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UK Residential Capital Markets

Spotlight
UK Student Housing

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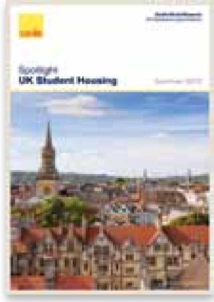
On the cover: Oxford University



Spotlight
UK Student Housing

Student housing continues to perform well as an asset class with higher yields than both residential and commercial property

Easing the housing crisis

With much of the national housing debate focused on a shortage of supply and the ongoing inability of housebuilders to deliver larger volumes, it is worth considering how the student accommodation market could help to ease housing constraints in major cities and towns across the country.

Student housing is an established alternative property investment class that behaves more like commercial property (yield driven investment) but can still have exposure to the housing market (direct lets). With the ability to deliver at higher densities, it has all the hallmarks of the type of housing delivery that the Government is trying to encourage through build-to-rent with the exception that it has a proven track record.

The rise of student HMOs

An overlooked element of the housing supply crisis is the role of the rapidly expanding higher education sector; according to HESA the number of full-time students in higher education grew by 540,000 between 1999 and 2012, an increase of 46%. With university halls of residence just about able to cope with the increasing numbers of first year students and private sector student accommodation operators racing to scale up, most students ended up in the private rented sector.

The growth in student numbers combined with the introduction of buy-to-let mortgages in the early 2000s and ever increasing house prices meant the role of student landlord was irresistible for many: be it an entire street or a single house for a son/daughter and their friends.

SUMMARY

An overview of the market

- The conversion of family housing into student HMOs has been an important but under-analysed feature of the housing boom and now offers an opportunity for councils and developers of student accommodation to contribute to the easing of the wider housing market supply crisis.

- We have identified 66,000 properties across England and Wales that could be freed up for family housing which would trigger the creation of an additional 260,000 student beds.

- Following weaker rents during the 2012-13 academic year, we are forecasting total returns of 9.3% for the 2013-14 year with static net initial yields at 6.3% and rental growth of 3.0% due to improving demand.

- An update of our university town/city ranking model puts Bath, Brighton, Bristol, Cambridge, Cardiff, Edinburgh, London, Oxford and St Andrews at the top of the list for investors.

Market performance

The student housing market has proven a resilient and stable investment during the downturn. Following the yield compression of the early to mid 2000s, average yields hit 5.75% in 2007, rose to 6.4% in 2009 and were 6.3% in 2012. Within the average yield there is the opportunity to take different levels of risk with yields generally lower in London or for halls with lease/nominated rights compared to those that are direct let and in secondary locations.

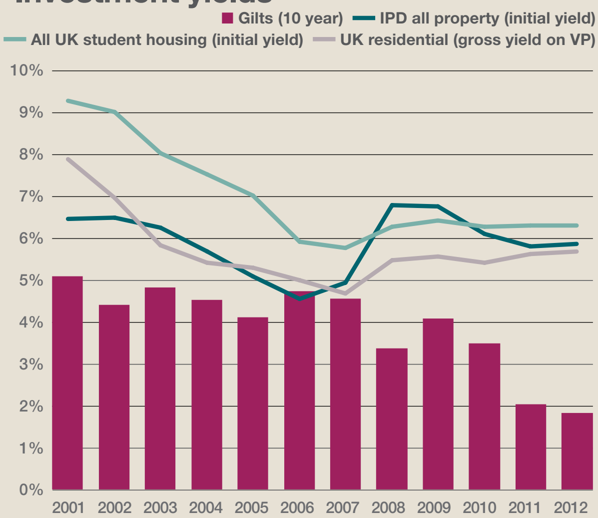
	Lease	Nomination Agreement	Direct Let
Prime London	4.75%	5.50%	6.10%
Super Prime Regional	5.00%	5.75%	6.25%
Prime Regional	5.25%	6.00%	6.50%
Secondary Regional	5.75%	6.75%	7.25%

Lease: *25 year lease to institutional grade university covenant on annual RPI linked increases with a cap and collar*

Nomination Agreement: *15 years+ nomination agreement to institutional grade university covenant on annual RPI linked increases with a cap and collar*

GRAPH 1

Investment yields



Source: IPD & Savills Research

As house prices rose, equity became more important in accessing the housing market. With students moving across the country in large numbers, investors followed suit and this lead to an increase in the mobility of equity, doing its part in turning the boom into a national event.

This increased mobility of investors' equity began to prove too much for local market participants as investors out-bid families for larger housing and young professionals for small flats in towns and cities across the country. This drove previous occupiers away in search of more affordable and less competitive housing markets and led to the formation of what some would consider to be student 'ghettos'. Examples of high density student areas include Clifton/Redland in Bristol, Oldfield Park in Bath, Jesmond in Newcastle and Cowley in Oxford.

This situation has only worsened since the beginning of the credit crunch as the withdrawal of higher loan-to-value mortgages, growing rents and a lack of alternative investments have continued to attract investors into the student private rented market. This has been at the expense of other less equity rich potential buyers while students have also priced-out many in the private rented sector due to a willingness to over-occupy accommodation and deliver higher rental yields.

A viable opportunity

Until now, much of the growth in student accommodation has been focused on the higher value and growing international student market but there is the opportunity, with both a carrot from the developers/operators and a stick from local and central government, to target the 500,000 students living in the private rented sector.

Local authorities could unlock a substantial supply of lower density family housing in central locations while still meeting the higher density and viability requirements of the current development environment by allowing the provision of more student accommodation.

From a council's perspective not only would this help with the housing supply issue but it could also add to its council tax revenues.

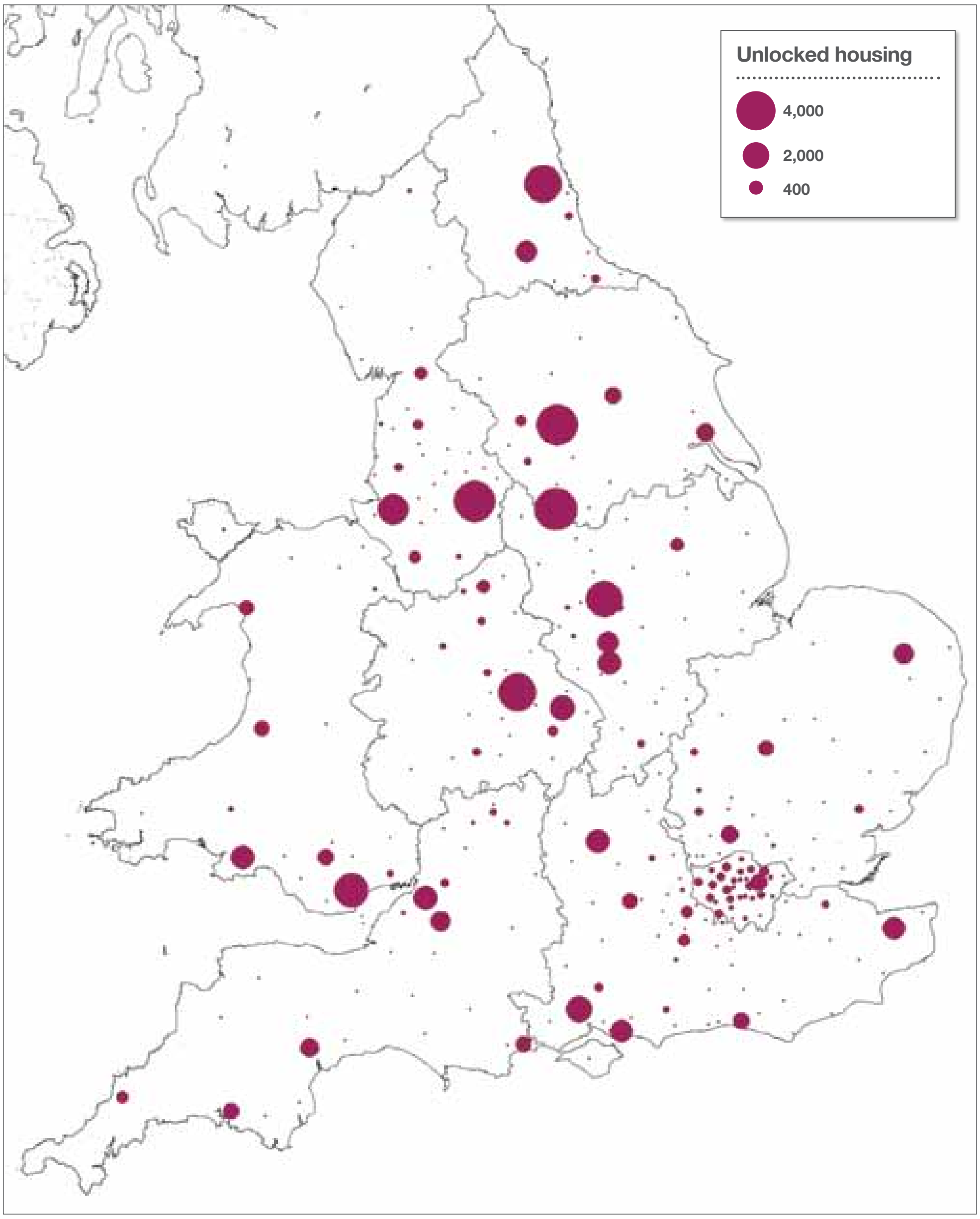
Households containing only full-time students are exempt from paying council tax and so switching to a new council tax liable occupier would result in on-going payments on the existing property and six years worth of payments through the New Homes Bonus on the newly constructed student housing.

Indeed, many local authorities have already realised the impact of students on their local housing markets and revenues and are consulting on and enacting Article 4 Directives (of the Town & Country Planning Act) to restrict the new supply of Houses in Multiple Occupation (HMOs) in markets with already high concentrations of student households.

If they prove enforceable, the use of Article 4 Directives without the provision of new student accommodation is likely to only displace demand into surrounding

MAP 1

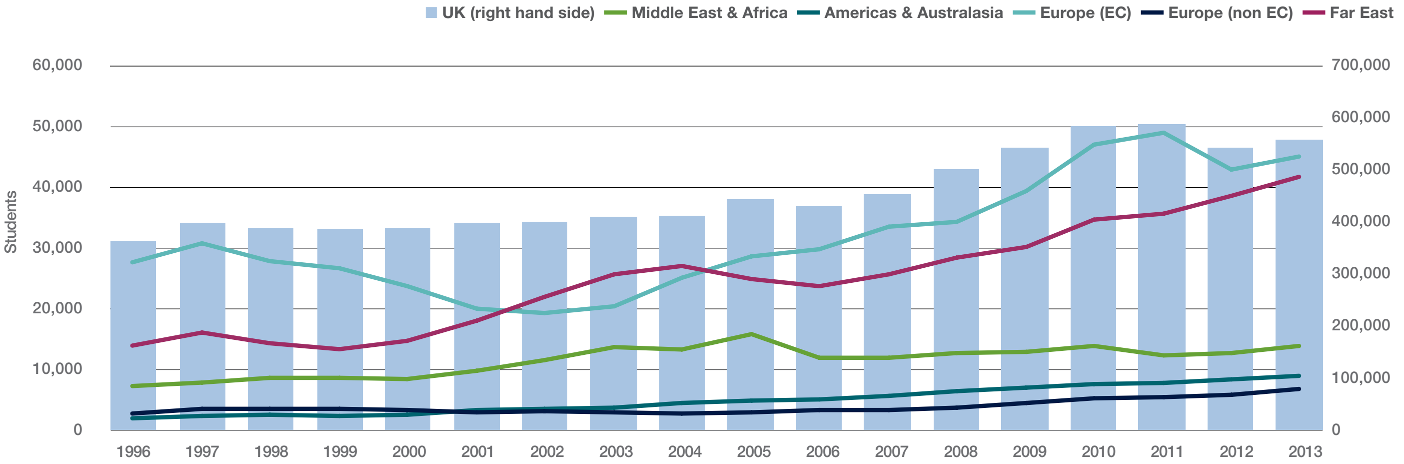
Potential to free up family housing



Source: Savills Research

GRAPH 2

Applications by country of domicile



Source: UCAS

markets or even increase overall housing demand as larger households are split into smaller ones.

Therefore, it is important that councils recognise the need to provide alternative desirable student accommodation to counterbalance any displacement of demand while also taking care not to damage the housing prospects for young professionals struggling with the unaffordable housing market.

Identifying the opportunities

According to the 2011 Census there were 132,000 full-time student households across England and Wales housing 500,000 people and we have identified those markets that contain high concentrations of larger sized properties and student households at the expense of families (data for Scotland has not yet been released and so we are unable to include it in this analysis).

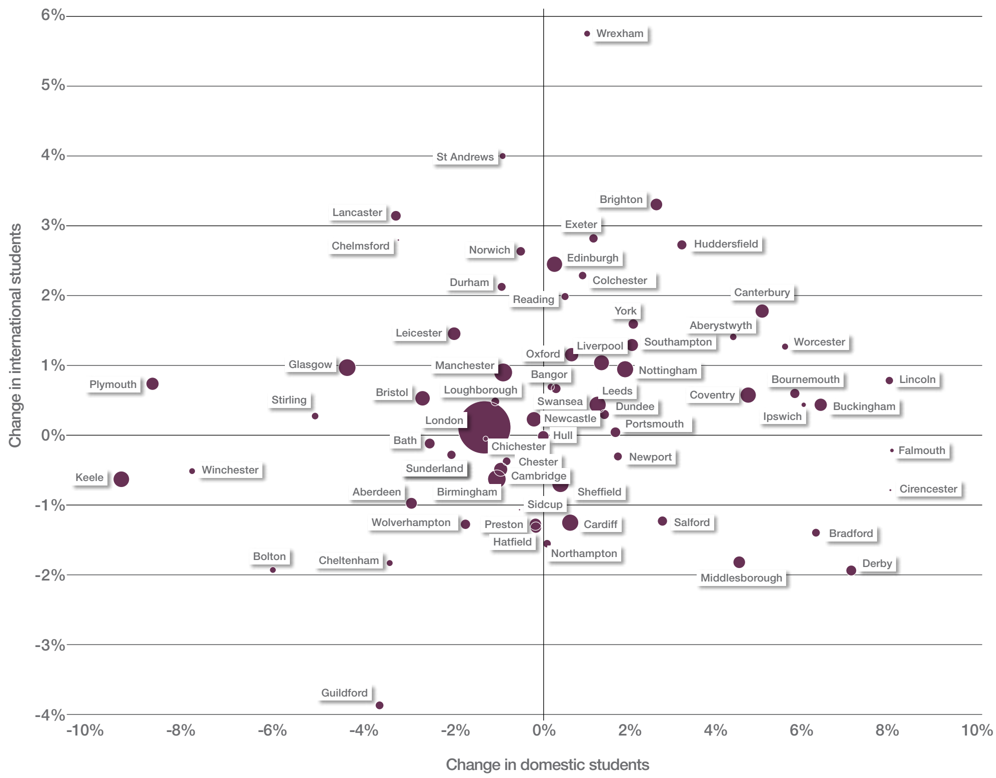
From this analysis we have identified a potential 66,000 properties that could be freed up for family housing. This would necessitate the creation of an additional 260,000 student beds across the country.

Two thirds of this unlockable supply is in the top 25 towns and cities and would be equal to 1.8 years worth of recent supply but the scale varies by location:

■ In Bath, the provision of student accommodation could unlock

GRAPH 3

Change in student numbers by domestic or international, 2010-11 to 2011-12

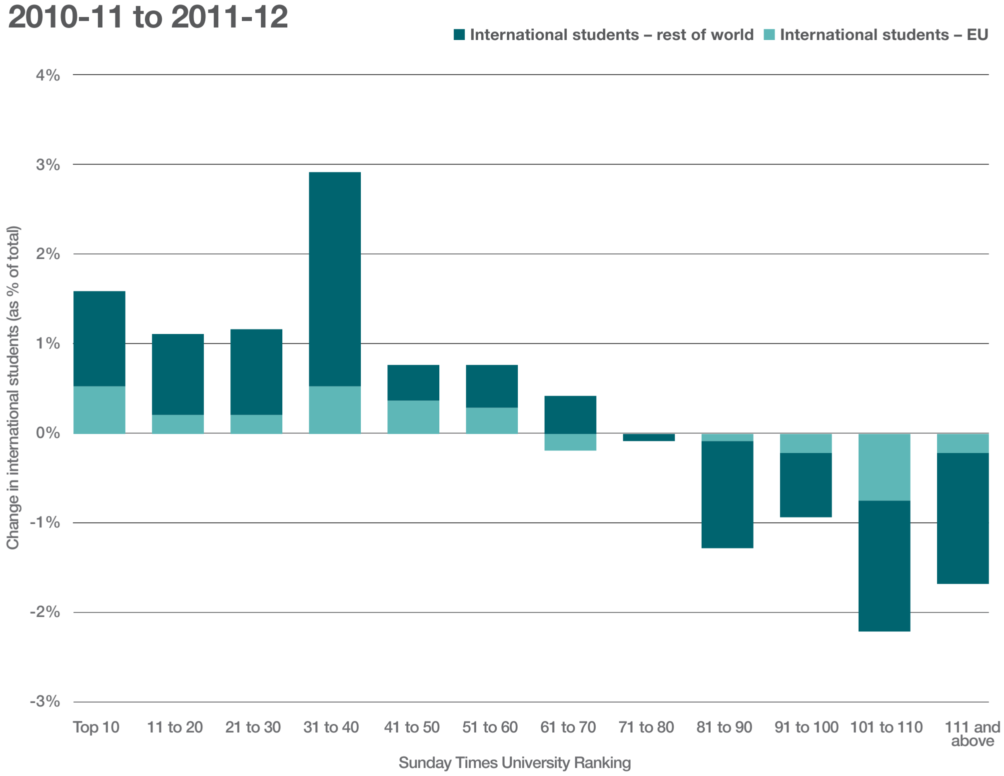


Source: HESA

> "Until now much of the growth in student accommodation has been focused on the higher value and growing international student market"
>
> Neal Hudson, Savills Research

GRAPH 4

Change in overseas students by university ranking, 2010-11 to 2011-12



Source: HESA & Sunday Times

1,100 homes, which is equal to three years of recent housing delivery and £1.4 million in additional council tax revenues per annum, excluding any New Homes Bonus.

- In Oxford it could unlock 1,400 homes, which is equal to five years of recent housing delivery and £1.8 million additional council tax revenue per annum.

- In Newcastle it could unlock 3,300 homes, which is equal to eight years of recent housing delivery and £3.2 million additional council tax revenue per annum.

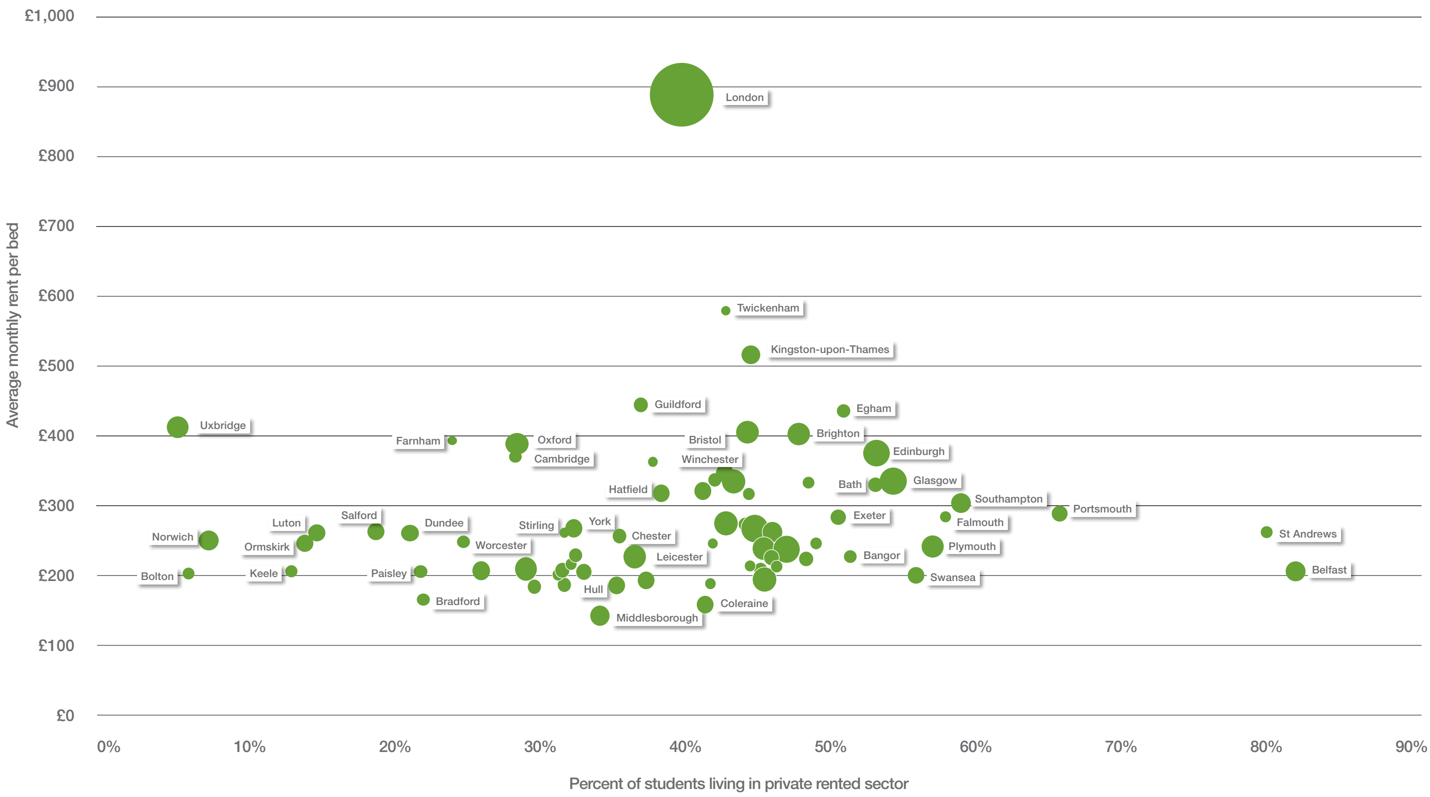
- In Bristol it could only unlock six months worth of supply but this is still 1,400 family homes and £1.6 million in additional council tax revenues per annum.

Supply & Demand

It is unlikely that student housing providers will be able to immediately tap into this new source of unlocked demand and so in the shorter term it is the supply and demand dynamics

GRAPH 5

Average rent per bedroom



Source: Rightmove

which are most important to identifying markets for investment.

Demand indicators

To help identify those markets that are most suitable for investment, we have created a ranking model for university towns and cities across the UK based on a number of inputs which we have examined in more detail in this section. The final rankings are on page nine.

UCAS applications

The relative performance of applications gives an early indicator of demand for the coming year. With the increase in tuition fees up to a maximum of £9,000 per annum for the 2012-13 academic year, university applications fell by 6.7% on the previous year but have recovered slightly (2.7%) for the 2013-14 year.

However, demand from outside of Europe has continued to grow during this period, particularly from the Far East, which has seen average annual growth of 8.5% over the last six years.

Student numbers

In terms of actual demand, the growth in student numbers at individual institutions is arguably the most important component although it is also important to understand the demographic profile including if they are domestic or international and whether they are likely to form demand for bespoke student accommodation.

The overall 0.4% fall in domestic student numbers between 2010-11 and 2011-12 was counterbalanced by a 1.7% increase in international students leaving student numbers broadly flat overall but this hides a wide variety of performance across different towns and cities.

Although some towns/cities in the chart opposite may demonstrate strong growth for one or both types of student over the period, strong growth may also hint at greater volatility in student numbers.

University rankings

University rankings are usually the first stop for prospective students and our analysis of those provided by the Sunday Times University Guide shows a trend between

Immigration reform

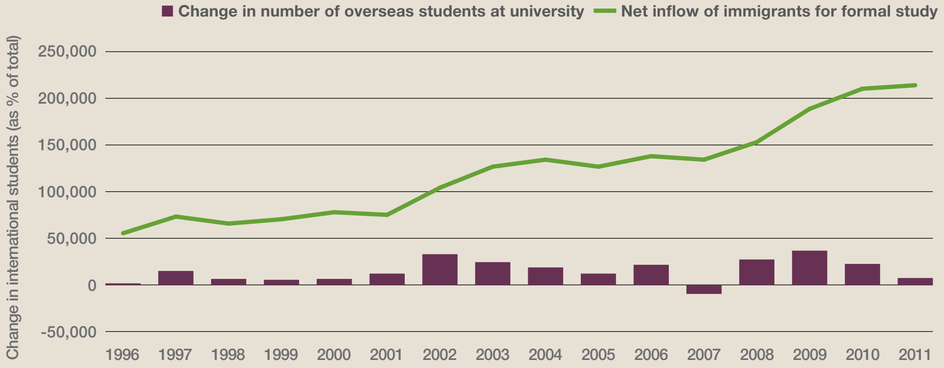
Caution is urged when targeting lower net immigration

The strength of international demand is important for both the continued financial health of the university sector and also the wider economy. However, with government policy targeting a reduction in net migration to the UK and the reason most stated for in-migration being 'formal study', there is a lot of pressure on the university sector over the quality of their students (the Home Office ban on recruitment of non-EU students at London Metropolitan University being the biggest example, although this has now been lifted).

While there may be issues with the monitoring of international students at some institutions, the chart below shows how small the increase in overseas students at universities has been compared to the overall scale of immigration for formal study. Therefore, any government policy aiming to reduce net immigration should take care to differentiate between those students attending accredited universities and those attending less well regulated educational establishments.

GRAPH 6

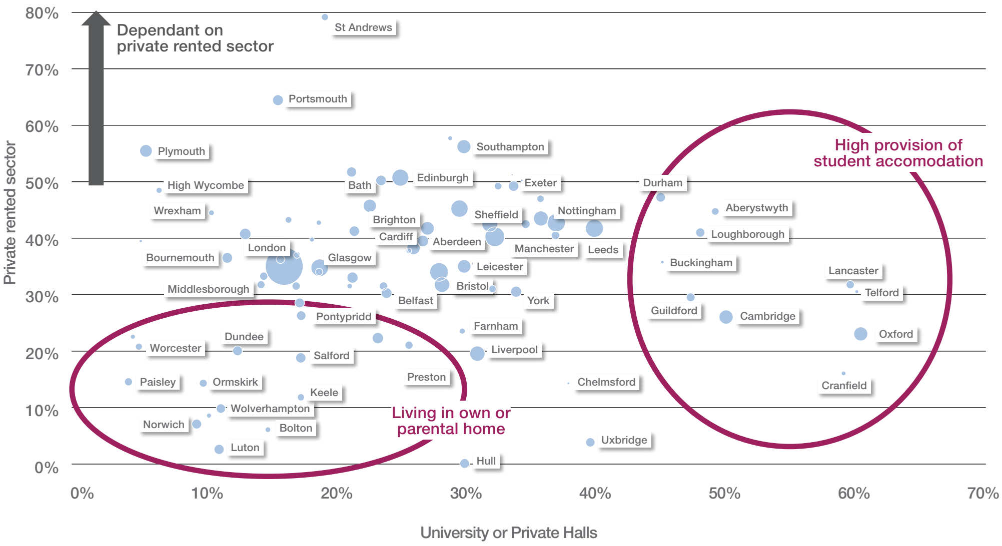
Immigration & the universities



Source: ONS & HESA

GRAPH 7

Students and where they live, 2011-12



Source: HESA

ranking and the recent growth in overseas student numbers.

Those universities that have higher rankings continued to see growth in overseas students while those ranked outside the top 80 have generally seen a fall in numbers.

Affordability

With increasing competition in the private rented sector (PRS) from young professionals and families priced out of the owner-occupier market, rental growth has been strong in many markets.

This is particularly true in London where rents have increased by 20% over the last three years and the average rent for a one bed property is £1,500 per month while a three bed property is a relative bargain at only £1,050 per month per bed.

The premium for one bedroom properties is found consistently across all markets with an average premium of 110% on a per bed basis relative to three bed properties but this ranges from 67% in Bristol to 172% in Swansea.

The trend in rental levels follow a rough north-south trend with those locations close to London generally seeing higher rental levels due to increased wider market competition.

Supply

The average university town houses 26% of its students in halls of residence (university or privately operated), 38% in their own or parental home and the remaining 26% in the private rented sector.

However, this average hides a wider variation in different mixes of provision from the traditional collegiate universities of Oxbridge to the universities catering to local demand with large numbers of students still living at home to those

Community Infrastructure Levy

Fairer, faster and more transparent

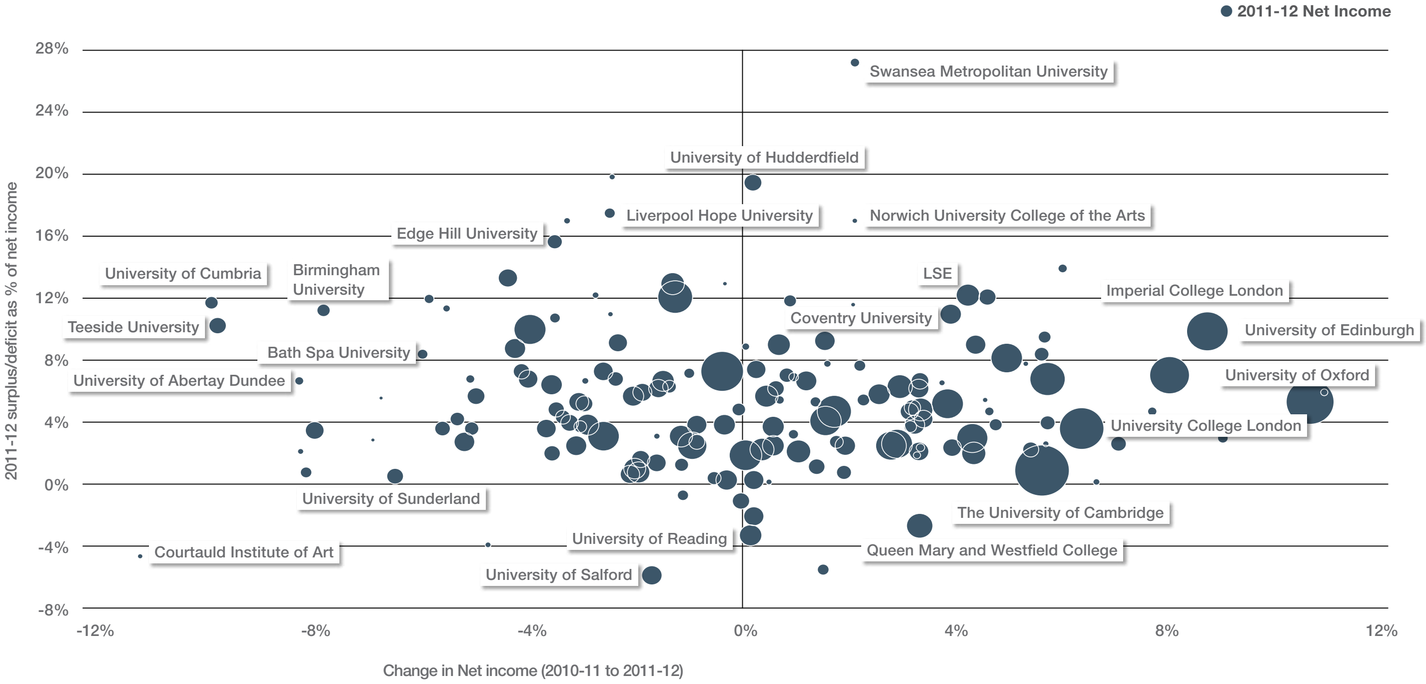
Community Infrastructure Levy (CIL) is effectively a tax on new development, so once adopted by a charging authority, it is non-negotiable even it if makes sites unviable. Unlike current planning obligations (S106), CIL is an area-wide approach charged at a set rate per square metre of new floor space for different types of development and it will be charged in addition to S106, albeit S106 should be scaled back.

Developers of student housing have not typically had to provide affordable housing under S106 agreements in the past and so the application of CIL to new student accommodation could significantly increase the cost of development.

Savills is working closely with a range of developers and housebuilders, individually and as consortia, across the country to influence emerging CIL rates through representations and proactive engagement with the CIL process. We recommend all student accommodation providers engage in a similar manner, to ensure the appropriate economics of student development is considered when authorities are setting their rates.

GRAPH 8

Financial health of institutions



Source: HESA

that rely on the private rented sector to house a significant proportion of their students.

The opportunities for student accommodation providers will likely be focused in those markets with a high dependence on the private rented sector and low levels of students still living at home.

Towns with high existing provision of halls of residence may still offer opportunities, particularly around the newer universities into those towns.

We have also measured the difference in numbers of students between 2010-11 and 2011-12 by type of hall to identify those locations that have seen a decline in student numbers and hence a possible excess capacity of halls of residence.

These locations are towards the lower end of the university rankings and so, although there may be unique reasons for this (stock refurbishment etc) they do raise some concerns over the investment potential for these markets.

Financial health

With the ongoing austerity drive, the financial health of universities is a key consideration for developers of and investors in student housing.

Graph 8 shows how net income and surpluses have changed between the 2010-11 and 2011-12 academic years. Universities that have seen positive increases in income over the last year are the strongest performers whilst universities that have seen a fall in income are at greater risk but the majority have still managed to record a surplus during 2011-12.

Universities that have recorded a deficit during 2011-12, particularly when combined with falling net income are most at risk although this may be due to on-going improvements such as at the University of Reading.

Overall ranking

Using the combination of the measures discussed in this report we have constructed a overall ranking system of university towns and cities across the UK.

Those locations within the 'First' category offer the strongest demand for accommodation but competition may be strong while locations in the 'Pass' category are considered those weakest demand indicators, although there may be specific reasons why investment is still warranted.

TABLE 1

Ranking of university cities and towns across the UK

First	Upper Second	Lower Second	Third	Pass
Bath	Aberdeen	Aberystwyth	Bradford	Bolton
Brighton	Birmingham	Bangor	Cheltenham	Carlisle
Bristol	Bournemouth	Belfast	Coleraine	Derby
Cambridge	Canterbury	Chester	Hatfield	Farnham
Cardiff	Chichester	Colchester	Huddersfield	Lampeter
Edinburgh	Durham	Coventry	Hull	Lancaster
London	Exeter	Dundee	Keele	Middlesbrough
Oxford	Glasgow	Egham	Leeds	Newport
St Andrews	Kingston-upon-Thames	Falmouth	Lincoln	Ormskirk
	Liverpool	Guildford	Loughborough	Paisley
	Manchester	High Wycombe	Luton	Pontypridd
	Newcastle upon Tyne	Leicester	Salford	Preston
	Portsmouth	Northampton	Sunderland	Stoke on Trent
	Sheffield	Norwich	Swansea	Telford
	Southampton	Nottingham	Winchester	Twickenham
	York	Plymouth		Uxbridge
		Reading		Worcester
		Stirling		Wrexham

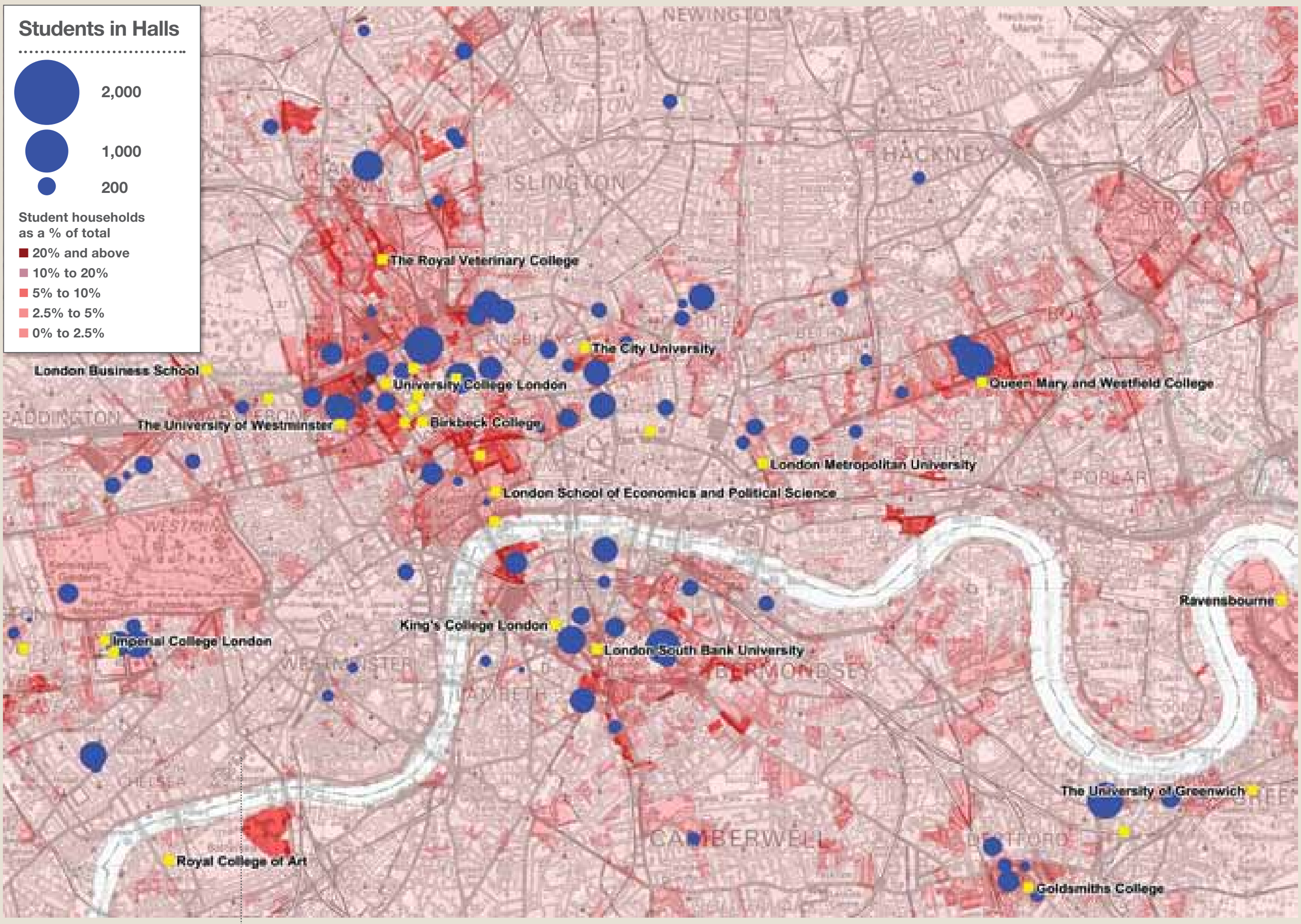
Source: Savills Research

London

Students and where they live in central London

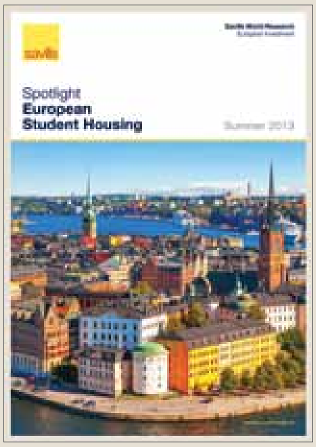
With 300,000 full-time students, and 110,000 part-time students, the student accommodation market is both the largest and most active in the country. Our analysis of the 2011 Census shows in fine-grain geography exactly where these students are living and whether they are in halls of residence.

With private sector rents forecast to continue growing, affordability for domestic students, who make up 75% of the student body, will continue to be stretched and drive demand into surrounding more affordable markets. Despite this pressure on affordability there are still many markets in central London that contain high proportions of students.



Source: 2011 Census

The Savills Student Investment and Development Team
The team provides consultancy advice for a range of clients including universities, language schools, investors and developers in assessing potential sites, advising on new build opportunities and providing strategies for existing student accommodation across the UK and internationally. The team undertake valuation work for a number of major lending institutions and also provide regular fund valuations for circa £2 billion of assets annually. The team is involved as an agent in the acquisition and disposals of sites and investments, with £1.4 billion transacted over the last three years and £190 million completed in the first six months of 2013.



Spotlight: European Student Housing
As the student housing market matures, can the investment model used successfully in the US and the UK be replicated across Europe?
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The Residential Research team produces highly informed, hugely influential analysis on all sectors of the UK's housing market.

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