Spotlight on Student Housing

Savills Research

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This publication

This document was published in August 2011. The data used in the charts and tables is the latest available at the time of going to press. Sources are included for all the charts.

Spotlight on
STUDENT HOUSING
Survival of the fittest: Buy, sell or hold?

SUMMARY

An overview of the market

■ An important combination of changes to the English higher education, combined with market forces, has created a market where there are distinct winners and losers in both the development and investment arenas. So the prospects for student housing as an asset class are diverging between first class locations and third class ones.

■ Universities are now faced with massive funding challenges and we expect to see a high degree of M&A activity within the sector over the next few years with some English universities at risk of bankruptcy and closure.

■ The combination of academic prospects and market prospects at a localised level will determine the fortunes of the student housing investor. We anticipate performance in the next 10 years to be every bit as good as the last in our first class locations.

■ The ability of universities to attract alternative sources of funding differs greatly but will substantially affect student numbers in a particular town. We have analysed this for English universities and concluded how supply and demand is likely to change in given locations.

■ Oversupply is a rare phenomenon in student housing as the dramatic 20% increase in student numbers over the last 10 years has left most higher education establishments short of accommodation.

■ Student accommodation continues to deliver strong returns compared to other mainstream asset classes. Despite current economic and property market conditions, the volume of recent deals has been high, pointing to continued investor demand.

■ Development funding has been less constrained in the student housing sector than others, allowing it to take advantage of the slowdown in the residential market, especially in London, where the development of high quality student schemes has continued to expand.

■ Universities are likely to seek private sector partnerships and outside investment in new accommodation and management solutions. We anticipate academic estates will seek agreements with leading student housing operators.

■ The risks to the higher education sector have increased greatly over the past year. The potential change to immigration policy is the single biggest risk to the university sector because international students have become a vitally important source of funding.

■ We have taken ths critical shift in policy and reform in England as a priority, and will analyse the opportunities that the impact of the Browne Review will have for Scotland and Wales in a follow-up report once the new academic year begins.

FOCUS ON HIGHER EDUCATION: ENGLAND

Degrees of separation

The prospects for student housing as an asset class are diverging between first class locations and third class ones. An important combination of changes to higher education combined with market forces has created a market where there are distinct winners and losers in both the development and investment arenas.

It is hugely important for developers, investors and funders in the student housing sector to understand that there are some towns and cities which now present a high risk and are likely to significantly underperform in future. Equally, there are still a large proportion of locations which now present significant opportunity and are likely to show attractive returns in the foreseeable future at relatively low risk.

Savills researchers have analysed each of the factors which impinge on the prospects for student housing performance and have combined them in a unique scoring system to assess which locations are 'buys' and which are 'sells' in the world of student accommodation.

University degrees

There have been innumerable stories in the press and media this year about the impact of changes to tuition fees and the impact of funding cuts in the wake of the Browne Review of the Higher Education system. Some universities will see a negative impact and dwindling student numbers while others will see positive impacts. The ability of individual universities to respond by attracting alternative sources of funding, foreign students and postgraduate students differs greatly but will make a difference to how student numbers wax and wane in a particular town and hence how demand for student accommodation is likely to change in a given location.

Our analysis of 114 universities across England shows there is a very widely different capability and potential for institutions to respond to change. There are some obvious winners in our league who are easily identified, like Imperial College, London for example. Others, like Salford University, are perhaps less obviously able to compensate for the adverse impacts of the Browne Review but, through other mitigating factors are able to emerge winners in the process. Overall, we found that there were 40 institutions that might be described as first class and likely to continue growing following the recent changes in higher education. Upper second class degrees go to 31 institutions who are impacted by changes but likely to survive, if not thrive, in the new regime.

At the other end of the scale, we have identified 10 universities that are in distinct danger from a combination of Browne Review impacts, inability to attract full-time and/or postgraduates and foreign students, coupled in some cases with a decision to charge high tuition fees. We anticipate that student numbers, and hence demand for accommodation, in these institutions will wane significantly in coming years. They are locations for investors, developers and funders to avoid.

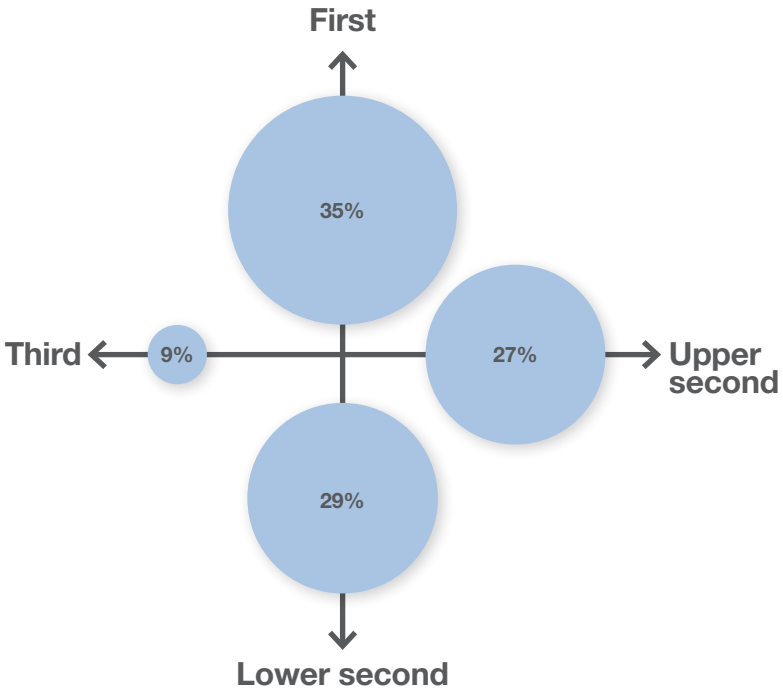
A further 35 universities emerge as lower second class, becoming overall losers in this first analysis of university prospects. In these institutions, it is likely to be a struggle to maintain student numbers and we would urge caution when it comes to investing in student housing in these locations.

FE response

Despite the dangers of falling student numbers, oversupply is a rare

FIGURE 1

Universities' response to change A combination of the ability to attract alternative sources of investment, full time, international and postgraduate students



Data source: Savills Research

> "There are potential opportunities in some of the locations that arise from the poor quality of the university-owned accommodation."

phenomenon in the world of student housing. The dramatic 20% increase in student numbers over the last 10 years has left most higher education establishments very short of accommodation – even for first year undergraduates. Strong competition from other sectors in the rental market can keep rents high in these locations and this in itself can act as a further deterrent to growth.

Where universities are competing to attract students, this consideration will weigh hard with decisions on tuition fee levels and the need to attract postgraduate and foreign students. Universities will therefore be faced with a need to upgrade and expand their student accommodation wherever possible but at the same time face cuts to finance which will severely limit their ability to do so.

As a result of these conflicting needs, we anticipate that the time is ripe for stock transfer to take place from universities to private sector owners. This will have the positive double whammy effect of raising revenues at a time of cuts while also enabling the upgrading of accommodation and further investment to take place.

Universities are likely to want to retain nomination rights and may even retain operational management responsibilities but the opportunities for the private sector to purchase real estate and take on some management will increase. Under these circumstances, it is important to understand the market context in which these, and other investment transactions, will take place.

Market response

This understanding of the market context forms the second tranche of our research. While there are winners and losers in the academic world that are likely to impact student housing demand, this is not the whole story for developers, funders and investors. Even the best and fastest growing institution will be a poor prospect for student housing providers if accommodation is fully supplied and/or rents are too low to make further development viable.

We have therefore scored towns and cities on both their overall demand from higher education institutions (there is often more than one in a single city) and on the balance between demand and supply factors.

Our second analysis covers 58 towns and cities in which the 114 higher education establishments of our first analysis are located. It takes into account the extent to which historic growth in student numbers, regardless of future trajectory, has been supplied – or undersupplied.

It also looks at the propensity of students to need accommodation, how many stay in the parental home, it examines the number of international students and full-time postgraduates as well as full-time undergraduates. We have also taken into account the rent levels in alternative accommodation in the town that might compete with purpose built student accommodation.

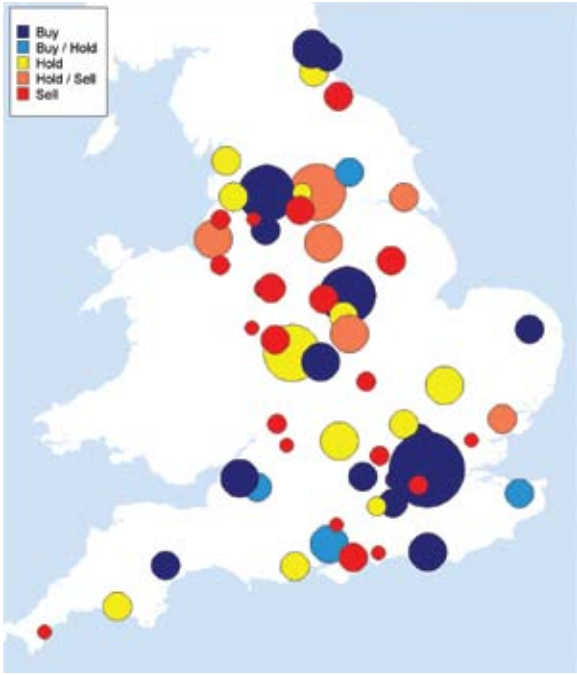
There are potential opportunities in some of the locations that arise from the poor quality of the university-owned accommodation which is currently provided. This not only presents a potential market for premium quality space but also creates the potential for stock transfers from cash-strapped institutions. The quality variable, in combination with a loss of funding/grant variable, is a powerful combination for identifying where opportunity for stock transfer exists.

It is the combination of academic prospects and market prospects at a localised level that will determine the fortunes of the student housing investor. We anticipate that there will be some very different outcomes for some schemes against others. It will be vital for anyone putting money into the sector going forward to correctly identify which is which. Our analysis provides the first step in doing this.

For those who eschew the third class locations and establishments and who manage to find development and investment opportunities in our 'buy' towns, we anticipate performance in the next 10 years every bit as good as that seen over the last decade. ■

FIGURE 2

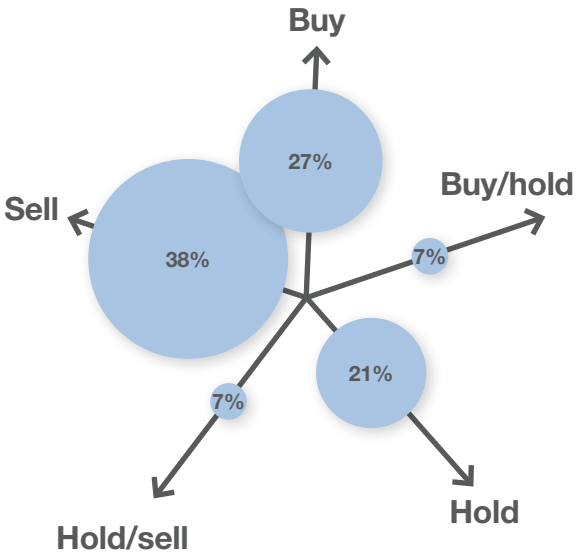
Marked context Prospects for investors by town or city



Data source: Savills Research, HESA

FIGURE 3

Investment, funding and development potential



Data source: Savills Research

INVESTMENT FOCUS

The student sector continues to deliver strong returns compared to other mainstream asset classes. Of the deals that involved direct let schemes in 2010, the average net yield was between 6.25% and 6.35%. Yields on the whole have moved in since this time last year because of higher volumes of investment. The sector has converged with the commercial property market, illustrating its position as a niche commercial asset class in many portfolios, rather than an extension of the residential sector.

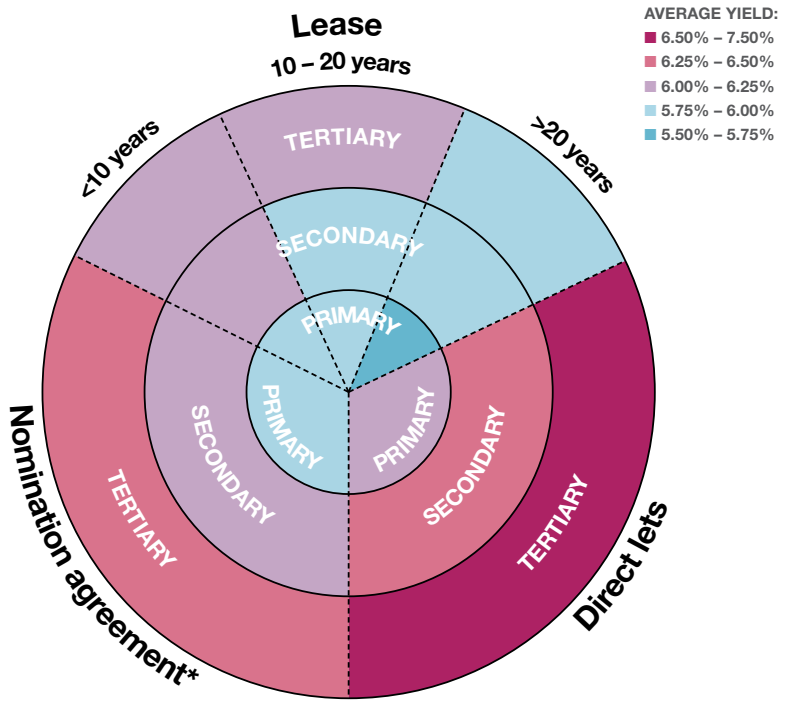
Despite current economic and property market conditions, the volume of deals in the student sector recently has been surprisingly high. We recorded circa 85 major deals in the 18 months to July 2011 with a total value of £1.3 billion.

This activity provides strong evidence of the attractiveness of the student sector and confirms that the sector has been successful in securing funding for student developments.

Despite this activity, there are few banks lending for development and those that are active in the market are being very selective. Development funding criteria have tightened.

FIGURE 4

Yields by location and type



*NA's must be hard core, ie. 15 – 20 years with a high % occupancy guarantee

Graph source: Savills Research

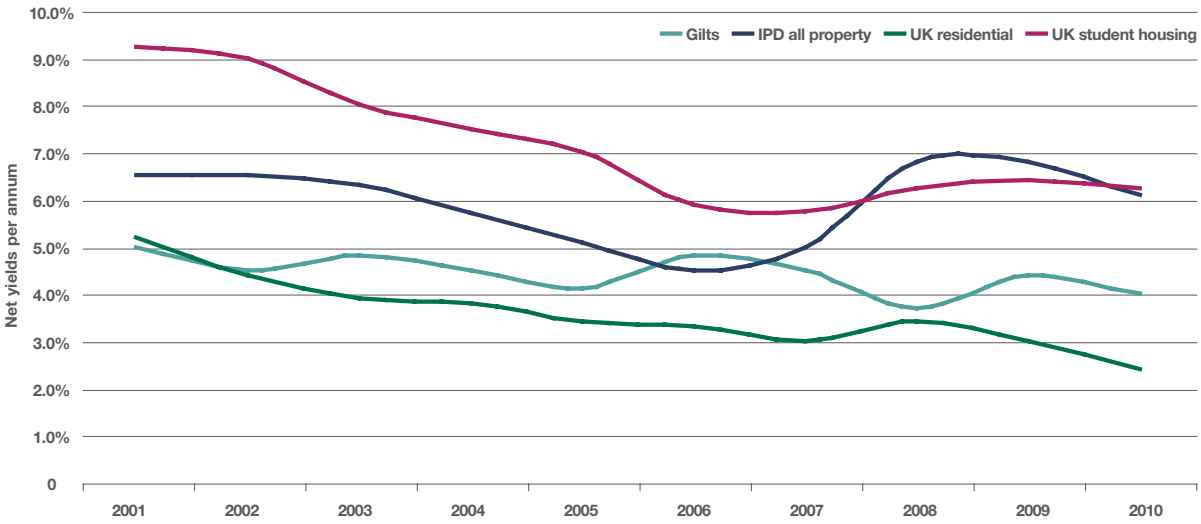
Increasingly, banks are focusing on the management/operational platform and have become more concerned with a scheme's occupational performance.

Of the £1.3 billion traded In 2010/11, 60% were investment deals for forward-funded or completed stock. Forty percent of deals involved sites, the majority of which have planning permission for student developments. The mainstream operators (including Unite Group, Mansion Group and Quintain) are still very active in acquiring sites in London and across the UK.

A large proportion (40%) of deals were concentrated in London with two or

FIGURE 5

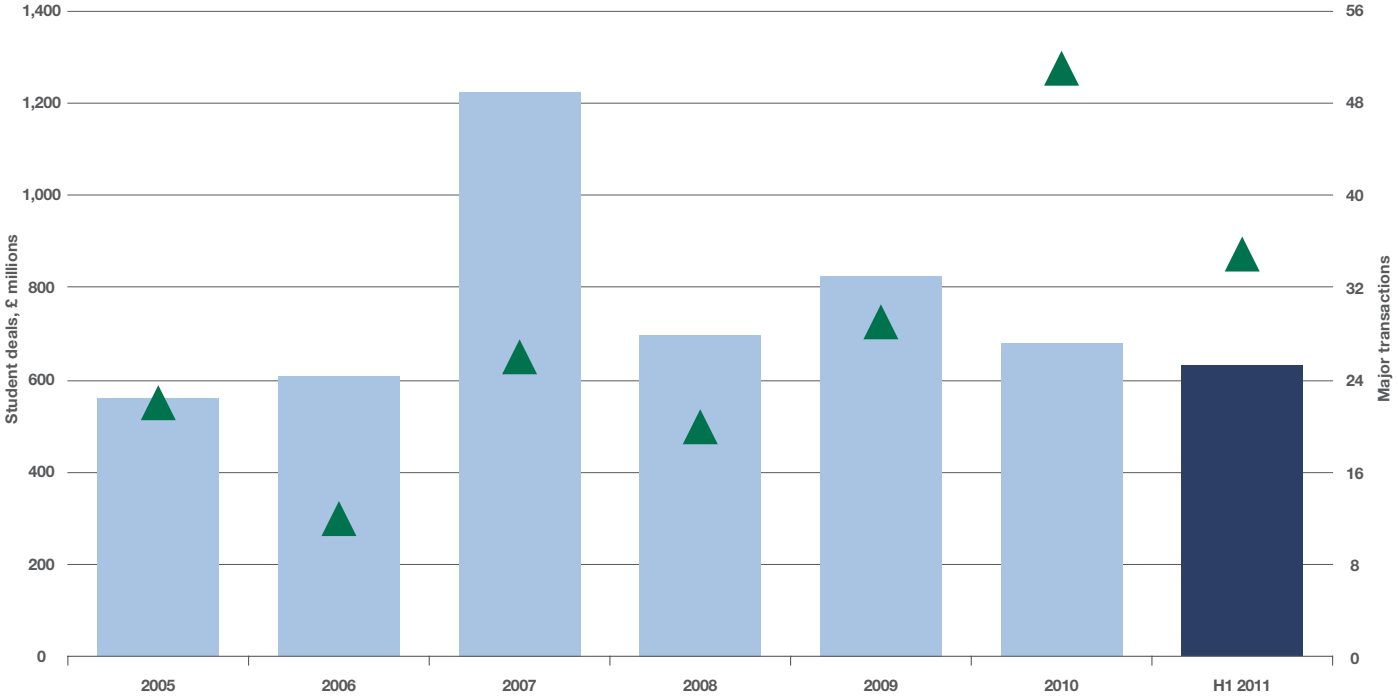
Commercial and student yields converge at 6.25%



Graph source: IPD / Savills Research

FIGURE 6

High levels of deals completed in 2010 and continuing into 2011 The number of deals completed last year and during H1 2011 is evidence of the strong appetite for student investment across the UK



Graph source: Savills Research

three deals each in most of the major regional university towns - including Edinburgh, Glasgow, Sheffield, Manchester and Nottingham.

Recent investor demand has shown a 'flight to quality' and focused on Russell group and the 1994 group university towns. This is interesting in the light of our analysis which highlights some of the top Russell group locations to be 'holds' rather than 'buys'.

Institutional investor appetite has grown with preferences for long-dated, secure income streams. Some investors will look at short term lease wrappers (say three years) and take direct let risk thereafter – but location / university specific risks become more important in this instance.

The major player's active in the market over the last 18 months included Urbanest, Mansion Group, McLaren Property and Unite Group but there has also been an influx of new players.

These have included private equity companies Oaktree Capital, Real Star, RPS Capital and Carlyle Group as well as a number of contractors filling the void left by the demise of residential development.

There are large sums of private equity looking for exposure to the student market, as well as middle eastern and far eastern investors seeking to access the market at all levels but focusing on secure income streams.

The smaller end of the market has been very active, involving high net worth's and Prop Co's looking to enter the market and create boutique schemes that are situated close to university campuses with between 50 and 150 beds.

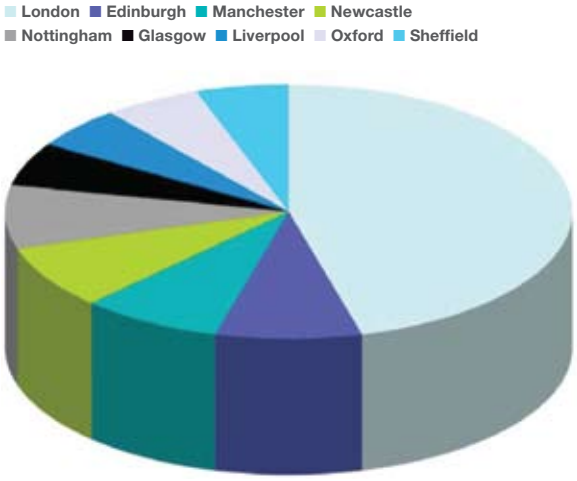
Going forward, we are likely to see UK universities increase their reliance on private sector investment to provide new accommodation and management solutions. This may well lead to academic estates being wrapped up within agreements and to the emergence of education REITs. ■

"Despite current economic and property market conditions, the volume of deals in the student sector has been surprisingly high"

Yolande Barnes, Savills Research

FIGURE 7

Location of transactional activity 2010/11



Graph source: Savills Research

DEVELOPMENT FOCUS: LONDON

Since the financial crisis, funding has been less constrained in the student housing sector than elsewhere. This has allowed it to take advantage of the slowdown in the residential market, especially in London, where the development of high quality student schemes has continued to expand.

London's student housing development landscape is dominated by higher risk, high density schemes that require high levels of forward investment. Seventy-five percent of all student accommodation schemes currently in the planning pipeline have more than 110 bedspaces each, and 45% have over 250 bedspaces. The sector dynamics have proven to be resilient over the past three to four years, outperforming many of the other mainstream investment sectors.

One reason for the divergence of student housing and the development of residential and other property is the counter-cyclical nature of student housing. During recessionary periods, the student population has expanded more rapidly and so rents rise. In the past year, the number of students accepted onto UK University courses increased from circa 65,000 in 2008-09 to over 92,000 in 2009-10, an increase of 40%.

Pipeline expands

We estimate there are currently 21,500 student beds in the London planning pipeline spread across 77 schemes In 19 boroughs. These are split between 4,600 planning applications (22%), 8,900 permissions (41%) and 8,000 under construction (37%).

Development starts were rare during 2008 and 2009. This has given rise to a low level of completions in 2010 and 2011. We estimate that completion levels were close to 3,000 bedspaces during 2010 and will drop to circa 2,300 in the whole of 2011.

In total, there are nine schemes due for completion before the 2011-12 academic year spread across eight different London boroughs (there may be some additional refurbishment units also ready for completion that are not included in these figures). Griffon Studios situated in Wandsworth, a joint venture between Berkeley First and Imperial College, is the largest scheme under construction with 452 beds. Other major schemes due for completion this autumn include:

- Victoria Hall/ Westbrook 435 bed scheme, Wembley
- Blackstone / Nido 272 bed scheme, Notting Hill
- Quintain/ iQ Hoxton 257 bed scheme, Hackney
- Quintain/ iQ 232 bed scheme Walworth Road, Southwark

Image supplied courtesy of UNITE

"London's student housing development landscape is dominated by higher risk, high density schemes that require vast sums of investment." Paul Savitz, Savills Research

Construction shortfall

During 2010, the marginally improved economic outlook, led to a bounce in student housing development starts across London which means a greater number of beds will be delivered in time for the 2012 academic year. Our data suggests that there will be at least 5,000 beds delivered in 2012 which are currently under construction.

We expect these schemes will be completed in the spring rather than summer of 2012 so that they can take advantage of the one-off wave of demand for accommodation that there will be around the Olympic Games. There will be considerable income for student operators if they can deliver these schemes to meet this demand, especially from the media sector.

Overall, the provision of student housing in London remains constrained in relation to the strong growth in student numbers over the past 10 years and the projected growth in the capital over the next decade. The number of additional students in London has been steadily rising with stronger growth in the last three to four years.

In total, there are circa 285,000 full time students studying in the capital. In 2009-10, there were an additional 17,000 students and 13,500 in the previous academic year. This is phenomenally strong growth which is creating a cumulative shortfall in housing provision as the delivery of new bedspaces to the market has slowed during the recession.

Based on the average annual number of extra full-time students over the last five years, we estimate there will be an additional cumulative shortfall in student bedspaces (above the current shortage) of 33,350 by 2016.

A major risk to the future development of new student housing schemes in London is the introduction of affordable housing requirements on student sites. The London Borough of Southwark (LBS) have introduced a policy (SP8) requiring the provision of affordable housing (subject to viability) on student schemes.

Although the policy broadly conforms with the London Plan (due to Southwark's particular housing need) it does not reflect the Mayor's approach of not seeking affordable housing where student schemes are linked to Higher Education Institutions (HEI's). While the policy was approved in principle, the mechanisms for operating the policy, particularly the assessment of viability, have still to be worked through.

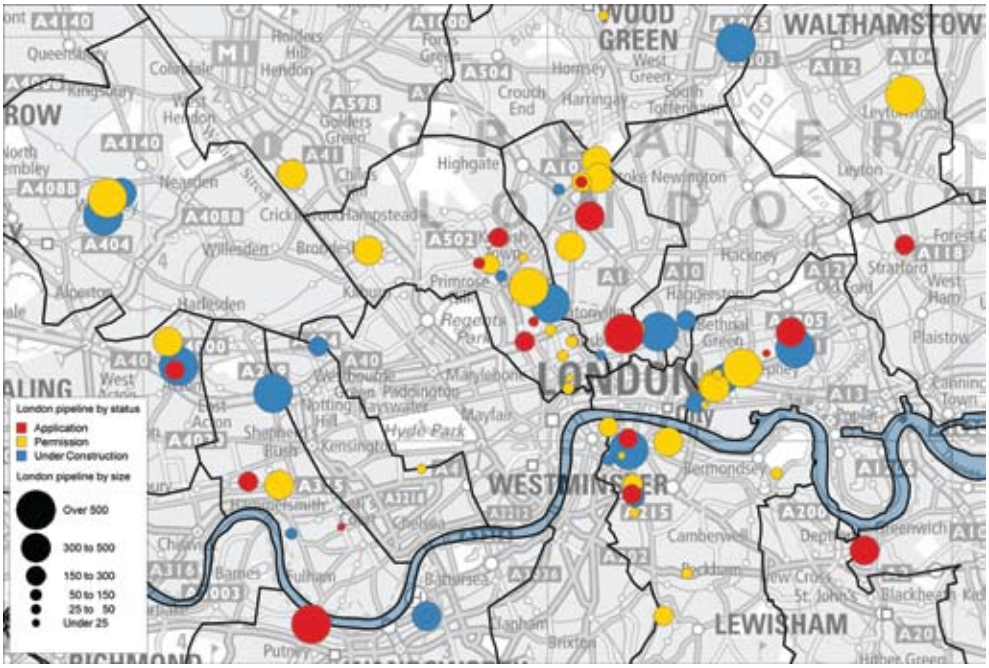
Student housing viability

The viability of student housing and general housing is quite different, particularly with respect to the exit points (where value/profit is realised). It will also vary significantly between proposals led by Higher Education Institutions (HEI's) and private developers. Resolving these technical issues is complex and likely to be a lengthy part of the planning process where viability is an issue.

Recently, the policy had its first real test with the planning application from the Quill scheme adjacent to London Bridge. The council decided not to require any affordable housing despite the scheme being (potentially) liable to some £18 million under the new policy approach.

FIGURE 8

London planning pipeline Autumn 2011 Supply of student housing in London continues to expand

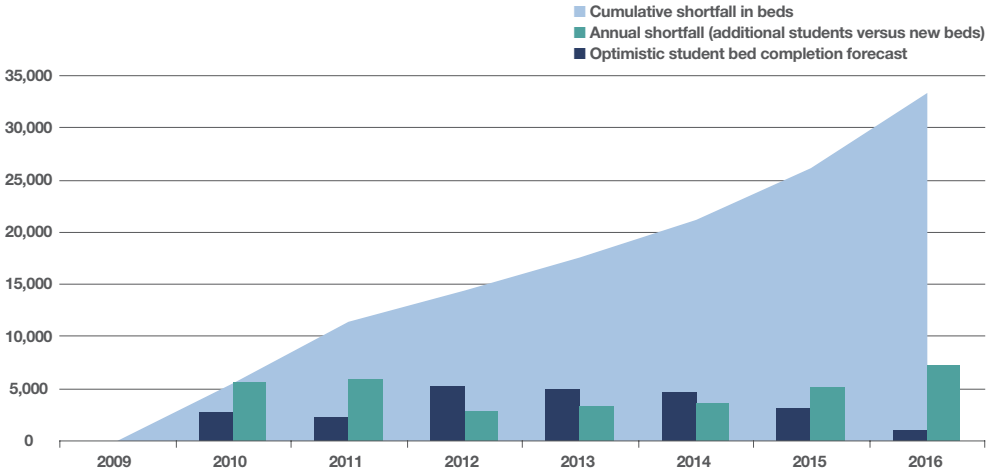


Note: 3 proposed London developments not shown totalling 210 beds (2 in Kingston upon Thames, 1 in Redbridge)

Data source: Savills Research

FIGURE 9

Construction shortfall will create opportunities across London



Graph source: Savills Research

It remains to be seen whether or not Southwark's new policy will produce any additional affordable housing or if the viability issues will make it unworkable.

There is also the issue of whether affordable and student housing are practical and compatible within the same development. In practice, where development viability permits, concessionary 'off site contributions' may have to be provided.
In our view, affordable housing would make many proposed schemes unviable and slow the market substantially.

On the flip side, a further stall in the development pipeline will insulate values in London and attract a premium on both sites and built stock alike. ■

UNDERLYING FUTURE RISKS

The Browne Review

The Browne Review has been a key event in higher education with far-reaching implications for the sector. In response to it, the government is removing all public support for courses in arts, humanities and social sciences and 80% of teaching budgets. The clear outcome is that universities will have to cover the cost of classroom based subjects with tuition fee income while funding will be maintained for 'priority' subjects (science and maths). To survive, universities will need to streamline their business operations, maximise their resources (including their property assets) and grow their expertise in subjects that continue to attract students.

One of the key principles from which the Browne committee undertook its review, was to increase student numbers by 10% over the next three years. It is anticipated that removing the cap on student numbers and funding students directly through the student support system, will permit this expansion. The presumption made is that popular universities with good teaching in priority subject groups will continue to grow.

Immigration reforms

A drive by UK universities to recruit higher fee payers and to diversify their income sources has resulted in rising international student numbers. The increase is set to continue as public funding of the UK higher education system is cut. International students make up 20% of enrolments at UK universities, split between non-EU (14%) and EU students (6%). In 2008-09, UK universities had the second highest share of all internationally mobile students after the United States. The largest numbers of international students are from China and India.

These students, either undergraduate or postgraduate, tend to occupy new, purpose built student accommodation for the majority of their university tenure. Across the sector, international student prerequisites tend to differ from domestic admissions, noticeably encompassing the ability to pay higher rents. A change to UK immigration policy could be a far greater potential risk to many UK universities and, by extension, to the student accommodation sector, than the change to tuition fees has been.

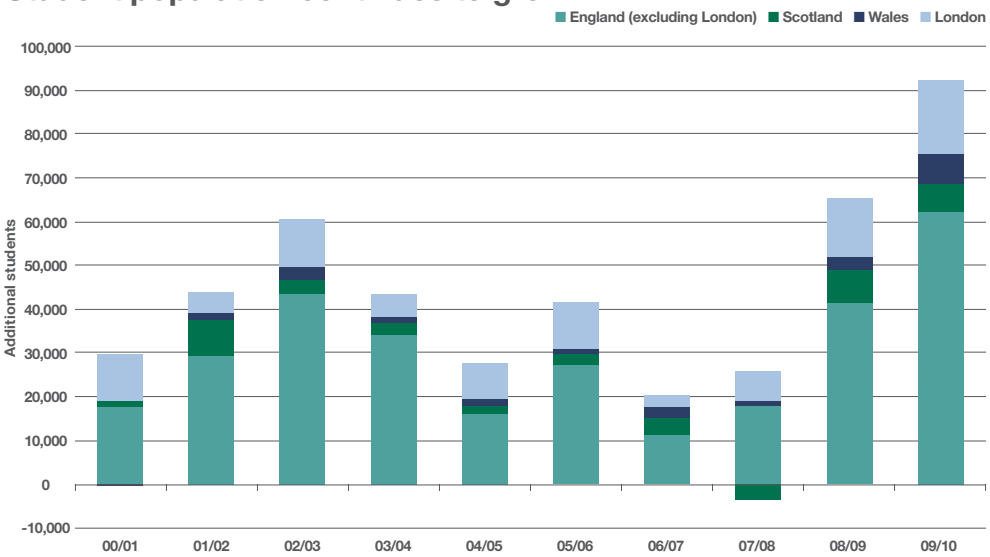
The Government's proposal to restrict the number of non-EU Tier 4 student visas and employment visas for skilled graduates and migrants could have severe consequences, potentially damaging the UK's global competitiveness and stemming the flow of international staff and students to UK universities.

It is estimated that the proposed changes would reduce the number of student visas by approximately 230,000 over the next five years. This would further reduce fee income for higher education establishments by around £170 million. This could present opportunities by encouraging future stock transfer. Most importantly for the existing student accommodation sector though, it would reduce demand for premium-grade bed spaces, which are overwhelmingly taken up by wealthier overseas students and postgraduates.

In recent years, several OECD countries have relaxed their immigration policies to encourage the temporary or permanent immigration of international students. Australia, Canada and New Zealand, for example, make it easy for foreign students who have studied in their universities to settle permanently in the country by granting them additional points for their immigration file. This makes these countries more attractive to students than a more restrictive UK regime would be. ■

FIGURE 10

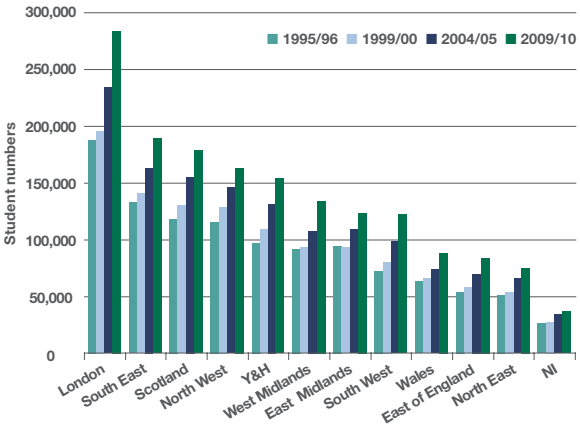
Student population continues to grow



Graph source: HESA

FIGURE 11

Full-time student numbers, by region



Graph source: HESA

> "The presumption made is that popular universities with good teaching in priority subject groups will continue to grow."
>
> Paul Savitz, Savills Research

OUTLOOK

The key findings in this document

■ A divide is emerging between those universities and locations able to withstand, or even thrive, under the changed higher education funding regime and those that cannot. This, and market forces and factors, are combining so that clear 'buy', 'hold', and 'sell' signals have emerged.

■ Analysis shows a combination of secure funding, ability to attract students, low or poor-quality existing supply and viable rental levels will create distinct winners for developers, funders and investors.

■ Meanwhile, there is a tranche of third-class universities where stock supply is high and student demand is dwindling alongside rents. This combination is sending strong 'sell' signals and we would encourage some providers to act on these.

■ New opportunities are emerging for the private sector as a result of university funding cuts. The prospect of raising cash by selling of stock will be attractive to some educational institutions. Many will start to see the quality and price of the student accommodation that they have to offer is an important component in attracting fee-paying students.

■ We expect the pressure on university funding to continue and new ways to raise and save cash, including stock transfer, to remain uppermost in the minds of university administrators. Any caps on the number of overseas students will only increase this pressure and will lead to greater competition for the best and most lucrative students.

■ High quality, good value student accommodation will be seen as a piece to be played in this game of strategy. Imaginative and well-informed providers of accommodation will have great opportunities to expand their business in coming years.

■ Universities in Scotland and Wales will look to take advantage of the new regime across England and will look to attract students across the border. Investment opportunities could arise from greater demand, but like England there will be distinct winners and losers, buys, holds and sells, which will require investigation.

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