



Savills Research
UK Development

Spotlight **Student Housing**

Summer 2012





Spotlight Student Housing



SUMMARY AND OUTLOOK

Putting national and global risks in perspective

■ Student housing may be considered a maturing sector but it has performed well over the last five years, showing average annual total returns outperforming many commercial property asset classes.

■ Not surprisingly, demand from investors for high quality stock in safe locations has been increasing in the light of this performance along with the number of equity investors looking for sound, long term income streams. We anticipate this will continue for the rest of the year at least.

■ In the longer term, we see prospects for increased investor demand with investment yields moving in for long dated income streams. Meanwhile, the demand-supply imbalance in the sector should ensure rental growth.

■ The prospects for additional demand to UK institutions from overseas students are good, at a time when global student mobility is increasing, together with a doubling of higher education students to 262 million by 2025, provided UK immigration policy allows for this growth.

■ Supply growth is severely constrained despite a relatively healthy flow of development activity during the downturn in prime locations.

■ The market will remain undersupplied at current levels in relation to both the growth in student numbers and latent demand from students currently housed outside the sector, as banks disappear from the debt and development markets.

■ Increasing risk aversion, combined with scarce availability of senior debt for

construction finance, correlated against a period where there is a need to refinance a number of significant maturing five year loans will allow opportunistic investment from globally mobile equity providers looking for secure, long dated income streams and to diversify portfolios.

■ There is a strong likelihood that universities will increasingly seek to avoid calls on capital and revenue arising from their own ageing accommodation and will look to generate capital receipts (and improvements to their accommodation) from investors through stock transfer.

■ This offers unprecedented opportunities for investors in high-quality university locations not otherwise available to them due to lack of newly built supply. We have analysed where the best opportunities lie.

→ SECTOR PERFORMANCE AN EVOLVING MARKET

Attractive investment

As the global financial markets began to recover during 2011, the fluidity of money into the more so called safe haven prime office, retail and residential property assets increased, as caution among investors, equity providers, and fund managers remained.

However, during that same period, other trends emerged which suggests that global investors are further diversifying their portfolios and investing in the relative attractiveness of more so called alternative investments such as student housing.

The counter cyclical nature of the student sector and secure long term income streams enables investors to offset riskier assets with a more defensive asset strategy.

Graph 1 places the UK student housing sector in context with other mainstream asset classes, as recorded by IPD. This shows a relative outperformance in blended initial yield of around 6.3% for direct let/leased assets.

Trading

Since the beginning of 2011 Savills has recorded approximately 80 major student housing deals, covering both sites and investment deals, with circa 36% London focused. As the sector escaped the worst of the recent economic downturn, a consequence of favourable market conditions, investment into the sector soared totalling around £2.1billion.

Of the deals traded over the past 16 months, 70% were investment deals for forward-funded or completed stock. The remaining deals involved post-planning site acquisition, with the majority located in Russell Group towns and cities.

London continues to be the prime investment location with 52% of the total transacting within the capital. The driving force being increasing student numbers, strong international demand and a shortfall in suitable accommodation, all factors which have led to a growth in London rents over the past year of around 3%-5%.

Investment prospects

Investment funds are beginning to fill the debt gap left by banks and have secured loans with operators such as Unite, iQ and Nido. This is encouraging to those already in the market as this is their first real taste of the direct let product and possibly the first step in acquiring direct let assets. M&G, L&G, Aviva and AIG have all entered or are entering this space.

Institutional investment appetite looks set to continue throughout the course of the year as longer term secure income streams become preferential, within a sector which offers long leases and provides high occupancy rates.

The student accommodation sector is expected to see investment flows of over £2billion in 2012, inclusive of the £600million already traded to the end of April 2012 (Graph 2).

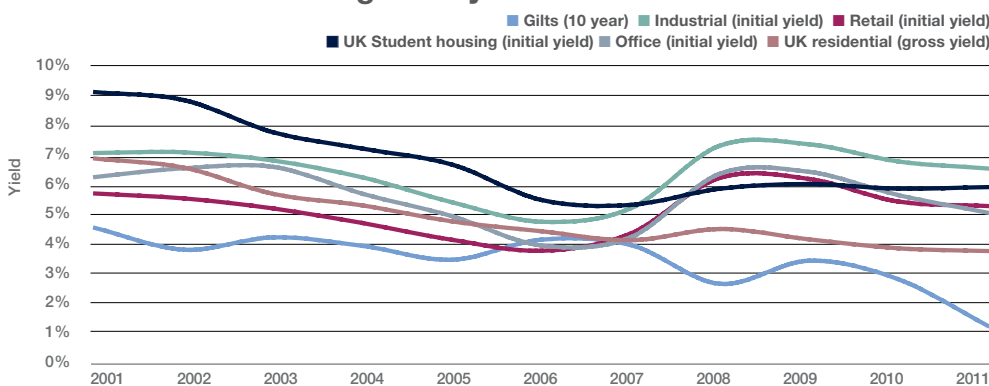
A further £1.4billion of student housing stock is expected to be traded in the second quarter of 2012, 26,000 bedspaces to the Dutch pension fund PGM and Blackstone's Nido portfolio to Round Hill Capital. This highlights the continued attractiveness of student housing as an alternative property investment class. However, large scale investment into the sector will become more location sensitive and focused towards strong covenanted assets as the effects of changing policy emerge and risks to investment increase.

Yield Play

We are increasingly of the view that there are inconsistencies in the relationships between investment returns from different asset classes and that over the next ten years or so we will see markets re-assess the returns they seek from different types of assets (Graph 3).

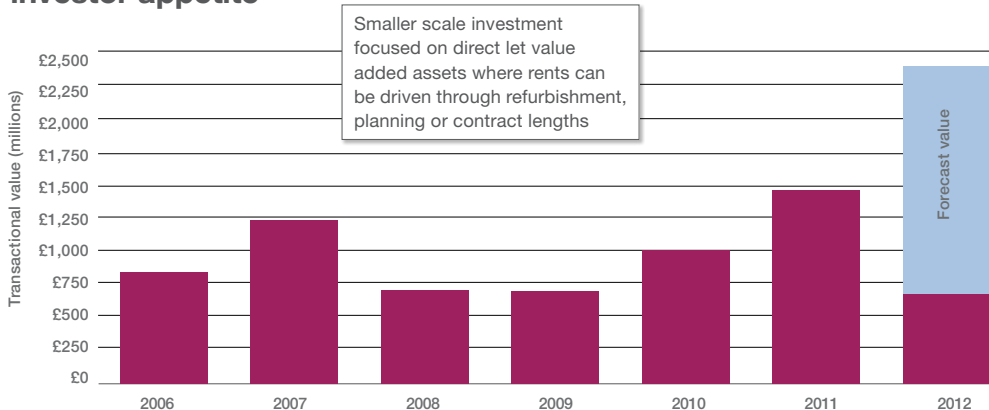
Under these circumstances, we observe that real estate assets

GRAPH 1
Blended student housing initial yields remain stable and attractive



Graph source: Savills Research, IPD

GRAPH 2
Value of student accommodation deals indicates renewed investor appetite



Graph source: Savills Research

are exhibiting good portfolio diversification characteristics but are set at much higher yields than other assets that have been highly volatile and poor diversifiers inside the 'risk on, risk off' investment environment.

If gilt yields are to remain low for longer than markets originally anticipated, the disparity between them and property looks increasingly unjustified. The quality and value of stable income streams against non-depreciating assets like residential property justifies lower yields (and higher capital values) in future.

IT'S ALL ABOUT RISK: DEMAND SIDE

Application trends

At this time last year, we reported on the prospects for the student housing sector in the wake of some very big changes in Higher Education. Some in the industry were concerned that the possible withdrawal of funding for some institutions and the raising of tuition fees would affect student numbers and demand for accommodation.

While our analysis did suggest that there were both potential winners and losers as a result of these changes, overall it does not appear that the student housing sector will be adversely affected as a whole. Indeed, underlying lack of supply in the face of continued demand seems set to sustain investment returns in the foreseeable future.

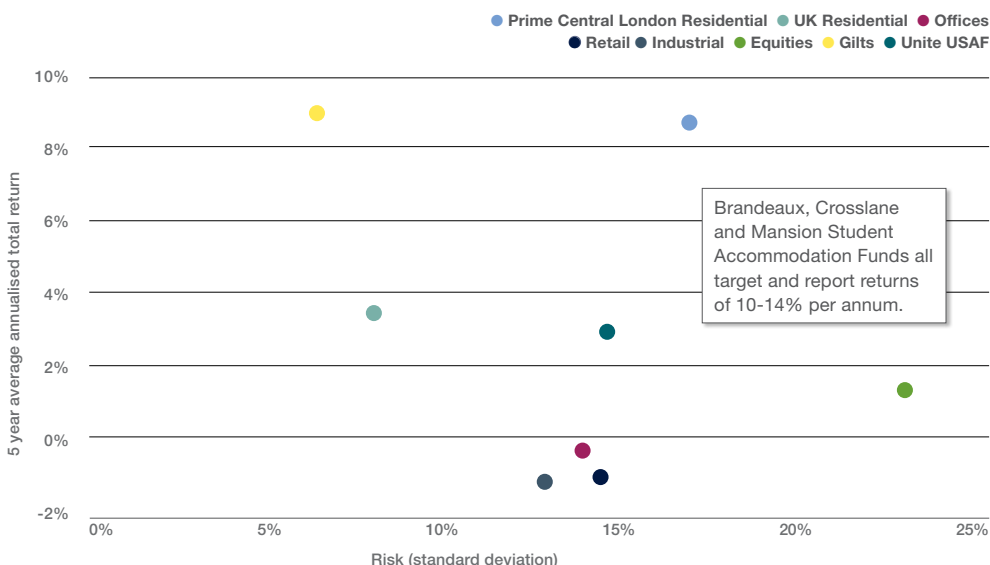
Although applications by potential students for undergraduate Higher Education places have fallen, this has not been significant in relation to the number of places available.

Headline figures as reported by UCAS (May 2012) have shown a fall of 31,665 UK applications from students aged between 18 and 20, or a 6.7% decrease since the previous academic year. This fall in full-time undergraduate student applications for the 2012/13 academic year, compared to the same stage of the previous years application cycle, has been attributed to the rise in tuition fees by many commentators.

Initial sentiment among investors, developers and operators of UK

GRAPH 3

Investment performance across all asset classes



Graph source: Savills Research, IPD, Unite Annual Report

student accommodation as a result of these headline figures would seem to be one of great concern. They needn't be.

The indications are that demand for Higher Education, even in the face of significant increases in tuition fees will continue to outstrip the number of places available in 2012. Total applications for the age groups of 18, 19 and 20 (the age bracket which accounts for over 75% of all applications) are already 91,200 ahead of the number of degree acceptances in 2011 for the equivalent age bracket. This is without taking into account further applications received before submissions close.

Population projections from the Office for National Statistics (ONS) suggest that this fall in overall youth student application numbers could have been predicted and is not linked to a rise in costs of higher education.

The national population projections are not forecasts and do not attempt to predict the impact that new or future government policies, changing economic circumstances or other factors might have on future demographic behaviour. The national population projections calculate future numbers of births, deaths and migrants. They show a continuing downward demographic trend in total numbers of 18 to 20 year olds across

all regions of the UK. A decrease of 47,000 was projected between 2011 and 2012, a fall of 2% and a further fall of 53,000 is projected over the current year.

Analysis of UCAS published application rates for 18 year olds, which takes into account these population changes, highlights only a slight fall of one percentage point across England since the previous academic year (see Graph 4). This fall takes applicant levels back to 2010 levels and the data paints a static picture for the rest of the UK. In other words, rising tuition fees have had a diminutive impact on potential university students who might see rising domestic youth unemployment as an inferior alternative.

It is the demographic changes which should bear further scrutiny by student housing providers. By 2020, the cumulative fall in the UK population aged 18 to 20, (the demographic which inhabits the majority of UK purpose built student accommodation blocks), is projected to decrease by 358,000, from a recent population high of 2.48million in 2010.

This has the potential to negatively affect domestic university application totals and domestic student accommodation occupancy rates over the forthcoming years in some of the less popular institutions. Having said this, demand for accommodation →

→ is not solely reliant on this demographic as postgraduates and overseas students are also a major source of demand.

The UCAS analysis shows that overseas student application numbers have held steady. Non-European applications increased by 5,106 applications – growth of 10% (May 2012). This figure was however negated by an equivalent decrease in applications from students originating from within European Union nations. The reason for investors, developers and operators to remain positive is that this increasing non-European demographic inhabits the second largest tranche of purpose built student accommodation, at values often above the domestic market.

Institutional performance

Since our last report where Savills Research analysed the potential winners and losers from the Browne Review, the Higher Education sector has now entered its period of financial and policy change. The analysis (Graph 5) shows which institutions have remained in demand and which institutions have as a result of a number of differing factors fallen in popularity. The graph analyses UCAS undergraduate applications for the forthcoming 2012/13 academic intake, compared to the previous 3-year average at the same stage of the application cycle.

The analysis immediately highlights the positive demand, from both

domestic and international students, across the majority of Scottish institutions (labelled as red). The Scottish Government has not followed the Westminster Government and has resisted charging Scottish students tuition fees when studying within its borders. The only exception is The University of Edinburgh, which has seen domestic (GB) applications reduce, possibly as a result of domestic students outside of Scotland having to pay higher fees to attend the prestigious university on a typical four year course.

Global demographics

Students from the Far East, Hong Kong, Middle East and the Americas bring additional sources of finance for universities. The future student profile of the UK market could well tilt towards non-EU students as global recruitment strategies become the norm. A combination of wealth creation concentrated amongst developing nations, UK universities increasing overseas recruitment strategies as domestic funding shrinks and student housing operators targeting and marketing product towards non-EU students will continue to increase the number of applications from non-EU students, as domestic youth numbers are projected to decrease.

The demographic profile of these major non-EU regions are changing. While African and South American youth levels increase, the United Nations Department of Economic

and Social Affairs 2008 population trends suggest decreasing levels of under 25s across China and India, as aging populations replace baby boom periods (see Graph 6).

The rise of the middle classes across these two nations will continue to generate student demand however. A larger proportion of the population will want to procure education at established, English speaking international universities and they will need accommodation. These fundamental adjustments in population growth and economics will shift the geo-strategic weight away from European applicants towards recruiting students from Asia, Middle East and Africa – if government policy allows.

Immigration policy

Global student mobility is increasing, with projections forecasting growth of students enrolled outside of their country of residence to 8million by 2025, from 3.7million in 2010.

This sentiment is echoed by a recent report published by the British Council: *The shape of things to come: Higher education global trends and emerging opportunities to 2020*. The report analyses economic, demographic and educational trends in more than 50 countries, and proposes that UK Higher Education stands to “reap the rewards of a coming decade of opportunity” in global markets.

The report highlights that within the next decade nearly 30,000 more international students can be expected to join university courses in the UK, second to Australia, and more than its greatest higher education competitor, the United States.

Much of the predicted growth in international student numbers to the UK will be fuelled by rising demand for university places from India, which is forecast to overtake China as the world’s fastest growing source of globally mobile students. It will also be driven by the UK’s high and expected growing share of other rapidly expanding markets including Nigeria, Malaysia, Pakistan and Saudi Arabia (Graph 7).

Government policy will dictate and determine whether these encouraging

GRAPH 4 **10-year application rates to university of 18 year olds across the UK**



Graph source: The Universities and Colleges Admissions Service (UCAS)

messages for both universities and those who invest in student accommodation transpire. The potential for UK universities to attract international students may well not be realised if the government sticks to its policy of placing obstacles in the way of prospective overseas students through tougher visa regulations.

IT'S ALL ABOUT RISK: SUPPLY SIDE

A good recession

Even though investors, developers and financial institutions reined back funding for commercial and residential development during the three years to the end of 2010, student housing was affected to a much lesser extent.

The flow of equity into the sector continued, and so the development of student accommodation aligned to strong institutions and in strategic locations remained fluid. It was helped further by opportunities

for land acquisition as competition from other use classes diminished, land values fell and sites became more viable.

The resilience and attractiveness of London's purpose built student housing (PBSH) sector immediately after the recent economic downturn meant it was one of a few locations that continued to see development activity. This has now borne fruit and unit delivery rates peaked during 2011/12.

London completions

Demand for student bedspaces in London was boosted by a surge in acceptances throughout the 2009/10 and 2010/11 academic years but accommodation supply has still not met the increase in student numbers.

Delivery has historically fallen short of student housing requirements as London's full-time student population now totals close to 290,000 and has increased by an average of 9,000 additional students per annum over

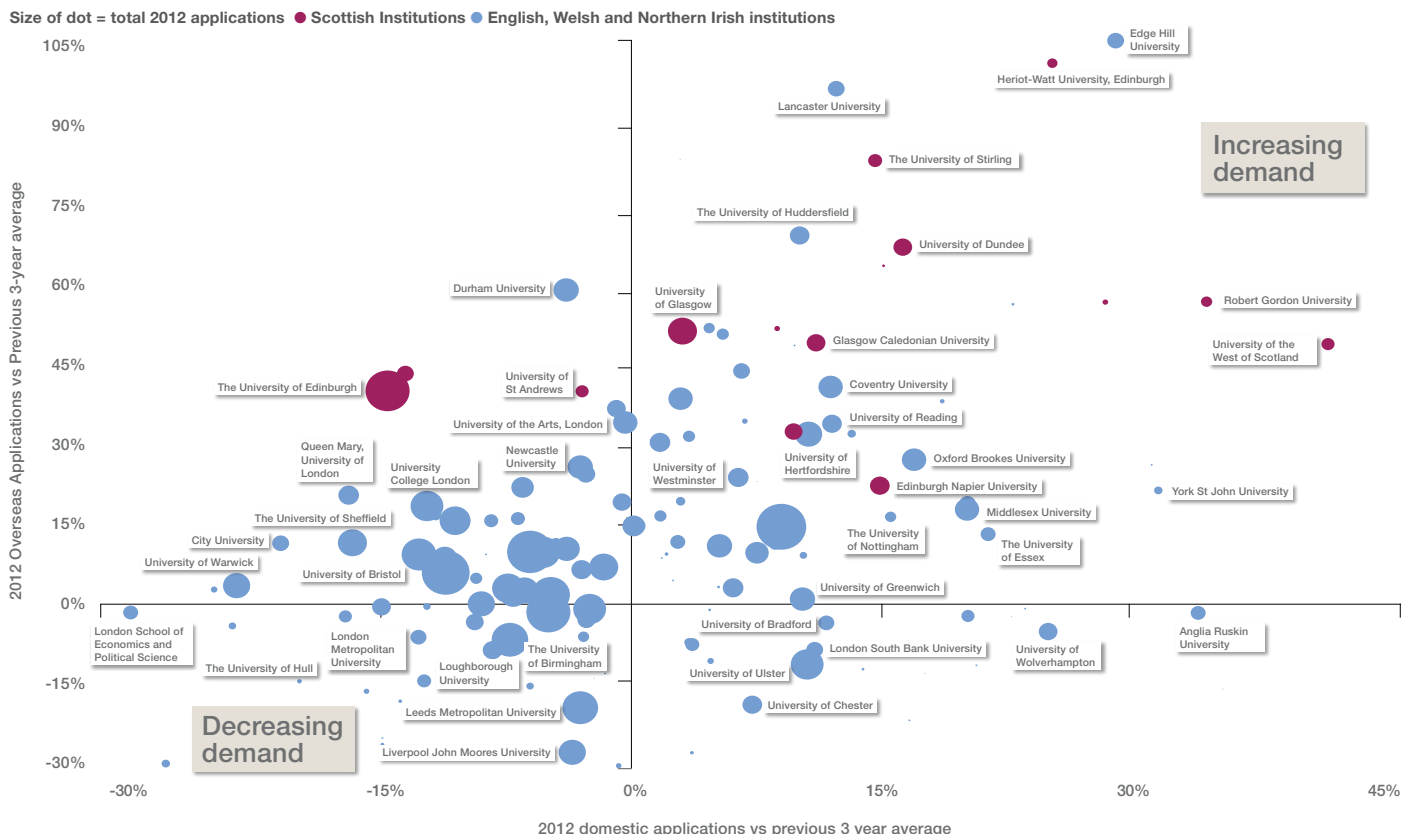
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 "Delivery has fallen short of student housing requirements as London's full-time student population totals close to 290,000" Paul Savitz, Savills Research

the past five years. The magnetism of London's burgeoning international and significant domestic student population, alongside increasing demand for private residential rental accommodation within the capital has attracted new equity into the sector.

Most recently, large scale investment activity into the London sector has come through Pure Student Living, a joint venture between global alternative asset manager The Carlyle Group and Generation Estates.

Consequently, at least 18 PBSH schemes across London will complete and be operational for the 2012/13 academic year. Most →

GRAPH 5 **Strength of Universities and Institutions based on UCAS undergraduate applications**



→ of these will be completing in time for the Olympic summer lettings period. These schemes account for approximately 6,500 bedspaces and are focused predominantly within London Underground Zone 1 & 2 locations. A further 3,800 bedspaces within Zone 2 are currently under construction and will complete during 2013 and 2014 (Map 1).

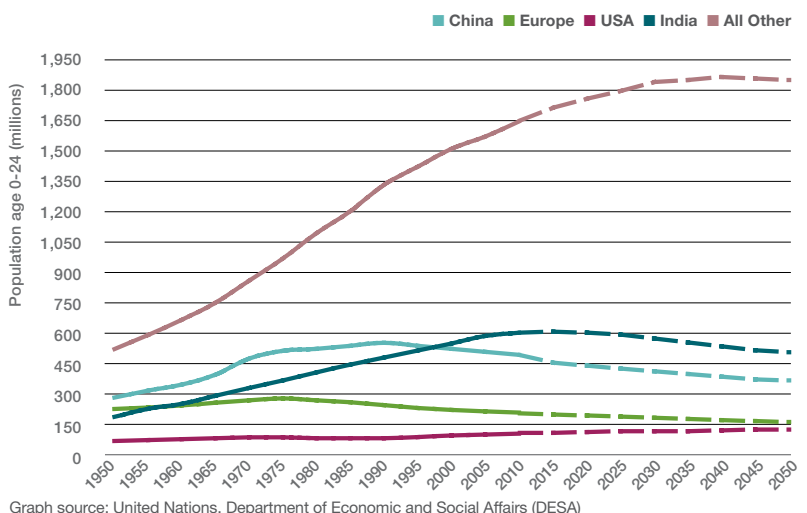
London supply pipeline

The supply pipeline of schemes at either planning application or planning permission stage has fallen to around 14,800 bedspaces. The pipeline remains dominated by large scale, capital intensive accommodation schemes, with 65% of the pipeline consisting of buildings over 100 bedspaces in size, as operators look for economies of scale.

This is a fraction of the total student accommodation need as they are likely to be delivered over a minimum of five years, if at all. At best this can only supply a third of the additional student demand each year and will not begin to address the demand from postgraduates, 2nd and 3rd year undergraduates who are currently not guaranteed university accommodation.

There continues to be opportunities for inward investment into the London market as vast sums of equity will be required to deliver all the bedspaces

GRAPH 6 Population Age 0-24 across major global nations, 1950-2050



Graph source: United Nations, Department of Economic and Social Affairs (DESA)

currently proposed. As traditional development and debt finance remains absent from the market, opportunities for new money from institutional investors, insurance companies and pension funds could fill the void, on low risk projects. It therefore remains unclear whether and how much of this supply pipeline will be delivered.

Planning policy

The future delivery of London's purpose-built student accommodation has been further muddled by the release of the

Mayor's draft Housing Supplementary Planning Guidance (SPG). The draft SPG highlights the need for the continual growth of the Higher Education sector if London is to maintain its world city status. It presumably therefore implicitly acknowledges that an accompanying first-rate accommodation market is essential to sustaining London's offer as a place to study.

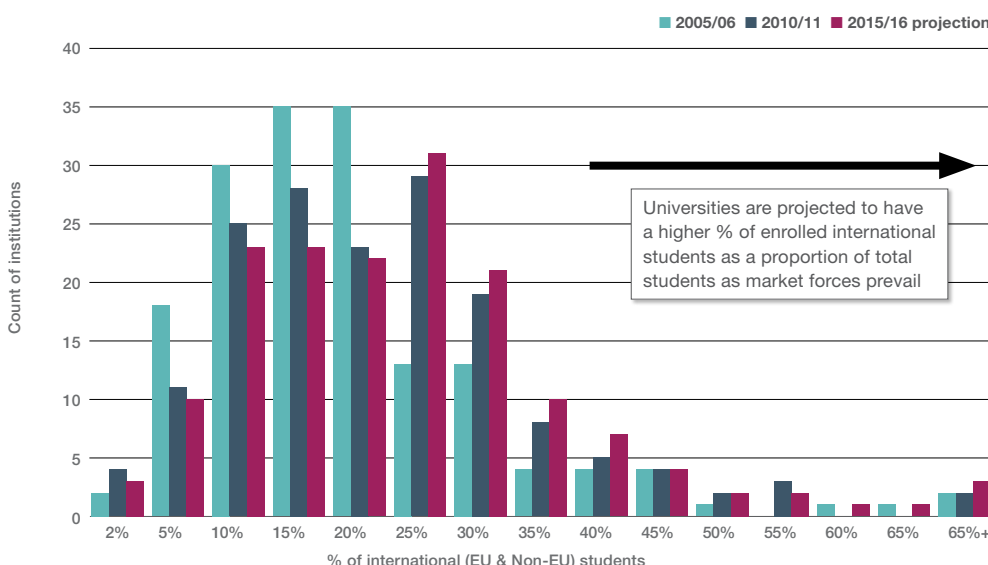
Affordability

However, the draft SPG also strongly notes the need to make student accommodation more affordable, by potentially reversing the current market led approach to rental levels to a benchmarked approach. This policy measure could easily impact future development viability if it affects schemes and sites which have hitherto been appraised and valued on market rents.

The new approach could render pipeline schemes uneconomic. It might also call into question the ability of future schemes to compete in land value terms with other use classes, notably residential.

Future policy to dictate or force student housing development away from core traditional hotspots has also been discussed and is a potential threat to future delivery of units. The aim would be to disperse development pressure away from certain Inner London Boroughs, in order to regenerate other London economies.

GRAPH 7 UK Higher Education student demographic to become more international

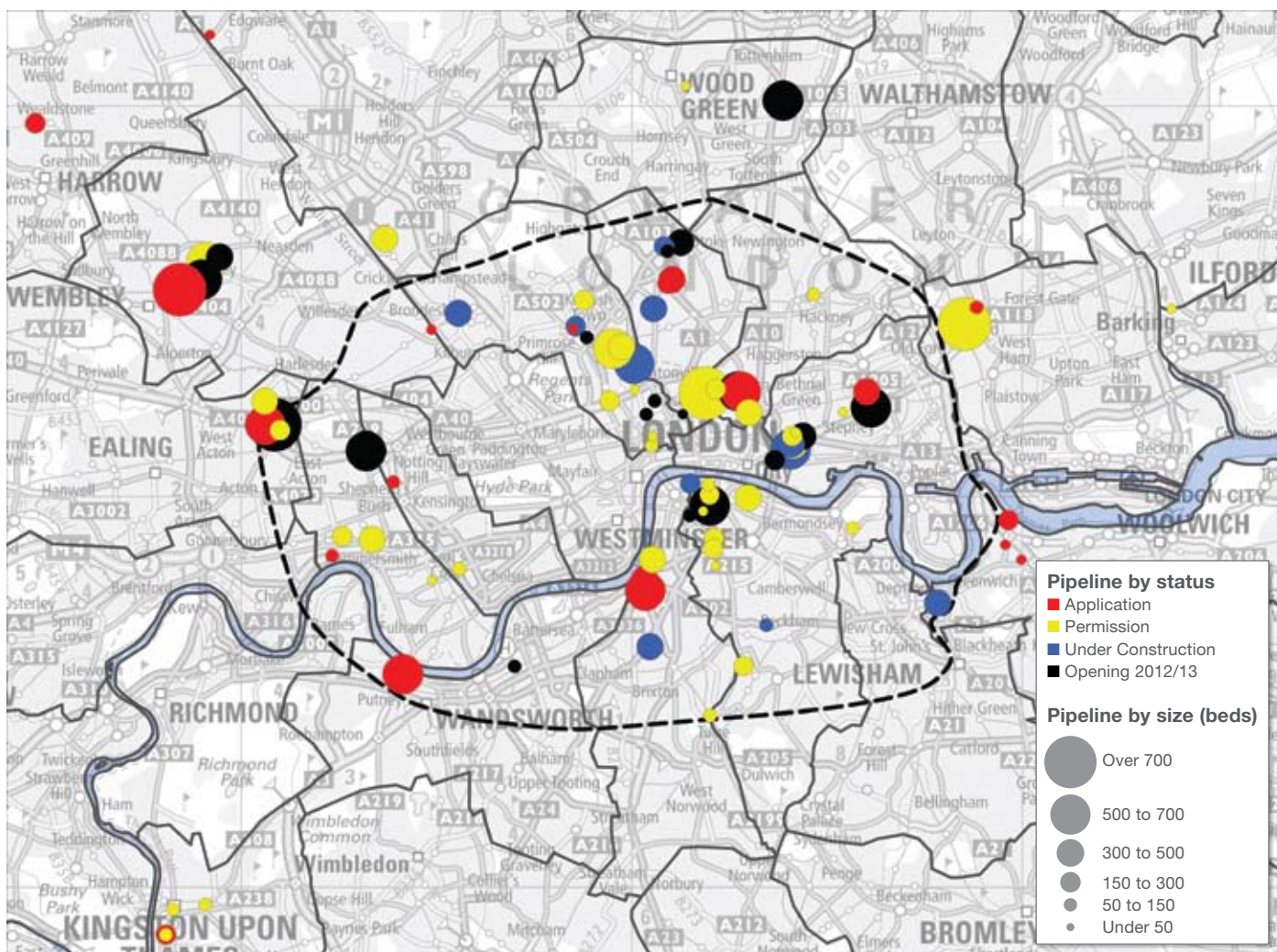


Universities are projected to have a higher % of enrolled international students as a proportion of total students as market forces prevail

Graph source: Savills Research, HESA

MAP 1

Development is concentrated within London Underground Zone 1 and 2 locations



Graph source: Savills Research

This policy has the potential to slow down the rate of new delivery because viability is more marginal outside core locations and land economics become more constrained away from the core. Highest market demand for student housing is generally in locations close to central London campuses.

**OPPORTUNITY:
STOCK TRANSFER**

Stock transfer opportunities arise from those higher ranked universities which require large sums of investment to improve their accommodation offer, in order to remain competitive in an increasingly difficult market. The transfer of poor quality university-owned stock to

investors achieves a double financial benefit for the institution involved: they avoid future calls on capital by avoiding future expenditure on costly repairs and upgrading as well as the annual costs of administering the accommodation. They also receive a capital sum with which to make alternative investments in their academic offer at a time when other types of funding are being withdrawn.

Private sector operators will look at these opportunities with interest because they provide investment opportunities in a market where the development pipeline offers much fewer prospects than in the past.

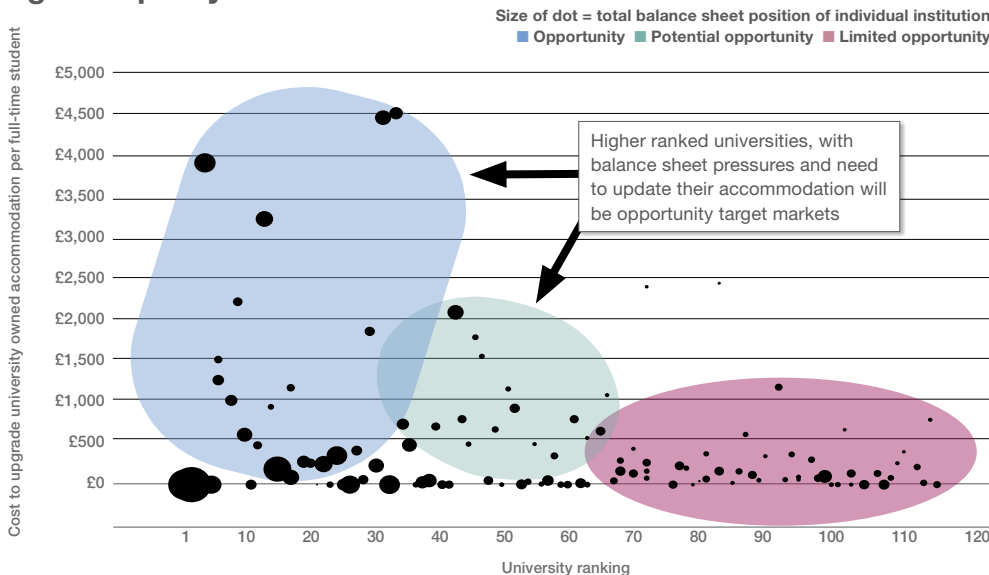
The combination of academic demand, asset quality and the

financial ability to react to a changing climate will be key to future residential asset performance. We have therefore analysed universities' need for funding, likely calls on funds due to asset condition, and their academic quality in order to assess where the best investment prospects lie.

Graph 8 (overleaf) analyses the cost to upgrade university owned accommodation which is categorised by HEFCE as either Condition C ("Operational, but major repair or replacement needed in the short to medium-term, generally three years") or D ("Inoperable, or serious risk of major failure or breakdown") as at 2009/10 to Condition B standard.

This Condition B standard is described by HEFCE as "sound, →

GRAPH 8
Financial ability of universities to update their residential portfolio against quality of institution



Graph source: Higher Education Statistics Agency (HESA) & Higher Education Funding Council for England (HEFCE), Times Good University Guide (UK University Ranking for 2012)

→ operationally safe and exhibiting only minor deterioration”.

The analysis takes into account full-time student numbers and produces a cost to upgrade per full-time student figure. The model takes the extra step and infuses each individual university’s balance sheet position, as at July 2010, and incorporates this figure to demonstrate the potential constraint and ability to improve an institution’s own residential accommodation to Condition B standard without private sector assistance.

This analysis is the initial stage of any investment or development risk assessment. The analysis does not begin to touch the surface of what information funders or developers would require pre-decision, but does begin to show strength of local markets.

Investors are likely to be drawn to opportunities arising from those

“Investors and developers will look to align themselves with universities towards the upper quartiles of university rankings”

Yolande Barnes, Savills Research

universities within the Blue Zone on the graph above, where supply/demand variables are positive and where the universities’ ability to fund redevelopment is limited.

A numbers market

In a period where equity is scarce and development finance is challenging to secure, viability, land values, planning policy, future supply pipelines, private sector rental values and the propensity of students to live at home in university towns or cities all grow to be even more significant.

The ability to adapt to changes to tuition fees and the funding of universities, alongside improving the recruitment strategy of international students will be key to future performance of the sector, at a time when equity and finance for large scale investment and development is restricted.

Investors, developers and funders across the UK student accommodation sector will look to be aligned to those institutions and locations which continue or become to show significant opportunity, in light of recent policy changes.

The trend in applications post-financial change will be key to future investment and development decisions. Most equity providers

and developers will also be aware of proposals set out by the UK Government to introduce more competition between universities from 2012/13, towards more market-based mechanisms, adding additional risk to their strategies.

The student market will require universities to compete on grade for approximately 65,000 younger full-time students who achieve AAB (or above) A-level grades and on courses which will be priced primarily at £9,000 per year.

Other universities, with a strong track record of creating opportunities for students from a wide-range of backgrounds and ages are unlikely to be able to compete in this market in the same way. These market-based mechanisms will impact on the demand for university places and subsequently affect accommodation demand ratios.

Those universities which will be disproportionately affected by changing government policy, and especially in current market conditions where equity and debt funders are less risk averse, are more likely to be those institutions which are ranked towards the lower quartile of university rankings (Red Zone).

Investors, developers and operators of student accommodation will look to align themselves with universities towards the upper quartiles of university rankings and those which show increasing or stable demand, alongside a need to upgrade their residential accommodation to an improved standard in order to minimise competition risk (Blue Zone).

Our analysis in this document does not factor in micro market factors that need to be considered in the later stages of the strategic decision making process. Thus, we would recommend that micro studies are made in all instances.

Not all investments will be a ‘dead cert’ in the areas and sectors that we have tipped as high performing. Equally, we have no doubt that opportunities exist in areas and sectors that we have begun to describe as poorer performing. ■



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