2014, pursuing its mission of making Africa's housing finance markets work. CAHF's work extends across the continent, and it is supported by and collaborates with a range of funders and partners.

COMMISSIONED BY: SAMRRA

SAMRRA institutionalizes South African Multifamily Rentals, prioritizing inclusive opportunities, consistent returns, and stakeholder satisfaction. SAMRRA's members include institutional landlords who own and manage large-scale, Multifamily Residential estates as well as entities which have interests in the industry or are sufficiently aligned with the interests of our members.

SPONSOR: DIVERCITY

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