Spotlight on…
Student Housing

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Spotlight on Student Housing

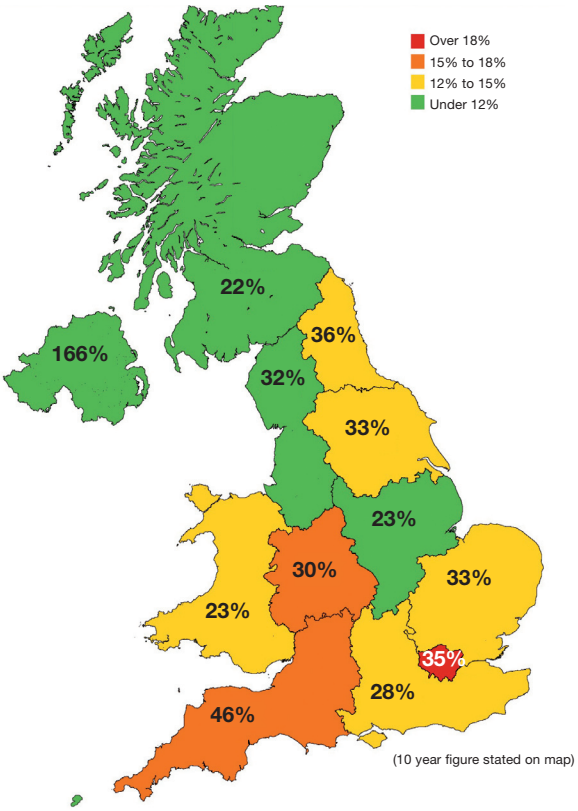
Will the associated risks involved dampen the attractiveness of investing in the student housing market in 2010?

Report highlights

The key question in 2010 is whether the market will continue to offer investment potential or if the associated risks now outweigh the advantages of investing in the sector. This report:

- reviews the recent changes to central government funding for UK universities and the likely impact that this will have on the growth in student numbers;
- examines the impact that the economic recession has had on the number of student beds available in both the purpose built accommodation market and the buy to let sector;
- identifies the universities that have benefited from the change in demand for courses since the downturn in the economy and those that are at risk because of a reliance on courses linked to city employment;
- outlines the investment potential of the student accommodation market;
- discusses the likely impacts of environmental legislation on the sector.

Map 1.
5 and 10 year growth in full time student numbers



Source: Savills Research using HESA

Student numbers continue to expand

The student market over the past 10 years has swiftly inflated. This is a result of government initiatives to increase the number of students attaining university degrees, together with the perceived importance of gaining a university education in relation to future employment prospects or opportunities and the expansion of international students studying in the UK.

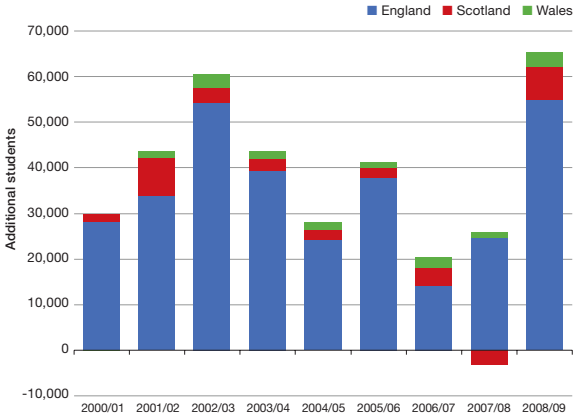
The latest HESA demand data for 2008/09 highlights this rapid growth. Over the past five years full-time student numbers in the UK have grown by 13%, (33% over the past decade) to 1,545,000. London remains the region where demand is strongest, buoyed by the overseas student. International students account for 30% of all full-time students within London, compared with a 20% UK average.

The capital has established itself as a premier global destination for students and has witnessed growth in full-time student numbers of over 18% during the past five years, and an increase of 35% over the past decade. The number of full-time students in London surpasses those Birmingham, Leeds, Liverpool, Manchester and Nottingham combined, offering opportunities to student housing providers as the supply of bedspaces continues to fall behind the pace of demand.

University funding is squeezed

This should be a buoyant time for the providers of student housing. The number of people trying to secure places at UK universities is at an all time high while the provision of new purpose-built student housing is limited. However, although new beds are estimated to have been delivered at a rate of just one new bed per eight new additional full-time students during 2009, the overall growth in the student population is potentially constrained by future funding restrictions.

Graph 1.
Number of additional students per year



Source: Savills Research using HESA

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After many years of increases, the higher education sector is facing a period of funding pressure. Students in the UK are funded through the student grant and loan system. The former Labour and current coalition government have again capped the number of places available to new students this year in England at 50,000 to reduce the pressure on student support costs. As a result, universities will see their funding reduce by 6% (£449 million), in the next academic year.

What is the impact on demand?

Reduced funding to the university sector may lead to universities pursuing other methods of funding such as the disposal of assets to the private sector or partnership arrangements with private organisations. 70% of purpose built student housing is owned and managed by universities and this proportion may reduce in the light of lower levels of central government funding.

In addition, according to the Higher Education Funding Council for England (HEFCE) the majority of universities have a high proportion of stock which is dated and in need of investment. This may act as a catalyst for universities to seek private sector investment. This trend is already evidenced by private student operators pursuing partnerships with universities to renovate and manage existing rundown on-campus accommodation, as higher education institutions struggle to raise capital to fund repairs, maintenance and renovation.

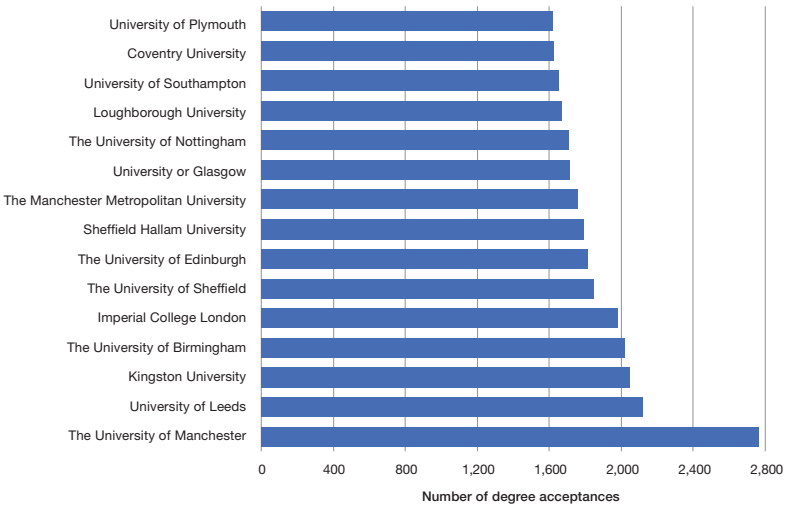
"The number of people trying to secure places at UK universities is at an all time high while the provision of new purpose-built student housing is limited."

Student numbers have been rising strongly over a prolonged period of time. The government's cap on the number of new students in England at 50,000 is in-line with the substantial growth seen in 2008/09 when new student numbers rose from 25,000 to 50,000 as shown in Graph 1. Therefore, although demand for student places is at an all time high, we expect to see student numbers stagnate this year. Even so, universities will be at full capacity and demand for accommodation will be strong.

It is important to identify the universities that may see a fall in demand because of an over-reliance on courses linked to the city and the financial job markets such as law, architecture, and property related degrees. Institutions offering STEM (Science, Technology, Engineering and Maths) courses will see the strongest demand, which is in-line with current Conservative-Liberal Democrat priorities.

As a result of changing government emphasis on subject priority a number of universities will be under pressure to continue to adapt and widen their teaching offer, or be at risk from under funding and reduced demand. As of 2009, The University of Manchester offered the greatest number of degree places to STEM students, 32% of all their degree acceptances, reducing their exposure to under funding and reduced student demand.

Graph 2.
Top 15 universities offering STEM subjects by number of acceptances



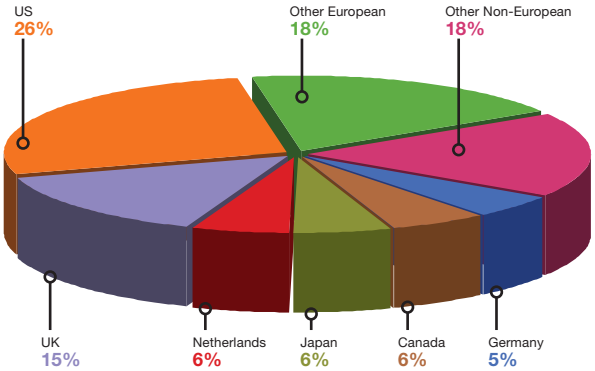
Source: Savills Research using UCAS (2009)

Competition from overseas

English-speaking nations are proving a threat to British Universities as student accommodation and non-residential academic buildings suffer as a consequence of decreased investment. Ageing campuses, with environmentally inadequate pre 1970s accommodation, is an important issue for under funded institutions.

The disclosure of a HEFCE database by the Guardian newspaper in February 2010 reveals that in more than 90% of higher education institutions, at least 10% of buildings have been judged below the "sound and operationally safe" category. One in 10 universities had at least 10% of their estate judged inoperable and at serious risk of breakdown, as of 2007/08 academic year. The database shows for some institutions, the cost of upgrading all "inoperable" and "operational but in need of major repair" residential buildings to "sound and operationally safe" would be a considerable proportion of their annual institutional income. The HEFCE figures reveal the cost to upgrade all UK residential university buildings from the two categories to "operational but

Graph 3.
World university rankings by country – top 200



Source: Savills Research using The Times Higher Education-QS World University Rankings 2009

in need of major repair" would cost over £825 million, approximately 11% of the total allocated government budget for the 2010/11 academic year.

A decrease in the financial ability of universities to upgrade, modernise and build new core non-residential infrastructure will open up the market for private firms to exploit the possibility of providing all university infrastructure, in addition to residential accommodation.

London and the UK remains a destination of choice for students, with four British universities in the top 10, and two London universities in the top 5 of the Times Higher Education-QS World University Rankings, second in number to America. However, competition from North American, Australian and European universities has become more intense. No longer can British universities rely on name and status to maintain high application levels from oversees students.

The 210,000 non-EU overseas full time students throughout UK universities add vital income to universities facing domestic funding cuts. As previously discussed, universities will need to seek to maximise other sources of income. Average tuition fees for non-EU overseas undergraduate courses now cost between £9,300 for standard courses and £11,500 for laboratory-based courses, compared with domestic and EU (who are not subject to visa requirements and pay the same fees as domestic students) fees of £3,290, capped for the 2010/11 academic year. It is fundamental that universities within the UK seek ways of upgrading and maintaining high standards of residential and non-residential buildings, to maintain their advantage over aspiring international institutions.

Supply expands in London

The development land market is returning to some form of stability, after a period of dramatic falls in value. Average UK greenfield land values are up 6% from a June 2009 low, with brownfield values seeing an increase of 3% over the same period. Despite this, values are still less than half of their 2007 peak, and availability of debt finance remains extremely constrained. Activity has therefore been limited to the most readily developable, serviced sites, which can be equity funded and turned around quickly to assist cashflows.

With land values so low, in many instances, the use of student housing produces higher values than that of residential or commercial use. Development of student housing is appealing since affordable housing is not levied on this type of scheme. Assuming funding can be secured, opportunities for new student housing development remains strong. However, planning policy remains the key obstacle and the unresolved issues surrounding the London planning process are hindering the development of good quality residential sites.

"The 210,000 non-EU full-time students throughout UK universities add vital income to universities facing domestic funding cuts."

The London supply pipeline has grown by nearly 30%, over the past 15 months to 19,000 bedspaces. The future supply of purpose-built student housing is spread across 67 schemes covering 19 London Boroughs, highlighting the widespread demand for accommodation. Notably student accommodation schemes at application stage have increased by over 25% since February 2009, a sign of private developers and investors taking advantage of, and seizing the opportunity of the high demand, low supply London student accommodation market.

Bedspaces at permission stage have increased by approximately 85%, while bedspaces under construction have decreased by -40%, indicating a lack of available

POST-ELECTION COMMENT

The impact of the new coalition government on the university sector has been outlined in the public spending review (May 2010). The Treasury's £6 billion savings plan has backtracked on the previous Labour government's commitment to make £270 million available in 2010/11 to fund extra university places in areas such as science and maths as part of a modernisation programme, which was expected to create 20,000 more places from September.

There will now only be 10,000 additional places available this autumn, split 80/20 between full-time undergraduates and part-time students. The government has reiterated that the funding will only be for one year, the second and third years will have to be funded by universities from additional savings, which will include teaching cuts and redundancies. The reduction of £200 million in university spending from the additional funding previously made available, will be in addition to £449 million already announced for next year.

The current financial year is already proving challenging to many universities as they absorb some higher than anticipated costs of pension contributions and utilities costs; while interest rates on investments are at an all time low (1%). The economic situation is affecting income from many commercial activities including conference income and in some universities research income is not meeting the budgeted levels, and is also getting increasingly challenging to secure. Any further cuts made in June's 'emergency' budget will further depress the sector's ability to invest in its future, without the aid of the private organisations.

The reduction of key strategic funding will soon force universities into seriously considering the transfer of non-core services such as student accommodation and non-residential infrastructure to private operators, to focus on core university operations such as teaching and research.

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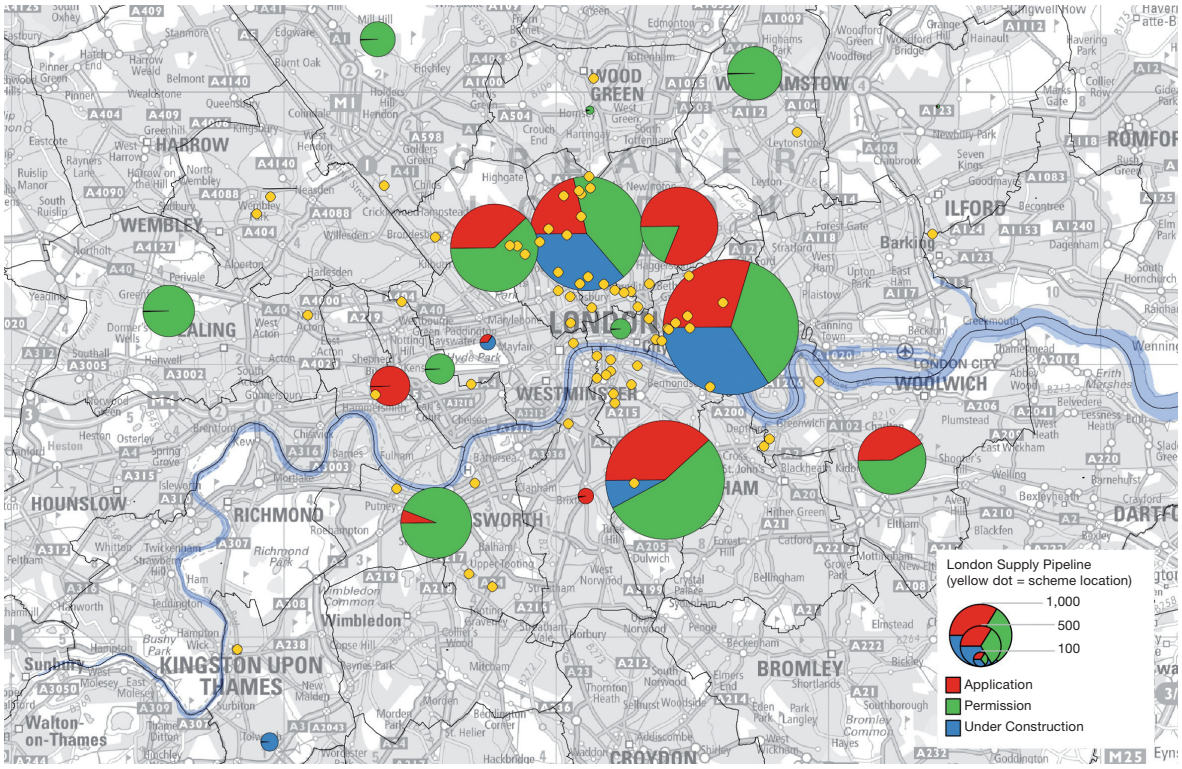
Map 2.
Distribution of London planning pipeline by individual location



Source: Savills Research using LRR & ABI

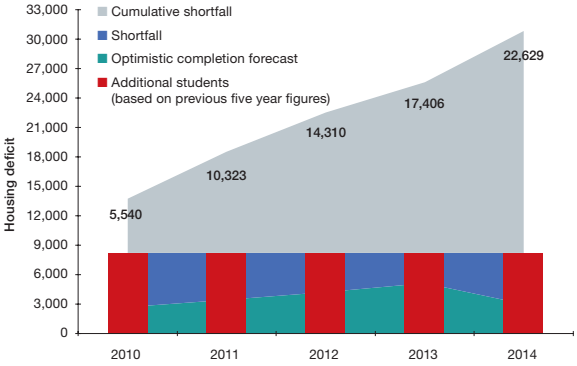
development finance, weak economic confidence and an uncertain economic future are still major factors affecting development within the sector.

The majority of the pipeline remains in city fringe locations, 85% of all bedspaces within the pipeline are located within eight London Boroughs (Tower Hamlets, Southwark, Islington, Camden, Hackney, Wandsworth, Greenwich and Brent), all boroughs which surround the low supply and high land value borough of Westminster, where student numbers are highest and demand for high quality, affordable accommodation is strong.

A lack of new private purpose built or newly reconfigured student accommodation blocks within close proximity to central London universities, together with the expansion of full-time student numbers, are significant commercial drivers for private operators considering future development strategies. Both factors would be expected to contribute to high occupancy rates at new or newly reconfigured, high quality, affordable student accommodation blocks in central London.

As site values in central London locations have fallen by approximately 50% since 2007, alternative site uses such as former office blocks and residential sites have started to show distressed pricing, and are now becoming affordable to private student housing operators and developers. During 2010 and 2011 we expect to see these centrally located sites to begin to appear within the planning pipeline for student housing.

Graph 4. Future shortfall of purpose-built student bedspaces within London



Source: Savills Research using LRR & ABI

New approaches to delivery

The London pipeline suggests that development opportunities are present, however the issue for those in the market is taking the next step. The combination of access to development finance, planning obstacles and viability challenges mean we expect both starts and completions in 2010 across London to be of similar levels to what was experienced in 2009, with a gradual increase over the following three years, dependent on barriers to development easing.

Purpose-built student housing completions, which historically have not equalled the growth in the number of new full-time students, are expected to remain lower than the annual increase in new additional students. This will continue to create significant student bedspace

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scarcity over time, with the prospect of a potential additional shortfall of a 22,000 bedspaces over the next five years, placing greater pressure on the lower end of the private rented and HMO markets across London. This housing deficit is not specific to London, this is a trend mirrored throughout a number of UK regions.

New approaches to enable the delivery of sufficient volumes of stock will be required to meet the demand for student housing, as university funding drifts away. We have already seen a shift towards the inclusion of purpose-built student housing as a way of releasing viable and affordable residential sites. Innovative joint venture strategies, between universities and the private sector have also helped alleviate barriers to development by creating synergies which reduce risk to all parties while providing high quality accommodation in good locations, as experienced through the Imperial College London and Berkeley First partnership.

Buy-to-let market starts to stabilise

A key feature of the previous decade was the change in attitude towards residential property as an investment asset, which was largely fuelled by the rapid expansion of the buy-to-let market. Council of Mortgage Lending (CML) statistics show the number of outstanding buy-to-let mortgages rose to over 1.2 million at the end of 2009 from under 75,000 at the beginning of the decade.

From January 2008 to May 2009 UK residential rental stock increased by 265% forcing values down by an average of 6%. However, falls were greater in the regional markets that were more exposed to high levels of new build supply. Since May 2009 the number of properties to let has decreased by 33%, enabling rents to stabilise and, in certain high demand areas, increase over the last six months. This has been a function of seasonal take-up of rented properties from students, graduates and other new employees, and reduced levels of new rental instructions on the back of improved conditions in the sales market.

Savills estimates the 2009/10 average weekly student accommodation rental cost for the UK stands at over £97, a 12% increase since 2007/08. This figure is in line with the March 2010 statistic from a National Union of Students (NUS)/Unipol rental accommodation survey. Reasons behind the rapid upward shift in rental costs over the past five years has been influenced by the increased specification offering by private operators, and a move away from the low cost institutional offering. The inclusion of broadband, concierge and lifestyle facilities within student accommodation blocks has increased the costs of provision.

The sharp increase in weekly rental costs has opened the debate about the capping of student accommodation fees, linking rental increases to inflation or enforcing low cost student housing options, such as dormitory style shared accommodation rooms or cluster flats, within newly reconfigured or newly built purpose built blocks.

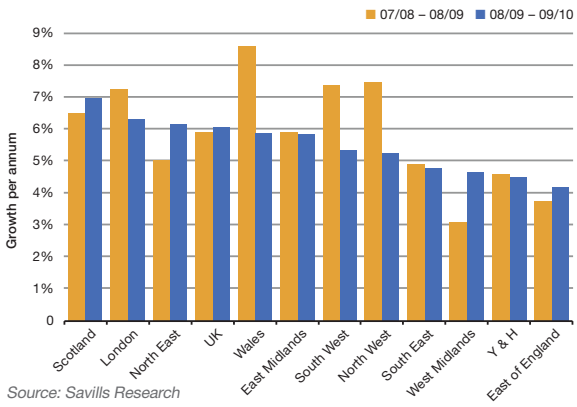
> "Purpose-built student housing completions are expected to remain lower than the annual increase in new additional students."

However, as reported in our 2009 Student Housing Report there remains an incredibly low supply ratio within many UK cities. For instance, London universities can only supply 36% of the bed spaces required to meet their accommodation needs. This is compared to a national average of 65%. Both first year and international students increase the demand for purpose-built accommodation as they seek to benefit from the ancillary services and pastoral care that accompanies professionally managed student accommodation.

As a result, annual rental growth has been consistently strong in London, by comparison with national averages. We anticipate rental levels to remain strong, however not as dazzling as previous years, with weekly rental growth in 2010/11 of 5.5% in London and 5% across the UK.

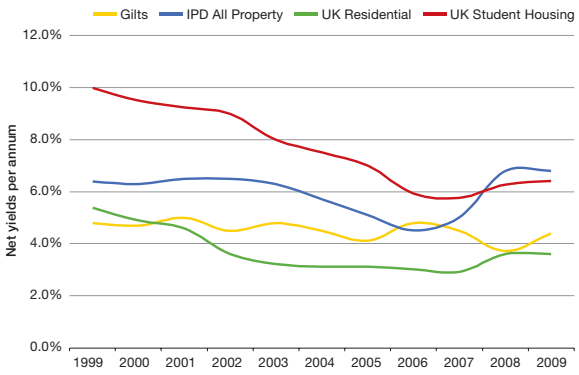
Savills Residential data reported a stabilisation of yields during 2009. Student housing remained strong in relation to other asset classes, and investors are again enjoying robust performance. However, evidence within the first quarter of 2010 is pointing towards a compression of student housing yields as highlighted by the £125 million portfolio sale by Sanctuary Group. The 1,800 student bed portfolio, spread over campuses in four universities in London and one in Brighton, would reflect a yield of around 6%, although still above UK residential yields. ■

Graph 5.
Rental growth remains strong across UK



Source: Savills Research

Graph 6.
Comparatively strong yields for student housing



Source: Savills Research, IPD

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New legislation focuses on the environment

While we are still facing the hangover from the financial crisis, environmental concerns have not disappeared. The government will step up their commitment to reduce carbon emissions through new waves of legislation. Up until now, this has been largely aimed at operators developing new sites, but this looks set to shift towards current stock. Going forward we expect to see increasing occupier preference for 'green' buildings that possess low operational expenditure characteristics.

Carbon reduction commitment

One important scheme coming into effect in 2010 is the Carbon Reduction Commitment (CRC). The scheme is aimed at non-energy intensive private and public organisations that registered a total half-hourly metered electricity use greater than 6,000 MWh between 1st January and 31st December 2008. This equates to an annual energy bill in excess of £500,000. It is thought that approximately 5,000 organisations may be liable, including property landlords and investors, as well as the majority of universities.

For organisations successful in reducing their carbon emissions, inclusion into the scheme could be financially beneficial. Any improved ranking on the league table would also be beneficial to organisations wanting to improve their 'green' credentials and meet CSR targets.

Capital Investment Framework (CIF)

The Higher Education Funding Council for England is developing CIF further in light of government targets on carbon reduction and new requirements relating to space management. The outcome will inform the capital funding available to universities after 2011.

The Climate Change Act 2008 aims to improve carbon management and help the transition towards a low-carbon economy in the UK. It sets the world's first legally binding reduction targets for greenhouse gas emissions of at least 34 per cent by 2020 and at least 80 per cent by 2050, against 1990 baseline.

BREEAM

As students become more aware of the environment and sustainability issues, they increasingly influence the need to ensure all new builds, including residences are BREEAM rated and many institutions are seeking an 'Excellent' rating as a minimum standard.

Building Regulations

After four years of carbon emission ratings, the Building Regulations have been revised and have now been published as the new Building Regulations Part L (2010) and will be in force from October 2010. University capital developments will become increasingly challenged to meet these revised regulations.

Zero carbon housing

Growing preference for greener buildings will lead to greater levels of sustainable refurbishment in the university sector. Landlords and investors will seek to improve running yields by reducing costs through improving building efficiencies. In addition, the higher education sector is extremely competitive, so it is vital for universities to provide quality facilities to attract future students. By developing sustainable buildings universities are expanding the awareness of environmental concerns, thus increasing environmental responsibility among students and employees.

Summary and outlook

- The student market over the past 10 years has swiftly inflated as a result of government initiatives to increase the number of students attaining university degrees, the perceived importance of gaining university education in relation to future employment prospects or opportunities and the expansion of international students studying in the UK. Over the past five years full-time student numbers in the UK have grown by 13%, (33% over the past decade) to 1.545 million.
- In the next academic year universities will see their funding reduce. The reduction of key strategic funding may lead to universities pursuing other methods of funding such as the disposal of assets to the private sector or partnership arrangements with private organisations.
- Assuming funding can be secured, opportunities for new student housing development remains strong. However, key obstacles, including planning policy and access to development finance are hindering the development of good quality residential sites that will attract students.
- Purpose-built student housing completions (bedspaces), which historically have not equalled the growth in the number of new full-time students, are expected to remain lower than the annual increase in new additional students.
- The Government will step up their commitment to reduce emissions through new waves of legislation. Up until now, this has been largely aimed at operators developing new sites, but this looks set to shift towards current stock. Going forward we expect to see increasing occupier preference for 'green' buildings that possess low operational expenditure characteristics.
- We anticipate rental levels to remain strong, however not as dazzling as seen in previous years, with weekly rental growth in 2010/11 of 5.5% in London and 5% across the UK.

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Residential research services

Savills has had a dedicated residential research team for the past 20 years. Based in London the team provides advice and analysis to clients, on all aspects of the residential market. The department has built up a strong reputation for producing accurate, well-informed and independent analysis and commentary on the UK's housing market.

The team is a leading national commentator on housing market trends. The success of the department has been built on its market insight, provided by the Savills network, in conjunction with a significant external consultancy business.

This market-led approach to our research is vital to our clients. Through the provision of analysis, commentary and forecasting we can add value to both assets and businesses. The department has been involved in a wide range of consultancy projects for public and private sector organisations across the UK. Typical consultancy projects include:

- Local area supply and demand analysis
- Research to support planning applications and development feasibility studies
- Investment strategy and advice
- Place-making site studies and research into housing-led regeneration
- Forecasting rents and capital values
- Research to inform policy making and statements of best practice
- Research for property finance and business planning purposes

Student investment and development

The specialist team focuses on agency acquisitions and disposals, consultancy and valuation of student accommodation across the UK. We assist residential, student and mixed-used developers and investors, landowners (including universities and NHS Trusts), registered social landlords, local authorities, charities, banks and building societies.

Areas of expertise include:

- Land and asset disposal and acquisition
- Investment agency disposal and acquisition
- Procurement of student halls ■ Valuation
- Estate and property strategies ■ Town planning
- Feasibility studies ■ Investment and agency advice
- Site assembly ■ Acquisition ■ Disposal

Agency

An agency-led team in the student accommodation sector. Focusing on asset and portfolio acquisitions and disposals, 'on' and 'off' market. Advising from site identification, planning, development funding to forward sale, and on trading investments for operators and universities.

Valuation

- Desk-top development and investment appraisals
- Loan security valuations ■ Portfolio valuations

Savills has panel valuer experience advising banks and building societies, investment funds and institutions, housing associations and property companies / developers.

Consultancy

Advisory services on property issues within the education sector, portfolio options appraisals, asset reviews and University Estates strategies, OJEU notices, assessing:

- Demand and supply dynamics
- Options appraisals from retention, part disposal, sale and leaseback, and SPV structures

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