Student Housing Emerges a Winner in an Era of Poor Returns

By Jo Winchester, Head of Student Housing Advisory

SUMMARY

Despite the prospect of higher tuition fees, the UK Higher Education system remains heavily oversubscribed and new development of halls has not kept pace with the growth in students. There is still headroom in the student housing market nationally, especially in London, although we expect to see some localised reductions in student numbers in some towns.

The lending market is dominated by large scale loans against well-managed portfolios, but debt remains restricted for new entrants, single property deals and proposals outside of London. Liquidity is increasing, with no shortage of investor demand, but the market is hampered by a shortage of debt and quality investment opportunities. However, changes to the REIT regime, together with the growth in operators could widen options for indirect investors by creating a greater choice of investment funds, and could create an alternative exit position for established operators. Overall, the outlook for rental growth is positive; direct let yields are stable, and trending stronger for long-leased properties.

HOW WILL HIGHER TUITION FEES AFFECT THE DEMAND FOR STUDENT HOUSING?

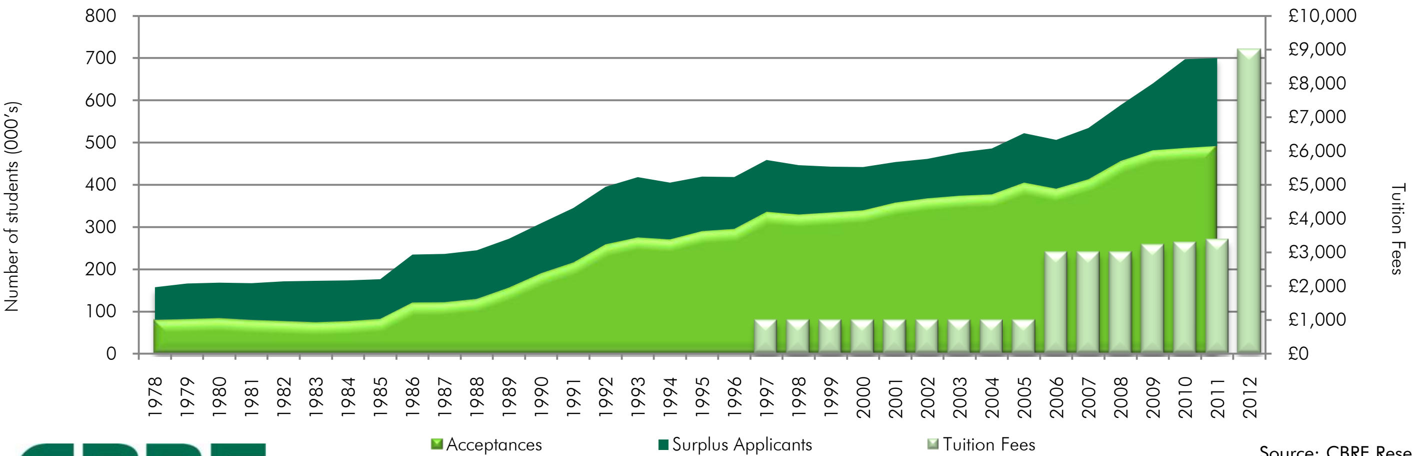
DEMAND

The UK Higher Education system is heavily oversubscribed with only 10 places for every 14 applicants. The number of student places continues to grow with 7.75% more students accepted into universities in 2011 than in 2007. Most of the private operators of purpose-built halls reported 99%+ occupancy for 2011/2012, which saw the highest ever intake of students. International student numbers continue to grow, attracted by high quality degrees taught in English and the weak pound. The poor UK job market and desire to secure a place before the tuition fee increases have been additional motivating factors for UK students.

Students are applying later, and aiming higher. However, the Russell Group Universities have reduced their annual intake by 3.5% since 2007, and the 1994 Group intake has remained static, due to courses being dropped.

The growth in student numbers has been almost entirely in the new universities, who provide more vocational courses. These statistics suggest that more students will obtain places through clearing, leading to later rental markets, but also that students are willing to pay for vocational courses which link directly to employment. Overall there are too few places nationally, but it is too soon to say how individual universities and towns will be affected. Also there is a growing mismatch between the new universities with the greatest accommodation needs, and 'fundability' in those situations. Although the rate of increase in accepted places slowed for 2011/2012, and applications as at January 2012 are down by 5.2% for 2012/2013 degree courses, there have still been 80,000 more applicants so far than the 2011 intake.

GROWTH IN STUDENT NUMBERS: APPLICANTS, PLACES AND FEES



Source: CBRE Research

TRENDS IN UNIVERSITY GROUPINGS

University Group	Proportion of Students	2007 Acceptance	2011 Acceptance	Change	Trend
RUSSELL GROUP	18%	93,164	89,921	-3.5%	
1994 group	10%	49,871	50,123	+0.5%	
UA UNIVERSITY ALLIANCE	22%	104,432	110,329	+5.6%	
million+ leading the university agenda	24%	92,946	116,280	+25.1%	
GuildHE	4%	15,884	21,239	+33.7%	
AoC Association of Colleges	4%	13,047	18,337	+40.5%	
Other	17%	87,283	85,801	-1.7%	
Total	100%	456,627	492,030	+7.75%	

Source: UCAS

SUPPLY

The building of new halls has not kept pace with the growth in student numbers, and most of the increase has been absorbed by the private rented sector (PRS). Nationally, there are now 155,000 more students living in the PRS than in 2007. According to HESA, in 2010/2011 only 19% of full-time students reportedly lived in university halls and only 4% in private sector halls. The growth in the number of specialist operators is proof of the business opportunity afforded by the sector and of a maturing market, with increased competition and choice. The PRS is subject to other rental growth pressures, caused by immigration and frustrated would-be buyers renting for longer. This means that students would also be paying more rent in HMOs. So private halls, even with rents being increased annually, may seem like good value on an all-inclusive basis compared to the PRS.

So, nationally the number of both degree course places and places in halls remains heavily oversubscribed. With reported 99%+ occupancy, and rental pressures in the PRS too, rents should continue to grow annually in most cities at least in line with inflation, but we expect to see reduced student intake at some universities which may subdue rental growth locally.

LENDING: INSURANCE COMPANIES ARE WELCOME NEW ENTRANTS

Against a backdrop of generally restricted bank lending, there is the added issue that some of the main student lenders have sought to reduce their sector weighting. As with other sectors, bank lending is increasingly relationship-based and it is challenging to secure finance for property outside of Central London. Insurance companies have spotted this opportunity and are welcome new entrants to the lending market.

Their motivation is primarily to fund their annuity liabilities via low risk income streams. They generally prefer large transactions. As their exposure is only based on a conservative percentage of valuation, they are able to fund direct let properties and still meet low risk criteria. There are numerous recent examples of larger loans made by insurers. M & G Investments (part of Prudential), recently provided a £266m loan for the acquisition of the Nido platform and have also lent £185m to the IQ fund in the form of a 5-year financing deal alongside Deutsche Postbank. L & G have recently concluded a £121m refinancing of a portfolio of Unite's properties in a 10-year deal, and Aviva provided £186.5m of debt to UPP Ltd on a long term fixed rate basis for their acquisition of Reading University stock. Evidence of larger scale bank lending includes the refinancing of the Liberty Living portfolio together with a simultaneous capital raising, recently concluded by a syndicate of HSBC and RBS, in the form of a bond issue. The new capital raised was $155m, increased from the original target of $100m, and was 5.5 times oversubscribed; the value of the refinancing was £200m.

These trends all suggest that the main lending appetite from banks and insurers is for low-geared portfolio scale deals backed by strong operational expertise.

For smaller scale deals and new entrants, debt sources remain extremely limited. Lending criteria especially do not favour direct let properties outside of London, except in a few high value towns. Hence there is little regional development at present. New entrants will improve their 'fundability' by joining forces with an established operator. The increasing number of operational platforms should also open up additional new partnership opportunities for investors.
Many of the companies on the list overleaf did not exist 5 years ago, and they already have significant portfolios under management and major pipelines.

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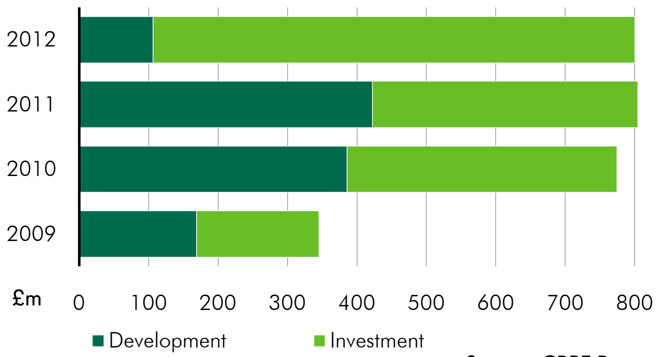
STUDENT HOUSING OPERATORS

Rank	Operator	Beds 2012	Pipeline	Total
1	Unite Group Plc/USAF	41,777	3,336	45,113
2	UPP	27,289	1,959	29,248
3	Opal Group	20,027	0	20,027
4	Liberty Living	15,969	852	16,821
5	CRM	11,011	2,942	13,953
6	Sanctuary Management Serives	8,255	267	8,522
7	Unipol (halls only)	6,431	0	6,431
8	Victoria Halls (as operator)	6,401	834	7,235
9	Cosmopolitan Student Homes	5,000	0	5,000
10	IQ	4,499	673	5,172
11	MSAF/Mansion	4,371	898	5,269
12	South Street	3,700	1500	5,200
13	Derwent	4,000	0	4,000
14	Campus Living Villages	2,900	0	2,900
15	Fresh Student Living (Watkin Jones)	2,576	4944	7,520
16	Nido	2,526	0	2,526
17	MCR	2,447	0	2,447
18	Viridian	2,312	0	2,312
19	The Student Housing Co (as operator)	1,657	2895	4,552
20	Touchstone	1,500	0	1,500
21	Downing Developments	1,249	1,480	2,729
22	Space Student Living	1,000	0	1,000
23	AC Collegiate	965	4,020	4,985
24	Prime Student Living (Crosslane)	950	1,800	2,750
25	Urbanest	484	964	1,448
26	Pure Student Living	404	1,373	1,777
27	Student Castle	247	1,526	1,773
		179,947	32,263	212,210

Source: CBRE Research

INVESTMENT: IMPROVING LIQUIDITY AND INVESTOR DEMAND

Investment volumes into student housing trebled between 2009 and 2011, bucking the wider trend of subdued transactional volumes in the mainstream markets, and there is strong demand from investors of all types.



Source: CBRE Research

We are seeing more forward funding type deals by institutions. LaSalle, Scottish Widows, Standard Life and F & C REIT have all been active in this space. LaSalle have funded the CB1 scheme in Cambridge, and the Watkin Jones scheme at Stockwell, SW9, both of which have long term nominations agreements to universities, but with variable cost elements.

Typically, forward commitment buyers can expect a 25bp yield discount on the completed and let value, with a full funding perhaps showing a 15% discount, depending on timing, letting responsibility and negotiation. Completed properties with long leases continue to be popular with the funds, with LaSalle having purchased two such schemes in Newcastle and Aprirose having bought schemes leased to Watkin Jones in Loughborough and Liverpool in the last 6 months.

The recent sale of the 2,294 room/2526 bed Nido operational business for £415m proves that there are investors and lenders for even the largest scale direct let assets, albeit the deal took some months to close and the 3 assets are in Central London. Oaktree Capital continues to invest capital through its partner Knightsbridge Student Housing Ltd, which has identified further acquisitions during 2012 in London and regional towns. Carlyle, in partnership with Generation Estates, is focussed on building a new Central London platform under the 'Pure Student' brand, with a current pipeline between 2012 and 2014 of 1,777 bedspaces. The AUB Student Accommodation Fund, Gatehouse Bank, and 90 North continue to actively invest Middle Eastern capital in mostly completed stock.

Institutional investors still mostly require long-dated or derisked income. This is unlikely to change, but we can observe a wider range of routes to market to secure those coveted long term income streams. The 'income strip' model was successfully proven by L & G's £116m purchase of Griffon Studios, SW11 last year into its annuity fund. The scheme was leased for 45 years, with index-linked annual rental increases to Imperial College, to whom the freehold reverts at lease expiry. The attraction of so-called 'income strips' is the ability to create a win-win structure. The university is able to control the residence and benefits from the freehold reversion; the investor is able to secure long-term income streams, and the vendor benefits from keen pricing (Griffon Studios achieved 4.5% yield). We are likely to see this structure replicated, based on University covenants rated at BBB or better (as many universities would be).

Pure Highbury

One of the issues is the lack of good properties to buy. Watkin Jones remain the most active developer and are the leading contributor of investment stock. Of the other operators, Unite Group Plc are mostly focussed on their London pipeline of five schemes or so. Berkeley Group, Mace, Balfour Beatty, and MacLaren are building (and investing) in the space, and are starting to bring investment stock to the market. The specifications continue to improve, trending towards interior-design led schemes. Other established businesses in the sector are hampered by corporate debt issues and are unable to progress their pipelines, which is very much a sign of the times.

Growing transactional volumes indicate strong investor demand, hampered by a shortage of debt and lack of transparent investment opportunities.

INDIRECT INVESTMENT: CHANGES TO REITS AN OPPORTUNITY?

Student housing lends itself to a fund type structure, which spreads risk between towns and maximises operational efficiencies. Indirect investment remains a preferred route for many institutional and individual investors. The Mansion Fund continues to attract considerable new funds through the IFA market, and is highly acquisitive.

Since its recent capital raising in Q1, Liberty Living has since purchased two assets in Leeds and Gillingham. The Unite UK Student Accommodation Fund, in which the investors are chiefly institutions with stakes of £10m+, is consolidating. It has recently made some disposals, and some of the proceeds will be used to refurbish other assets. Shares in this are successfully traded on the secondary market.

Student Housing Investment Vehicles	Beds inc pipeline	Typical Investor
UPP Ltd	29,248	Private Equity
Coral Student Portfolio	27,593	Retail
USAF	22,475	Institutions
Liberty Living	16,821	Retail
Knightsbridge	6,594	Private Equity
IQ	5,172	Single Institution
Mansion Student Accommodation Fund	4,127	Retail
The Cordea Savills Student Hall Fund	2,900	Institutions
Round Hill/Nido	2,526	Private Equity
The Aviva Beach Fund	2,413	Institutions
Carlyle/Generation Estates	1,777	Private Equity
UCT	1,457	Institutional

Source: CBRE Research

* The Coral Student Portfolio invests in Student housing funds and joint ventures. The above figures indicate its total exposure.

The potential purchase of a majority stake in the UPP 29,000 bed operational platform by a Dutch Pension Fund is evidence of significant indirect investment by an institution into an operational business. Most of the assets are not freehold (being fixed term concessions) and not all of the income is secured to universities. This tends to endorse the sector in general and UPP Ltd's operational business, rather than just purchasing a long leased property.

Good management and portfolio scale are again key ingredients for indirect investment, but despite the growth in investment vehicles there are limited indirect fund options for investors. Proposed changes to REITs will hopefully be effective in 2012, and should make it easier to create new, more transparent fund structures.

Some key barriers to entry are being relaxed for REITs. The 2% entry tax is being abolished, and REIT regulations are being eased to allow listing on the London junior AIM and PLUS markets and their foreign equivalents, to improve accessibility for early stage REITs. At the moment REITs are prohibited from being a close company (controlled by five persons or fewer). Under the current system, an institution can cause a REIT to be a close company even though technically its ownership is diverse. The UK government is set to introduce a diverse ownership rule for institutional investors, to get round this problem. This should serve to increase institutional investment in REITs. The key benefits of REITs are tax breaks and greater transparency for investors. Tax is not levied on income and capital gains as in a normal company structure but only on the dividends paid to investors. As 90% of the REIT's profits are paid to investors, the tax burden is reduced and simplified.

The government particularly hopes to encourage residential REITs, and some are already mooted (London and Stamford Property Plc recently announced plans for a residential REIT backed by two international investors). Student housing would suit a REIT structure better than residential blocks because it is a more established, higher yielding investment asset class.

Together with the growth in operational businesses, changes REIT structures could serve to widen the choice of investment funds, and create an exit position for established operational platform. Overall, the sector dynamics remain robust, evidenced by continued investor interest and the rapid growth in operators. Scale is no barrier even for direct let property, but good management is a key ingredient to fundability.

OUTLOOK AND OPPORTUNITIES

• UK education system is still oversubscribed nationally, but we expect some localised reduction in student numbers.
• Purpose-built halls are undersupplied nationally, and there is scope for more development.
• Robust rental growth prospects in most locations.
• Well-managed portfolio deals are more likely to be fundable.
• Relaxation of the REIT system could provide an alternative exit route for operators.
• The growth in operators offers greater scope for partnerships to be formed, which could help to widen the market for new investors.
• Investment yields to remain stable for modern direct let product, trending stronger for long leased properties and weaker for more secondary.

REGIONAL DEALS

Manchester Portfolio: In April 2012, Mansion Group purchased a 437-bed portfolio of four direct let properties in Manchester from Unite. The total purchase price was £21,000,000, equating to 7% NIY/£48,000/bedspace.

Liberty Dock, Clarence Road, Leeds: In March 2012, Liberty Living bought this 612-bedroom scheme from the University of Leeds. There was a 15 year nomination agreement to the University of Leeds, along with an 80% rental guarantee from the University with a cap and collar of 2% and 4.5%. The scheme sold for £23m, which represented £37,581 per bedspace.

Windsor Court, 112-128 London Road, Liverpool: This direct let scheme completed in 2011 comprising 97 studios, three 2-bed apartments and 9,000 sq ft of retail was sold by Westville Developments to Mansion Student Accommodation Fund in March 2012. The property sold for £11.4m, representing 6.50% on student accommodation.

LONDON DEALS

Nido Portfolio, London: In May 2012, Blackstone sold the three direct let assets operated under the Nido brand at Kings Cross, Spitalfields and Notting Hill, to US equity firm, Round Hill Capital. The purchase price of £415m equated to £180,906/room or £164,291/bedspace, and around 6.25%.

Derwent Point, Wakley Street, London, EC1: In May 2012 Ahli United Bank Fund purchased Derwent Point, a 136 studio scheme, from Derwent Living. There are 2 years left on the Nomination Agreement to City University. The purchase price of £23.24m equates to £170,882 per studio and a yield of 5.90%.

The Quadrant, London, SW9: In March 2012, LaSalle Investment Management funded Watkin Jones' scheme in Stockwell. The scheme will consist of 258 ensuites and 70 studios for completion in 2013. There will be a 21 year lease to the University of the Arts, with a break at the 15th year, with 2.5% fixed annual rental uplifts. The yield showed 6.27%.

STUDENT HOUSING YIELDS

Direct Let

	June 2012	Trending
Central London	6.00%	→
Top Tier Regional	6.50%	→
Second Tier Regional	7.00%	↓

University Lease

Central London	5.25%	↑
Top Tier Regional	5.50%	↑
Second Tier Regional	6.00%	↑

Trending Stronger	=	↑
Trending Weaker	=	↓
Trending Stable	=	→

Nido Notting Hill

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