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Policy-Driven Investments in a Downturn: The Role and Potential of ARH REITs in China's Housing Market Transition

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Abstract. As China's real estate sector contends with a significant downturn, Affordable Rental Housing (ARH) REITs are gaining prominence as a pivotal financial innovation. These instruments are designed to channel private capital into addressing the critical shortage of affordable housing, offering a new funding model to the traditional market. Pilot programs such as the China Merchants Fund Shekou Rental Housing REIT serves as clear example to demonstrate the sector's expansion potential through successful new listings and follow-on offerings. Based on the analysis of secondary market indices, the project has truly shown notable financial resilience, which maintains a stable occupancy despite broader operational headwinds. However, for ARH REITs to evolve from a short-term crisis mitigation tool into a sustainable long-term solution for the housing market, they must successfully navigate the persistent challenges of widespread market oversupply and tepid consumer demand. Their ability to scale is greatly hinged on overcoming these systemic market weaknesses.

Keywords: affordable rental housing (ARH), real estate investment trusts (REITs), real estate, investment analysis, policy-driven investment

1. Introduction

As China's real estate market transitions from rapid expansion to structural optimization [1], affordable rental housing has emerged as a critical solution for addressing the housing needs of new urban residents and young professionals. According to Cushman & Wakefield's Greater China Outlook 2025, there is a particular growing investor interest in affordable long-term rental housing across mainland China for 2025 [1]. This trend is fueled by policy measures introduced in 2024 aimed at stabilizing the property market and stimulating domestic demand [1], which are the direct results of a robust middle-class expansion along with urbanization. Furthermore, since 2021, the pilot scope of China's infrastructure REITs has gradually expanded to include the affordable rental housing sector [2]. This expansion provides new financing and exits channels for both local governments and private entities [2].

However, this optimistic portrayal may downplay ongoing difficulties. Research suggests the sector remains in a downturn trend rather than a seamless optimization, with nationwide primary

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property sales projected to fall 8% in 2025 amid persistent polarization and chilling effects on developers [3]. Additionally, while Affordable Rental Housing (ARH) REITs provide stable cash flows, they face challenges from broader economic headwinds, including declining rents due to oversupply and weak consumer confidence, potentially undermining long-term affordability and investor returns [4].

This essay explores the intricate connections between China's persistent real estate downturn and the evolving role of affordable rental housing as a policy response, and the impacts of financial innovations like ARH REITs poses on housing affordability and investor dynamics. The essay will first examine the cash flow stability in the ARH REITs market, and then it will analyze the expansion potential of pilot programs and eventually use one pilot program of Shenzhen's China Merchants Fund Shekou Rental Housing REIT as a case study to explore practical limitations and future implications, linking its performance directly to broader themes of stability and growth.

2. Background on China's real estate sector and ARH REITs

China's real estate sector was once a major driver of economic growth. However, since around 2020 it has faced a sustained crisis. Key features of this crisis include falling investment, oversupply, and deflationary pressures. According to statistics, China's domestic property sales dropped significantly to 8 trillion yuan in 2025, about half of the 2021 peak, with the situation being more severe in smaller cities due to high housing inventory [5]. This decline in property values has reduced household wealth by an amount close to china's one year GDP and has led to weaker consumer spending remaining at approximately 38% of GDP [6]. Some comparisons are made to Japan's real estate collapse in the 1990s, but China's situation may be more serious because its housing bubble was larger, and households may rely more on property in terms of their personal wealth when housing typically makes up about 70% of household assets across the nation [6].

In response, the central government has promoted the Affordable Rental Housing (ARH) program as a key solution under the 14th Five-Year Plan (2021-2025). The plan aims to provide 8.7 million subsidized rental units to low-to-middle-income groups and new urban residents with stable employment. By mid-2025, about two-thirds of these units were completed, with significant allocations in major cities [4]. In cities like Beijing and Shanghai, institutionally managed rental projects maintained high occupancy rates of approximately 90% as of February 2025, reflecting strong demand from young professionals and new urban migrants [7]. However, high rental costs remain a critical concern. In Shanghai, rents consume up to 36% of tenants' incomes, raising concerns about long-term affordability amid potential economic fluctuations. Additionally, local governments' conversion of unsold properties into ARH units assists developer liquidity but risks prioritizing market stabilization over equitable access for vulnerable populations.

Investors have shown considerable interest in ARH, viewing it as a stable asset class comparable to new infrastructure sectors like data centers due to its strong government support and policy advocacy [1]. Nevertheless, the market faces short-term challenges, including pricing pressure and higher vacancy rates that affect returns. The market recovery is also uneven, mainly happening in the largest cities. Notably, foreign investment declined by 27.1% in 2024 amid high financing costs, whereas domestic state-owned enterprises expanded their dominance, holding 162,000 units in 2025, a 27% year-on-year increase [4]. Meanwhile, long-term housing demand drivers are weakening. Although urbanization exceeded 66% and may reach 75-80% by 2035, its pace has slowed due to population aging and low fertility rates [8]. Compounding this, per capita housing space of 43 square meters indicates market saturation, leading analysts to warn of persistent sales slumps [9]. Consequently, 2025 forecasts project a 5-8% property sales decline and 3.8% price drop,

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albeit less severe than initial estimates [10, 11].Since 2021, REITs expansion into ARH has created critical financing channels, with the market value surpassing 200 billion yuan by June 2025 through 44 IPOs and three follow-ons [12]. Specifically, five pilot ARH REITs listed by 2024 (including China Merchants Fund Shekou Rental Housing REIT) raised approximately 8 billion RMB, primarily in high-cost cities, including a June 2025 follow-on offering projecting 4.11% annualized returns [12]. Researchers describe this policy as a "spatial fix." The idea is to redirect excess capital from the struggling homeownership market into rental housing. This approach combines social goals for housing with market-based profit motives [13].

3. Case study: China Merchants Fund Shekou Rental Housing REIT (fund ID:180502)

As one of the first nationwide ARH REITs with a high level of market-oriented operations, listed on October 23, 2024, The China Merchants Fund Shekou Rental Housing REIT serves as a compelling case study, illustrating both the cash flow stability and expansion potential of ARH REIT pilots while revealing their limitations in China's challenging market. The fund issued 5 billion shares at 2.727 yuan each, raising 13.635 billion yuan, which is an 11% premium over its planned 12.48-billion-yuan target and underlying asset assessment of 12.46 billion yuan, reflecting a strong investor interest [14]. By December 6, 2024, the closing price had risen to 3.087 yuan per share, a 13.20% increase from issuance, though this appreciation diluted projected 2025 distribution rates from 4.42% (based on planned funds) to 4% (actual issuance) and 3.58-3.64% (at market price), it still reflects the strong market confidence and growth expectations for this emerging asset class [14].

3.1. Overview and asset characteristics

The REIT's underlying assets are the Taiziwan Talent Apartment Phase I (affordable rental housing) and the Linxia Project (public rental housing/senior talent apartments). Both are located in the Shekou Free Trade Zone in Nanshan, Shenzhen, a densely industrialized area with high population mobility and strong demand for quality rental housing. The properties include 927 leasable units, 15 commercial spaces, and 502 underground parking spots. Although developed and managed by social entities with an affordable housing mandate, their leasing models, unit layouts, and pricing methods are similar to market-based long-term rentals [14]. According to government benchmarks, the rents for the projects are set with discounts of 80–90% off market rates, as low as 60% for exceptional talents. This combination of policy support and market alignment helps create stable, low-risk revenue streams that remain attractive during economic downturns [14]. This operational approach supports cash flow stability, and also reflects a broader trend in China, where infrastructure REIT products doubled in number during 2024. Successful listings such as the CM Science and Technology Innovation REIT indicate that the market is maturing and has potential for further expansion [15].

3.2. Financial operations

The fund's revenue is primarily derived from rentals (over 92%), supplemented by property management fees and parking income, with steady growth observed from 2021 to 2023. A projected 8.83% decline in the second half of 2024 stems from potential key corporate tenant turnover at Linxia, yet rental discount ratios remain stable at 90-93%, slightly below regional market averages, aided by policy incentives amid cap rate compression [14]. Occupancy rates have climbed to 94.66% at Taiziwan and over 97% at Linxia, though expected to dip to 90% post-turnover, with

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incentives countering oversupply risks into 2025-2026 [16]. For 2025, asset-level costs are forecasted at 56.39% of revenue, with depreciation and amortization at 35.96%, yielding a 77.13% NOI margin and 72.19% EBITDA margin, indicating a strong cash flow capability despite short-term pressures from maintenance and marketing [14]. This mirrors broader trends in public REITs, where cost control bolsters profitability, as seen in China Merchants Commercial REIT's 2023 revenue of nearly 500 million RMB and 39.0% gearing ratio [14].

3.3. Investment value

As of June 2024, the assets' assessed value stands at 1.246 billion yuan, with a 6% discount rate and capitalization rates of 5.53% for Taiziwan and 4.69% for Linxia. The figures are highly influenced by the project's extended land term to 2074. As for its investment value, the project's static ROI is 2.46% (below loan benchmarks), with pre-tax IRR at 4.41% potentially rising to 5.32% assuming land renewal. A 23.88% NAV premium reflects elevated secondary market valuations over fair assessments, limiting short-term appeal amid yield disadvantages, though forecasts of a multi-trillion-yuan market from stock renewal and rentals suggest policy-driven IRR improvements [14].

3.4. Development trends and policy influences

Informed by the previous case, long-term trends for ARH REITs show continued policy support through land guarantees and tax incentives. In 2023, public rental issuances reached 28 billion yuan [17]. Market-oriented operations help maintain occupancy and support growth, while tenant diversification reduces risks. Land renewal arrangements can also extend investment returns.

The Shekou REIT shows that market-oriented ARH projects have competitive advantages. However, high NAV premiums and operational risks may limit their current value. Over the long term, renewal options and growth potential could improve returns. Academics describe this approach as a strategy to manage real estate crises [13]. In 2024, the mainland REIT market grew 85% in value, suggesting that pilot programs could expand if market stability is maintained [15].

4. Conclusion

In summary, China's ARH REIT market provides cash flow stability during a real estate downturn. This is achieved through high occupancy rates, government-backed yields, and efficient cost management. Pilot programs also have expansion potential through policy-driven issuances and greater market penetration. The China Merchants Fund Shekou REIT illustrates these patterns. Its premium issuance and strong NOI margins demonstrate financial resilience. However, tenant concentration risks and high NAV premiums reveal current limitations. These could restrict scalability without further reforms. Going forward, ARH REITs must address demographic changes, oversupply, and weak demand. This will help them evolve from crisis management tools into sustainable forms of urban housing. Their long-term success will require a balance between financial returns and social goals, ensuring they support a healthier structure for China's property sector.

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