EDUCATION NATION

The Graduation of Student Housing

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1 INTRODUCTION AND EXECUTIVE SUMMARY

Introduction

Executive summary: Student housing graduates with honours

Nottingham Trent University - Byron House

Addleshaw Goddard advised long-standing client, University Partnerships Programme (UPP), the leading provider of student accommodation infrastructure and support services in the UK, on the design, construction, operation and maintenance of student accommodation at Nottingham Trent University

Introduction

Addleshaw Goddard
Stewart Womersley
Joint Head of Student Accommodation

Much has changed over the 25 years since Britain's purpose-built student accommodation (PBSA) sector put down its roots in Bristol. Just as grants and polytechnics have been consigned to history, so too has the need to endure substandard university housing which had defined so many people's experience of higher education. Now with investment in the UK sector surpassing North America's, it is safe to say that PBSA has matured as an asset class.

The phenomenal growth story of PBSA has in many respects been tied to that of the wider residential market: were there a plentiful supply of high quality housing on the open market near to universities, then arguably PBSA would not have experienced the stellar growth we've seen.

But where the sector once consisted of a handful of UK-based developers converting office buildings, today a whole host of developers, operators and investors are active in the market. They range from global institutional investors and sovereign wealth funds to domestic listed funds and Plcs, private equity companies, family offices and universities themselves.

European institutional funding initially drove the market. Now North American, Asian and Middle Eastern capital can be found across the sector with annual investment for 2015 estimated at nearly £6b - over ten times the amount invested in 2010.

The reason for this diverse array of investors and investment opportunity is largely down to the historic performance of PBSA - it offers a long-term, stable income play which other assets classes no longer provide. Fixed-income returns have gradually been eaten away by quantitative easing and the fallout from the financial crisis, meaning defensive assets do well. In recessions, more people tend to go to university while less money is spent in shops, so it figures that property tied to students does well while retail declines.

Of course, that does not mean there is no ceiling on demand. One of the questions many have asked is that while the cap for student numbers has been removed, there may be a cap for how much student housing we need.

The reality is that a demand-supply imbalance remains in many core university towns, but pinning down the nature of this demand is crucial. What this means is that those able to build the right product at the right price and in the right location will prosper.

For example, Unite Students' open-ended Unite UK Student Accommodation Fund (USAF) has a gross portfolio value of over £2b and has delivered on average a 15% return over the last five years.

Open-ended funds are generally better suited to the long-term nature of student housing, however there is no reason why managers, developers and sponsors generally cannot also examine the possibility of launching private closed-ended funds. While private closed-ended funds have a fixed and relatively short-term life, investors and managers have plenty of choices available to them as the fund reaches the end of its initial term including restructuring, complete exit or looking at a conversion into a REIT.

REITs themselves are a relatively new entrant, with only GCP Student Living REIT and Empiric Student Property REIT currently playing the UK market.

Since its introduction into the UK market in the mid-2000s, the REIT structure has already proved its suitability for student accommodation. For example, Empiric is about halfway to achieving their target of a 10,000 bed portfolio just over a year after successfully launching an initial public offering in mid-2014.

Overall, student housing as a market is historically resilient and stable, with good overall prospects for the future.

A 'build and they will come' mentality - which some fear could result from massive investment flows - would undermine confidence in PBSA.

Those who have been most successful are those with a long-term view. While funds are still relatively thin on the ground, those which dominate the sector have continued to boast impressive figures, outperforming many core property businesses over the last two cycles.

While the major attraction of REITs is the significant tax benefits, as Empiric have evidenced, with a little tweaking and explanation to the regulators, the structure has the flexibility to allow development to be undertaken. The benefit of this is that a wider pool of investment can be sought and the general public have the opportunity to share in the development gains as well as the stable income streams.

There are of course headwinds that all participants in the market will have to navigate. The UK's political landscape has thrown up some risks to the sector, notably tougher immigration rules on visas. Most people believe these are well-intended measures which won't have too many negative consequences for higher education. But, if the message is misheard by other countries then Britain could potentially lose out.

Overseas students - particularly Chinese and Indian - are vital to many universities, student housing investors and developers' business plans as they subsidise domestic students.

While this may not be an immediate concern for the top tier universities, such as Oxford or York which will always be desirable study destinations, mid-tier universities may see their international cohort depart for universities in Europe or America, where costs of entry are lower and there is less chance of being sent packing after graduation.

Keeping a watchful eye over this will be wise to ensure that any negative implications can be anticipated and dealt with in a timely manner.

But no investment ever takes place in picture perfect conditions. Overall, student housing as a market is historically resilient and stable, with good overall prospects for the future.

Of course, any new entrant to the student housing will also need to grasp the fundamentals. As companies such as Urbanest have shown, branding is vital to attract students from afar and the importance of having first-rate relationships with universities is absolutely key. And as they remark, the sector is most definitely in "rude health".

Our report 'Education Nation: The graduation of student housing' brings together many of the key players in the market. From investors and developers (including universities), to lenders and key consultants, we have sought to provide unique insight into what the future looks like for PBSA. As a practice, Addleshaw has unrivalled experience in the PBSA sector and has experience for acting for the majority of the key players in the market.

Executive Summary: Student housing graduates with honours

Student accommodation has grown to become a truly mainstream asset class for real estate investors with a record breaking year of activity. However, universities are yet to fully maximise the potential benefits of collaborating with private sector players.

This report, 'Education Nation: The graduation of student housing' estimates that roughly £6 billion of transactions and capital investment took place during 2015 of purpose built student accommodation (PBSA), completing the sector's first quarter century. It has transformed itself over that period from a niche asset class to one that is now increasingly views as mainstream.

The sector now attracts more investors, developers and operators than ever before. Investment in UK surpassed that of North America for the first time during 2015, underlining the scale of activity.

Much of this activity has been the result of long-term investors seeking to make their mark in the sector by amassing sizeable portfolios. They are attracted by long-dated income and, with a low cost of capital, some have been willing to pay over the asking price in order to scale up quickly.

These transactions, along with the soaring appetite for investment from global institutions, have contributed to on-going yield compression, which has been amplified in prime areas by rising land costs. This has not stabilised, although we estimate that there is some potential left for further yield compression as returns fall into line with commercial property in comparable markets.

Most in the market take a muted view on yield compression however, with rental growth expected at a modest 1 percent to 2 percent per annum in the regions. London may experience slightly higher rental growth, with most estimating rises of 2 percent to 3% per annum

Further yield compressions in PBSA could see some banks reduce their exposure to what they may perceive as over-valued assets. This may come in the form of reduced lending or banks may offer loans with lower loan to values, making development costlier.

The university challenge

Universities could be major beneficiaries from this growing appetite from long-term investors if they choose to foster closer ties with the private sector. This would mean partnering with private investors backed by pension funds who would re-develop university property on their behalf with the university receiving a capital receipt which could fund its core teach activities.

Doing so allows them to unlock capital from their land holdings which may not be delivering any value; enhance their operational efficiencies (by having more modern, fit-for-purpose teaching spaces) and allow them to vastly improve the quality of on-campus housing (making them more attractive to students).

We estimate that UK universities are currently only optimising around 25 percent of their land and that around 30% of on-going cost savings could be made if they took a more commercial approach to managing both their on-campus housing provision and other real estate.

Rising student fees and the removal of caps are increasing competitiveness among universities. This places greater pressure on them to offer excellent academic credentials and modern accommodation. Making better use of space could free up billions of pounds of capital that universities could plough into their core businesses of teaching and research.

Around 100,000 on-campus university beds are in need of refurbishment, which alone could generate more than £5 billion of investment.

In an increasingly competitive and global higher education sector, UK universities need to cement their place as some of the most attractive institutions for overseas and domestic students.

First generation opportunity

Another sign of PBSA's growth is that the sector is now multi-generational: development of new stock is happening; relatively new portfolios are being traded; and older stock is now ripe for refurbishment and redevelopment.

The key point is that there are opportunities beyond just investing into the new build schemes. The older 'first generation' stock - built around 10-15 years ago, will in some cases be in need of updating. Estimates range from one-third to two-thirds of this first generation stock may be suitable for repositioning.

This churn will be on-going and offer continued opportunities for investors to gain exposure to the sector.

For private equity firms this is likely to present the next big play in the UK market as it allows for an increased capital appreciation. This 'layering' of mirrors the experience of the North American multi-family housing sector which after 25-30 years is very much a mature asset class.

Flexible friends

Student housing is increasingly proving itself an asset class that is suitable for a wide range of investment vehicles and deal structures.

Real estate investment trusts (REITs) are a relatively new entrant to the UK market, despite the UK-REIT regime having existed since 2007. Trailblazers such as Empiric are showing how REITs can flourish just over a year after entering it.

Funds – both open and closed – also have a role to play in the market. Unite's open-ended USAF fund has played a starring role in the sector since its launch. Crosslane is one of the few in the market using a closed ended structure. There is no reason why speculative investors cannot use this structure more.

From a macro perspective, there is no doubt that the UK's student housing market is in rude health. However, there are some concerns, including expectations are that a number of ill-prepared new investors and developers who are entering in search of perceived easy returns will fail over the next few years.

This will present opportunities for existing players or speculative investors to reposition assets or add to their portfolios.

Market-leading players such as Unite and UPP, and prime-focused brands such as Urbanest and GSA will continue to prosper as newer entrants such as Empiric continue to go from strength to strength.

We expect to see a greater degree of consolidation in the PBSA sector over the next three years and while transaction levels are highly unlikely to meet 2015's highs, they are likely to well exceed £2bn on current market estimates.

We can also expect to see a greater number of funds and especially REITs enter the market off the back of the likes of Empirics and GCP's recent successes. Developers will also likely increasingly look to follow UPP's lead and partner with universities on mixed-use developments.

Finally, student accommodation's journey towards graduating into a mature asset class has a applicable lessons for the fresher alternative asset classes in the UK, such as PRS. For example, successful PRS will be just as reliant on location and amenities as student housing. On the investment side, as the UK's nascent PRS sector builds a head of steam as more schemes get off the ground, it should prove that it has the same core fundamentals that has made the comparable, yet older, student housing sector so attractive to a wide array of investors.

The UK's student housing sector is a success, and we are proud to present this report celebrating it.

2 INVESTMENT AND OPPORTUNITIES

East goes West
Addleshaw Goddard

Investment view: Location, Location, Location
Blackrock UK Property Fund

What is attractive about student accommodation as an asset?

Q&A: Massive windfall for universities who have vision to regenerate estates
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Brand view: The sophisication of simplicity
Urbanest

Stratford ONE, London

Unite's market leading Stratford One property forms an integral part of their London Portfolio.

Over the last two years the UK's purpose built student accommodation sector has seen a surge in investment with nearly a third of the sector by value traded during 2015. Capital flows for Britain this year even exceeded those for the United States. Behind this flurry of finance lay an increasingly diverse base of investors using a range of financial structures.

For an asset that was once traditionally only funded by the banks, student accommodation has come along way in a quarter century. It now attracts - among others - funds (private and listed), REITs, institutional investors family offices and private equity firms. During the first half of 2015, £3.8b was invested in PBDSA - a figure expected to exceed £6b by the end of 2015. This would be more than three times the amount invested in 2014 (£1.7b).

Equally, investment into the UK market is now coming from across the globe. North American and European institutional money has largely been behind the recent surge in investment. But the UK's student accommodation market is also attracting Middle Eastern capital from places like Kuwait and a greater array of Asia Pacific-based investors.

This investment has seen yields compress across the board and in London, for example, PBSA has similar levels of returns compared with private rented sector (PRS) housing, around 4.5%. General consensus is that further yield compression may still occur in prime regional locations and in some of London's regeneration zones, such as Wembley or Tottenham. But with investment activity unlikely to continue at its recent pace - and with land values stabilising - any future pressure on yields will be more subtle that changes seen over the recent two years.

East goes West

Addleshaw Goddard
Leona Ahmed
Divisional Managing Partner, Real Estate & Joint Head of Real Estate Sector

UK higher education's close relationship with Asia brings both challenges and opportunities both at home and abroad.

When it comes to the UK's higher education sector, there are strong ties between Asia and the UK. There is both Asian demand at an individual level for British education, and Asian capital is increasingly looking to invest into UK student housing as an asset class.

British schools and universities enjoy a gold standard reputation in Asia.

In Asia, going to a UK university is seen as a blue-chip education that helps you secure a better job, and therefore future for your family. There is anecdotal evidence that in Singapore and Hong Kong – two key professional service hubs in the region - locals with a British university degree tend to be employed in better paying jobs than their domestically educated peers.

The only other university market that is bracketed with the same prestige in Asia is the US market.

British-educated parents will invariably want to send their offspring to places they studied at. And as we have detailed in this report, Asian students choosing to come to the UK will be an increasing demand factor for student housing. While this is widely seen as being solely a 'London thing', the reality is that Chinese students still make up only 10% of the current student population. It means growth prospects are strong - both across London, Manchester and the rest of England.

It follows that the product will increasingly have to cater for the cultural sensitivies of different groups.

Building abroad

Providing accommodation up to the modern standards required by jet-setting teenagers is a global challenge. In Britain, it's about deliverability, construction costs and overall product quality. But there are also cultural issues to consider.

Many of the student accommodation facilities found in Europe (and Britain in particular) will not differentiate between male and female students – something that will need attention in some areas.

Global players like GSA recognise this. In Tokyo for example, the demand is for very private accommodation. And rather than gyms, they prefer spas – something that would be unheard of in Manchester. Meanwhile in Dubai, a much more communal living space is demanded.

Fundamentally, scaling up globally will likely only be for those developers that have the capacity and economies of scale necessary, such as GSA and UPP, which is rolling out European expansion plans.

Investing overseas

The continued global hunt for yield is seeing Asian capital continue to be deployed in other parts of the globe, including the UK. While London retains its 'safe haven' status, there's a strong sense of recognition around major Russell Group institutions.

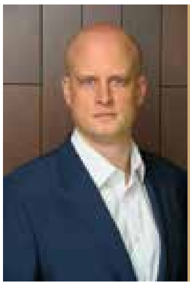
The stable return profile of student housing has, in recent years, made it attractive to institutional investors. And many now see it as a key part of a diversified portfolio of investments in the UK.

Global investors understand universities and they understand the asset class. But given yield compression we have seen over the last 18 months, there may be limited headroom for some investors. Finding the right stock has pushed down yields and price-savvy investors – whose sole focus is a return – should not be taken for granted. Additionally, Student housing is extremely location specific. Foreign investors are likely to become more selective over where they invest as fringe locations risk over-supply.

In the short term, there will be significant opportunity for investment in revamping old on-campus housing stock. Around a third of university beds are in need of redevelopment – that's almost 100,000 units in poor condition. Together with rising student numbers, and an expected increase across the board in foreign students, we are some way off the ceiling of investment for student housing.

Although many of the private equity investors and institutions who have funded the sector are not 'asset sticky' the narrowing divide between Britain and Asia can only have positive effects for the growth of both regions. While this may not pull thousands of people out on to the streets of London, it should be keenly welcomed by investors in bricks, mortar and minds.

Investment view: Location, Location, Location



BlackRock UK Property Fund
Paul Tebbit
Managing Director

Location, Location, Location

BlackRock UK Property Fund's Managing Director Paul Tebbit explains why location and product quality is fundamental to the fund's strategy.

Student housing may still be seen by some as an "alternative" asset, but its fast becoming more mainstream. Even as increasing levels of capital moves into the sector, pushing up pricing, the steady cash-flow with inflation linked characteristics, remains attractive and is likely to continue to draw in new investors.

As with any real estate asset, the tenant - in this case the student - is key. While student's aspirations for quality of accommodation and service are becoming far more refined, in our view this won't outweigh a desire for the best location. If a student can cut 15 minutes off their walk to lectures, this can outweigh all the amenities and add-ons you could possibly offer.

The University sector is a very important industry for UK Plc, accounting for around 3% of annual GDP. Unlike many industries, the UK's university sector has the ability to attract international "consumers" into the regions as well as London. Our building on Hope Street in Liverpool, has 95% Chinese students, largely because of the very strong links the city and university has with China.

BlackRock's Approach

We own around 2,500 direct let beds within the BlackRock UK Property Fund and 800 beds leased to a University in our Long Lease Fund. Our approach is focused on having a detailed understanding of a micro-market and using that insight and knowledge to select locations that we believe will continue to be fully let, and experience rental growth over the long-term.

In short, our approach is to source stock in the closest, or best location, around a university; to buy large-scale schemes offering operational efficiencies, and to focus on brand new assets with a full suite of amenities. In Birmingham for instance, our site in Selly Oak is located immediately next to the university campus, and is the closest scheme to that institution.

We also believe that having a good spread of unit types is really important. We prefer having a cluster-led scheme, as this offers a more attractive price point for students, and is generally what universities favour. Although the student is the ultimate customer, having the type of accommodation that universities prefer means that referrals and nomination agreements are much more likely. The range of units and lower rental levels means that the cluster lead schemes should be attractive to a wide range of students, and have a defensive position as more supply comes on stream.

London versus regions

It is fair to say there has been considerable fanfare over the attractiveness of investment in student accommodation in London. These schemes are aimed almost entirely at overseas students.

While we don't doubt the growth of international students, or the supply constrained nature of London, I am always surprised by how "patchy" the cash flow for all but the very best London assets actually is. London offers an ability for students to live across a very wide radius and there is a lot of non-purpose-built student accommodation to compete with. A fixed micro location is far less likely than in many regional cities, which don't have strong public transport links, or as vibrant peripheral-locations as London has in every part of the city.

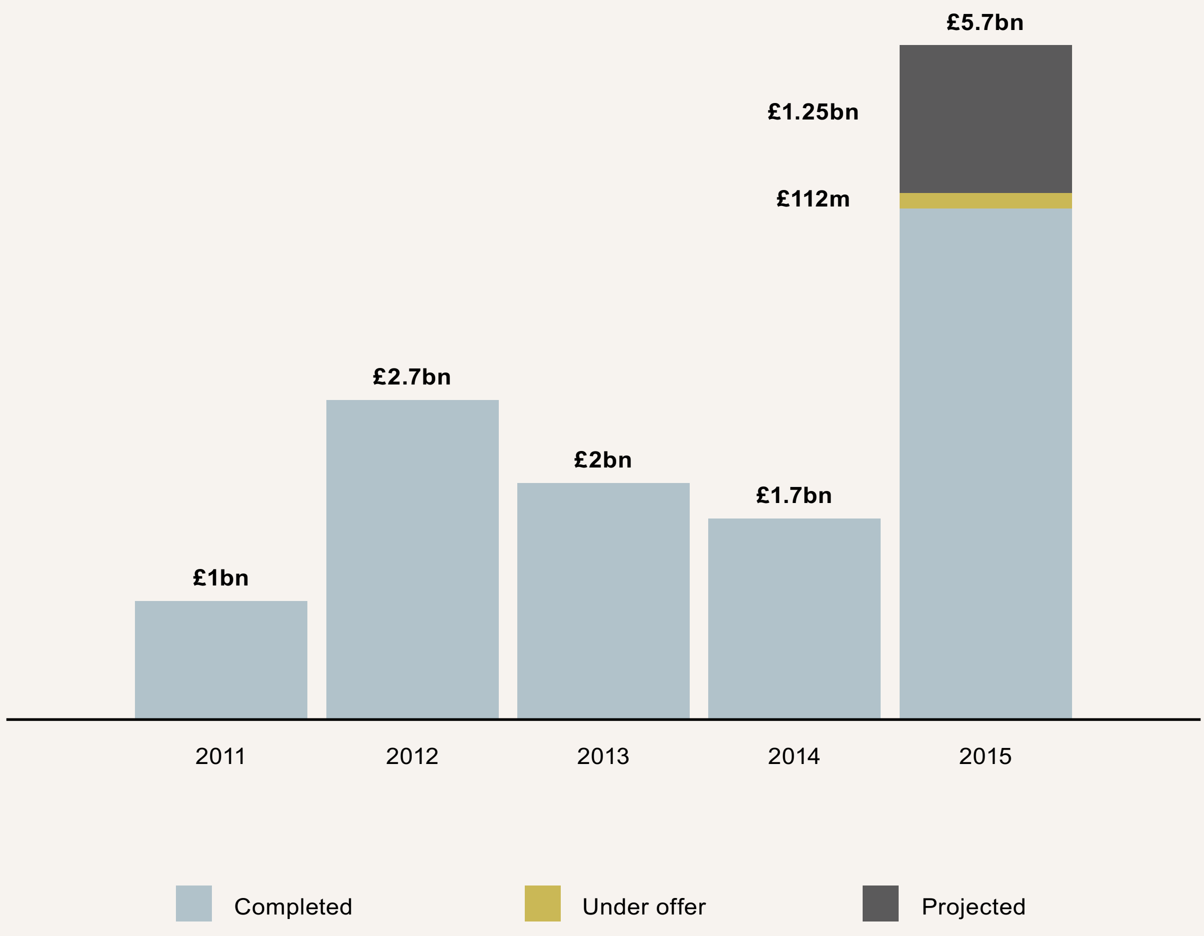
We believe that prime regional student accommodation offers a 150-200bps yield pick up over London, as well as a more consistent cash-flow. This is of course micro-location specific: there is a risk that with an increase in development activity, an over-supply could occur in some regional locations. As long-term investors, we believe it is important to keep a very close eye on development pipeline and constantly review whether the fundamentals of an investment have changed. A lot of markets are becoming mature enough that we'll start to see a divergence between the really great schemes and the rest. You don't want to be the marginal supplier in an oversupplied city.

Student housing may still be seen by some as an "alternative" asset, but its fast becoming more mainstream.

Summary

In summary, success will come down to quality of product and location, and not being at an overly expensive price point. Student accommodation offers an attractive yield, which can be increased through a combination of market inflation and good management. The sector has strong prospects provided investors do not get overly carried away by the current excitement around the sector. Like all good investments, you won't go far wrong if you stick to good property fundamentals and focus on cash flow.

FIGURE 1: PBSA Transaction Volumes 2011-2015 (Source: JLL)



Stable Income

For any investor seeking stable income, student accommodation is very attractive. Rents are stable and have historically remained above RPI. An added benefit for institutional investors is that the asset has a low risk profile as student tenants typically have parents acting as guarantors. Occupancy risk will be an issue in crowded markets, however.

Increasing demand

More 500,000 undergraduates came into the university system in 2014 - then the highest intake on record. Acceptance figures for 2015/2016 stood at 511,730 as of September 2015. With the caps off on student numbers, leading institutions will be seeking to grow their numbers. But as worries about debts rise, weaker universities could see students thinking twice. This means demand may be weighted towards certain institutions.

Mismatched supply and demand

There is a disconnect between supply and demand of student accommodation. Of course, this is a broader window in Britain's housing and which has certainly helped drive PBSA demand. The 'build it and they will come' philosophy that may have once been successful in the PBSA sector is now unlikely to succeed as a flood of new development means location will be crucial going forward.

High occupancy

Influencing the steady income that student accommodation produces is the high occupancy rate typically associated with the asset. Successful PBSA players continue to agree nominations agreements with key universities to drive occupancy numbers as institutions become quasi "anchor tenants" for some major schemes.

Diversification

Student accommodation offers institutional investors a valuable way to diversify their investments away from traditional assets such as sovereign bonds, which due to wider macro-economic conditions have not been offering the traditional returns expected.

Volatility

Student accommodation is arguably acyclical, as when a recession hits more people tend to go to university to either re-skill or delay going into a tough and competitive job market. The sector has performed well during downtowns, notably during the financial crisis.

Inflation proofing

Student accommodation has delivered above inflation rents over the last number of years. One factor that drives this is that students have short-term leases for student accommodation which allows more frequent rent hikes than other property types.

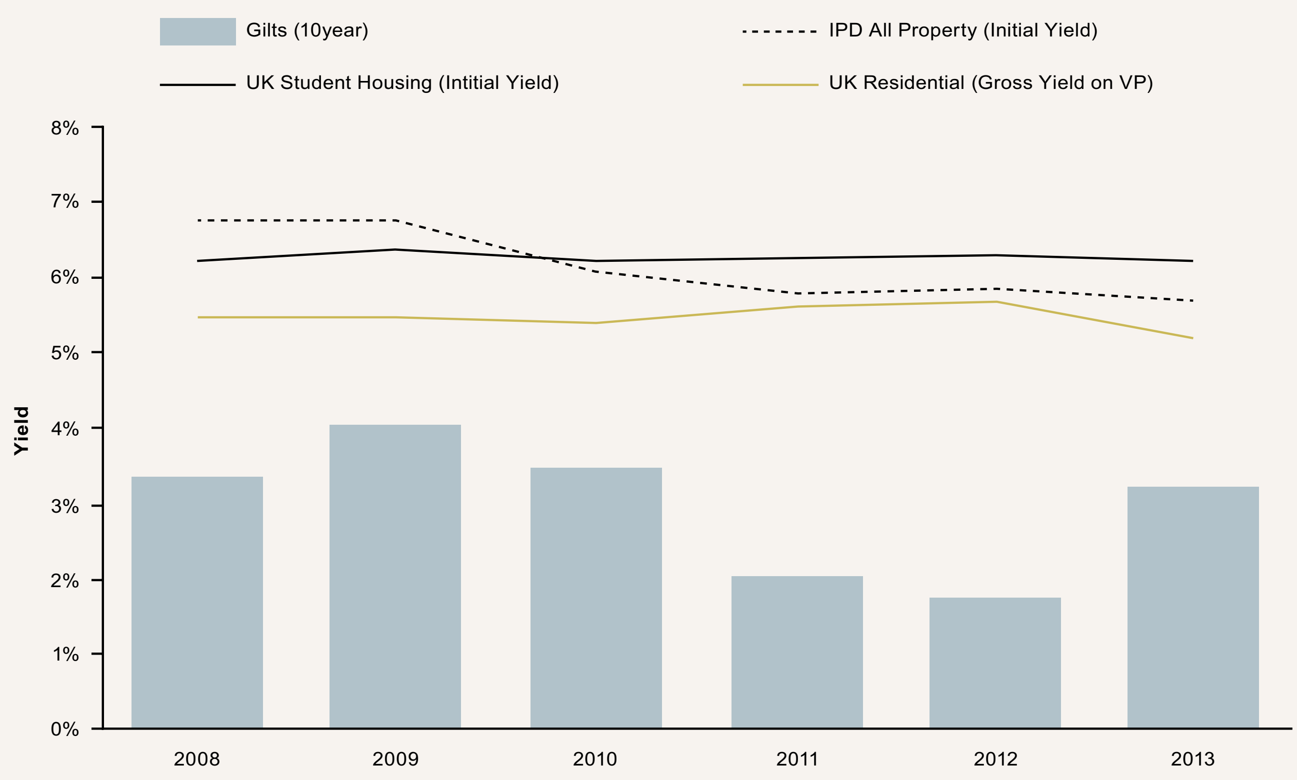
Yield compression

Since 2013, yields offered by student housing have hardened. For example, according to JLL, yields offered by purpose-built student accommodation in central London have compressed from around 6.3% in 2012 to 4.5% in 2015.

FIGURE 2: PBSA Yield Forecast by Region (Source: JLL)

YIELD FORECAST				
	Direct Let		25 Year FRI Lease	
	Current	Forecast	Current	Forecast
Prime London	4.50%	Hardening	4.00%	Stable
Inner London	5.00%	Hardening	4.25%	Stable
Prime Varcity Regional	5.25%	Hardening	4.50%	Stable
Prime Regional	5.50%	Hardening	4.75%	Stable
Other Regional	6.25%	Stable	5.00%	Stable

FIGURE 3: PBSA Yields (Source: Savills, IPD, Bank of England)



What is attractive about student accommodation as an asset?

Why are yields hardening? There are several considerations: Firstly, a lack of quality assets creates competition between buyers. Second, others willing to pay a premium to acquire a portfolio and gain a foothold in the market. Finally Institutional investors coming into the market have lower capital costs than competitors, and many believe they will be happy to pay higher fees to gain access to long-dated income which is in short supply.

Q&A: Massive windfall for universities who have vision to regenerate estates

University Partnerships Programme (UPP)
Sean O'Shea
CEO

UPP has a unique position in the university and property market as the leading provider of affordable and high quality space developed on-campus. The company has 30,000 beds and is increasingly focused on expanding into academic infrastructure and support services. Its chief executive Sean O'Shea believes this is a major untapped opportunity.

The market to attract students is more competitive than ever, and being able to offer quality accommodation is crucial.

Given the vast amount of investment we have into student housing, what's the ceiling for more?

I think there is still quite a way to go given the backlog of maintenance on existing campus housing is about £5b. Students are now seen as consumers within an increasingly commercialised marketplace. What this means is universities reassessing the quality of what they offer and knocking it down where it is not up to standard.

Why don't more companies get involved with on-campus development?

It is mainly because of the complexities of dealing with universities and the time it takes to build those relationships and conclude the transaction. There are significant barriers to entry and not so many people do it. As we've seen recently, an increasing amount of investor focus has been relatively short-lived: people want to come in and come out for a fast buck. We take a full lifecycle approach to what we do, which underpins our success.

How have the structures you use and investor appetite evolved over the years?

Broadly speaking, our structure is an evolution of the PFI model, but the major difference now is that it is primarily institutional funds who provide the senior debt on a long-term basis. We have received significant interest in recent projects largely because investors understand what we do and are buoyed by the stable income growth and strong fundamentals.

Given the amount of capital chasing investment, is there a wider opportunity that is been missed by universities to make better use of land that they own?

Undoubtedly. The space utilisation figures for universities are embarrassingly low, with only around 25% optimisation. The big risk for them is obsolescence. The market to attract students is more competitive than ever, and being able to offer quality accommodation is crucial.
We are in discussion with some partners to now deliver teaching space as well, ensuring everything is configured to meet today's high standards of connectivity. The better designed it is, the greater the utilisation will be, which is a win-win for everybody.
The key thing for universities to recognise is that UPP takes demand risk - so there is no guarantee of revenues for us.

What kind of cost saving could universities achieve from wide-scale partnering?

Realistically, it could be in excess of 40% of ongoing costs through a blend of increased space utilisation, efficiency savings and the fact that the university would be much more attractive in terms of teaching space. There are both income and cost savings with a payback period of less than 10 years.

What do you think the future looks like for the sector and UPP

We are moving into a knowledge-based economy and there is still a considerable graduate premium over your life even if you do leave with a substantial amount of debt. Many universities are lowering their cost base so they don't have to raise fees - and this is where the work UPP does really offers universities a competitive advantage.
Our ambitions are to double the size of our portfolio, expand our business offering into shared services in the academic space, and move closer to Europe and the international markets over the next couple of years. There is quite a lot of interest in our model and we have a large pipeline at the minute, particularly in London.
Nationally, we are concentrating on Russell Group or just below that, that is where considerable investment will be attractive for us.
Looking forward, there is much more emphasis now on social and amenity space. Student accommodation will become less institutional and more homely - which will further enhance the value of having a great place to live.

Brand view: The sophistication of simplicity

Urbanest
Mark Morgan
Managing Partner

Mark Morgan, Managing Partner of Urbanest, explains why not overcomplicating your strategy is the path to ensuring success in the student market.

There is courage in simplicity. It is human nature to want to over-complicate things. But we pride ourselves on doing the simple things very well. As with any brand, trust is at our core. The relationships we hold with universities and with our residents are critical (in many cases also with residents' parents).

When you say you are going to do something, deliver it, when mistakes are made, be open. With residents, that is about honesty. And with the universities it means acting as a partner and not a supplier. It is about stepping up and being supportive; seeing accommodation as a gateway to someone's learning and more broadly their life in London - yes its an asset made up of units but it is far more than that - how often does someone say 'those years were some of the best of my life'. We understand that exceptional pastoral care is crucial to a successful learning experience and we do whatever we can to support the universities we work with.

As someone who came into property from a consumer goods background, it has been an interesting journey seeing student housing evolve. Unlike commercial property - where people using a building rarely have cause to interact with the landlord - our sector is very much consumer-facing. The only thing we outsource is cleaning. So yes, we are control freaks, but that is largely to our credit I hope.

Smart pricing supports universities better

From a product position and pricing perspective, providing choice has been a key strategy in establishing a foothold in a crowded market.

Certain parts of the market will only ever buy one thing while others who can afford to may opt for premium options where they see a benefit. This applies to smartphones, clothing, eating out and, yes, also housing. As a business that remains focused on central London, this can be a challenge. Our strategy has been to offer a broader range of price points than any competitor. And with universities well aware of the need to keep a diverse mix of students housed, it is a commitment that has been warmly received. So rather than filling prime sites with the most expensive properties we could build, we've spent a lot of time crunching numbers and working on designing the best mix of spaces to offer the widest range of room types.

Product and service

As an investor focused on holding for the long-term, having institutional-grade assets is essential. For customers who neither understand nor care for such jargon, this means having buildings several notches above the competition that are kept that way.

Touches like under-floor heating, superb kitchens, thicker walls with enhanced acoustic engineering and one of the fastest internet connections possible make the difference, just as we are known to staff our buildings more heavily than most - I would argue the number and quality of our team members at the property genuinely set us apart.

Costs may be higher than others - but our investors are comfortable with this approach because it creates long-term value. By offering a better service, occupancy rates are higher; renewal costs are lower and relationships with universities stronger. Each of these can very easily be converted back to a spreadsheet when you look at our lease-up rates and noms agreements.

A broader range of price points

Concern over excessive studio flats flooding the market has been fair and we were keen not to fall into this trap. We saw a straight forward opportunity to help everyone by disrupting existing design standards to enhance value for our residents and universities. Putting two studios together and rearranging them gave us three private flats at far lower price points without reducing overall revenue. Students might not get the same space as someone paying £300 a week, but what they're after are the basic brand checkpoints: location, specification, service; the Urbanest experience.

By offering a better service, occupancy rates are higher; renewal costs are lower and relationships with universities stronger.

This approach at Kings Cross supported our first agreement with the London School of Economics by offering a superior product and service in an excellent zone 1 location.

We are innovating further with our Westminster Bridge scheme where residents have the option to pull an acoustically treated dividing wall down the centre of a shared studio. In short, it means we can offer price points down to £169 per week opposite the Houses of Parliament.

By thinking a bit like a shopping centre owner who has an anchor tenant to begin with and then works around that, we are able to lease up our buildings quickly and create the right environment for residents. We'll often have a mix of nomination agreements and open-market lets; but by giving the universities what they want we are able to underpin the service we deliver.

There are many ways we monitor our business performance, but two of the simplest, more human, indicators ('wow factors') that work for Urbanest are purely down to the handwritten notes (yes people still do that) we receive from parents and residents after they check-in or when students have left us after their studies. It is that simple, if we can enhance the overall experience and share in the pride that comes with going to a top rated university or of just having a great time living in London, then mission accomplished. As Leonardo de Vinci said, simplicity is the ultimate sophistication.

Urbanest Tower Bridge building

Urbanest Westminster Bridge

3 ROUTES TO MARKET AND DEAL STRUCTURES

Deal structures

Q&A: Choosing the right route to market
Crosslane Group

New entrants

Q&A: Breaking the mould
Empiric Student Property plc

History of PBSA sector

Private Equity view: A safe European home
Roundhill Capital

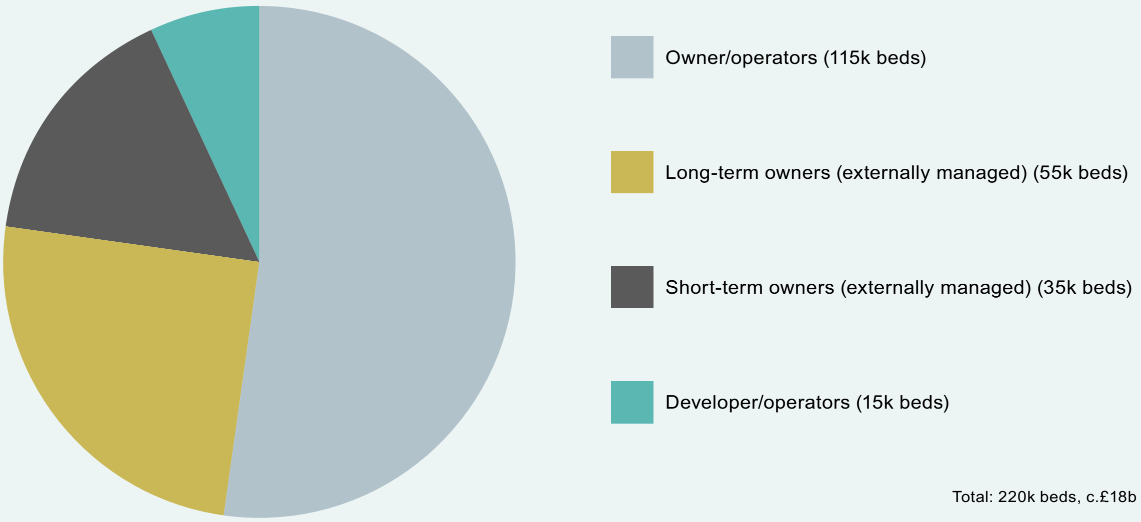
Private Equity view: Servicing students
South Street Asset Management

CGI of University of Brighton – Preston Barracks

Addleshaw Goddard advised University of Brighton on its latest expansion with the acquisition of the Preston Barracks site. The new site, which will be developed in a joint venture with Cathedral Group (now known as U + I the product of a merger between Development Securities PLC and Cathedral Group), will form the core of the University's £150 million redevelopment master plan, which covers three adjacent sites and will provide new employment space, academic buildings, student accommodation, 350 new homes and 25,000 sq ft of retail space.

Deal structures

FIGURE 4: Estimated structure of the PBSA market (Source: Unite Students)



One of the markers of success for PBSA is the variety of routes investors can take to gain exposure to student housing. From listed and unlisted vehicles, to investment, development and debt, many businesses are developing increasingly innovative routes to market. In this chapter, we consider some of the structures in play and speak with some of the most prominent players in the market to share insight around investing into PBSA.

Nominations agreements

The university providing an occupancy guarantee around how many rooms its students will take. This can range from a year or two to a decade or two. Typically, short-hold tenancy agreements will be made between the provider who sees his risk massive diminish as a result of having a high level of certainty around demand.

Direct-let

Direct-let involves the independent building and operation of student accommodation assets. It is reliant on location, management and quality, and the lack of a partnering university means operators are reliant on strong brand presence and reputation to achieve (and maintain) higher occupancy.

Partnership model

Partnerships are when a provider builds accommodation in partnership with a university, taking on the construction and development risk and essentially 'renting' the block back to a university for an agreed period and fee.

Income strip

Income strips are essentially forward-funding deals. A developer and an investor agree to build a new residence, to which the university commits upfront having provided access to the development opportunity. The leases attached can be anywhere between 35-45 years. Fixed rental incomes are also agreed, with an annual increase for RPI. The university is liable for the running and upkeep of the residences, meaning the investor only has to supply the funding. At the end of the lease, the university can buy the residence back for a nominal sum.

Q&A: Choosing the right route to market

Crosslane Group
Matthew Ryall
CEO

Crosslane, across three divisions, develops, finances and operates student accommodation in the UK and Europe. Matthew Ryall, CEO of Crosslane Fund Managers LLP, explains the purpose of different fund structures for student accommodation and how he sees the sector progressing.

You have a corporate structure that allows you to develop, operate and fund. How does that affect your approach to the market?

Crosslane is an integrated group that develops, acquires and repositions student accommodation, managing the assets and will also sell them. Our strategy has changed over time - in our first fund we acquired existing assets that we could add value to, but more recently in the UK our focus has been on developing assets.

What kind of investment vehicles do you like to use?

We run a mixture of closed-ended and open-ended funds. It really depends on the strategy of the investment. With a longer-term goal, you'd be looking at an open-ended fund or a REIT structure, so investors can get in and out more freely. With the earlier, closed-ended funds we've set up, we were looking to buy and reposition older stock then sell it on. The advantage of a fund structure is you can take advantage of specialist management and diversify risk as you are not just reliant on one asset.

Is there space for more funds in the student market?

Twenty years ago, student accommodation as an investment class in the UK did not really exist, so it was treated as a niche sector. This year we've seen coming up to £5b in transactions in the student accommodation sector in the UK. That is larger than the commercial property markets in most European countries. The sector has become part of the mainstream. You will see more funds coming into the market as it is something investors want exposure to.

Are you focusing on high rent payers and international students?

We do not pitch ourselves at the very high end within the student accommodation world as we are looking to provide value for money and affordability. We deliver the service that the students are demanding, such as larger beds and a fast broadband connection in good locations close to the university and the city centre. We have a high proportion of foreign students staying within our accommodation, reflecting the make-up of the universities. To really extract value from student accommodation you have to be managing it on a daily basis with a specialist management team. Every year we ask the students their opinion and this has an impact on the managing of the asset going forward. The type of student accommodation that we build for is constantly changing.

Are there any danger spots in the UK that might be oversupplied?

Every city has or will have at some point in time a potential danger of oversupply. We focus on locations that are as close as possible to the university, so they will remain relevant. We won't compromise on that. The further away you are building, the greater difficulty you'll have in leasing it. While some cities are seeing a lot of development, if you still have a well-built, well-managed and well-located property, you shouldn't have problems fully leasing it.

Will rising construction and competition over land slow down the pipeline?

There is a reason more stock needs to be built. It reflects the fact that more students are attending university and many don't want to live in some of the older stock.

Q&A: Finding the right route

Aberdeen Asset Management
Ed Crockett
Director - Residential Fund Management

Student accommodation makes up around a third of our residential exposure at the moment, explains Ed Crockett from Aberdeen Asset Management.

What routes to market are Aberdeen currently comfortable with, given it is a sector you've invested in for over a decade?

We are comfortable with everything except debt as it wouldn't properly be 'investment' in terms of our classification. We've got debt teams and they may look at that. But in terms of all the other routes, we are really comfortable with the market and the asset class. We are doing speculative development in this sector that we wouldn't do in, say, offices or other property sectors. The depth of demand in student housing - and in residential full stop - is much easier to prove over a long-term basis.

What is the outlook for further yield compression?

You have to consider things on a town-by-town basis. We look at yields as a function of our IRR, so working back in those areas where we are confident we'll see strong growth, we can accept a slightly lower yield. This is because we are confident it will deliver the long-running income level we'll need to get to somewhere between 6-7% or more on an IRR basis.

There may be some yield compression for brand new stock in areas which continue to display an undersupply, but I don't think we will see a continued fifty basis points per annum inward yield shift. Where things are at now fits neatly against the wider commercial property market, except with the continued robustness and consistency we have come to expect from student housing rents versus commercial property.

Where do you see your exposure climbing to over the next few years?

We are opportunity-led, and we still have the opportunity to invest in the sector and we will continue to invest in it. But we haven't got - and we wouldn't put - a target on where we wanted to grow. There is more of an aspiration in PRS right now but when we can unearth deals that look sensible we'll do them. And I would say that we are seeing more sensible deals in PBSA and PRS than we are in the commercial market. On that basis you'd expect our exposure to grow significantly over the next three years based on opportunities that seem to be coming our way.

And how much of what you've gleaned from student housing are you able to port into your PRS operations?

Quite a lot as the model is reasonably similar. Students are simple in terms of leasing up: there is just one letting period meaning the letting strategy for the year is very focused. PRS is three-dimensional by comparison - letting can happen any time; voids can happen any time; and you need to be able to respond to that. In terms of the operating of the physical asset, they're really very similar.

New entrants

A number of new investment vehicles have entered student housing over the last few years.

Adam Kerr, head of transactions at Legal & General Investment Management explains: "The sector has been targeted by a number of overseas investors, particularly the US REITs, attracted by the relatively high yields on offer compared to net yields from residential."

- The Student Housing Company: In June 2011, Oaktree Capital Management-backed Threesixty Developments (formerly Knightsbridge Student Housing) launched The Student Housing Company to manage purpose-built student accommodation in the UK and Europe. The company has developments in seven UK locations.
- Empiric Student Property, a UK REIT, is a relatively new entrant to the market. This year Empiric raised £75m in equity capital through a placing and offer for subscription, which was oversubscribed and significantly exceeded the target of £50m. It went on to announce five deals within a week in 2015, including the acquisition of a 162-bed development in Nottingham for £18.4m and a 134-bed development in Sheffield for £10.7m.
- Canada Pension Plan Investment Board (CPPIB): With the 2015 acquisition of the UK student accommodation portfolio operating under the Liberty Living brand from the Brandeaux Student Accommodation Fund for £1.1b, CPPIB entered the UK PBSA market in style. Since being established in 2000, Liberty has been one of largest providers, with over 16,700 rooms.
- GCP Student Living: The UK's first student accommodation REIT since its IPO in 2013, GCP Student Living has a portfolio worth £177.2m. GCP targets a 5.5% annualised income yield growing in line with inflation, alongside a total return of between 8% and 10%. Most of GCP's investments are in and around London as the company sees fundamental supply/demand imbalances and a good quantity of international students.

Q&A: Breaking the mould

Empiric Student Property plc
Paul Hadaway
CEO

"At first, we didn't make life easy for ourselves," admits Paul Hadaway, but the CEO of Empiric believes they are on course to hit their target of 10,000 beds in five years with an emerging reputation that has very quickly become one of the most prominent names in the market place.

How did Empiric become one of the few REITs playing the UK student market?

Empiric's journey began in 2008 under the guise of London Cornwall Property Partners which had been around for about nine years, doing various opportunistic deals. But it was in student property that London Cornwall morphed into being an investor rather than a trader, building its first property in Bristol.
By summer 2013, London Cornwall with a joint venture partner had a portfolio of six student schemes.

Why did you IPO?

We had three options. Sell, launch a private fund or look to go public. Various events led us towards the public markets. Of the six London Cornwall schemes, four became seed assets when Empiric completed its IPO in June 2014.

Can others follow suit and launch an IPO?

People say it is getting harder and harder to IPO because the threshold is getting higher. Similarly it also seems that the level at which institutions will invest directly in property, seems to increase. One of the reasons for the success so far for Empiric is we appeal to a lot of large investors whose property colleagues could not invest in the sort of things we invest in. So we are forming a bridge from that investor level down to the very liquid property market we trade in. We are now over £425m market cap.

How can you develop given the demands of the REIT structure?

Fundamentally, there isn't a limit within REITs as to how much you can make from capital appreciation as long as most of the income you have comes from rents.
Where we forward fund, Empiric charges a licence fee for access so it is regarded as rent, or we do it as a compounded discount of the purchase price and take it that way so it isn't taken as interest.
We had to talk about how we would look to develop with both the UK Listing Authority and high-level investors, which meant looking very closely at the rules surrounding REITs.
There was much to-ing and fro-ing there. The UKLA initially wouldn't regard forward-funding other developers as development even though an enormous risk has been offset. To help explain the point, we did a detailed analysis of Empiric buying an office building that was going to be converted, and that was going to be regarded as investment. If we bought a site, that was investment. What amounted to development costs was just what you spent on the building, not the whole business plan costs that went into a development project.
There was also a lot of testing the water with potential investors and brokers before the IPO about what mix would work; whether they still just wanted income, or whether they wanted a bit of risk for capital growth.
With hindsight, we might have made it slightly easier for ourselves and talked about more forward-funding and less direct development, because the investor constituency does get the difference between those, even though UKLA don't differentiate.

How well does forward-funding work for you?

We didn't fully anticipate how well forward-funding would work for us as a fund. Our anticipation at IPO was that we'd likely be split 50:50 between direct development and forward-funding. From now onwards, it is probably going to be more like 10:1 forward-funding to direct development. The reason being that not only does the maths work better on a single forward-funding, but also helps Empiric builds relationships.
We brought a funding model to a level of the British property market where it is not normally available.

Do you think some of the newer entrants might get burned, that the market is becoming congested?

On the forward-funding side, I think we've already passed a lending peak with the banks, leading to more opportunities for Empiric. There is a chance that some people are getting carried away because they don't know the market as well. We do know the market and fundamentally you've got to get people through the door every year, and they need to be pleased that they've made the decision to pay the rent to be in your building. Some people out there are building properties where tenants won't think that when they walk in.
I do not think there is big trouble brewing, though there are products in pipeline we won't touch due to overpricing until they're in receivership - and then we'd look to buy it at a reduced rate.

History of PBSA sector

EARLY 1990s

The UK's purpose-built student housing market emerges. Handful of developers and banks play the market.

MID 1990s

Banks became more confident about student demand being sustained over the long-term and investors started to see that the asset could work without a lease from university.

2006

More developers enter the market due to difficulties securing deals in commercial and residential spaces. The Moorfield student portfolio was also sold to Brandeaux/Liberty Living. Unite Students establishes the Unite UK Student Accommodation Fund ('USAF').

2008

The then high point in terms of transaction levels, with around £400m to £500m a year concluded, which then slowed down due to the global financial crisis.

2008/2009

Student accommodation shows resilience as an asset throughout the recession.

2012

Direct investment per year into UK student housing hits £2b mark for first time.

2013

Opal Property Group goes into administration, UK's first student REIT, GCP Student Living lists.

2014

UK's second REIT Empiric REIT successfully IPOs. Institutional investment into sector ramps up.

2015

Direct investment into UK expected to reach nearly £6b.

Private Equity view: A safe European home

Roundhill Capital
Paul Bashir
CEO

Roundhill Capital's Paul Bashir expresses why he thinks Europe is a better bet for student housing right now and what private equity's next big play in the sector might be.

Where do you see the opportunities in the sector at the moment?

We have actively been trying to purchase student housing portfolios in the UK for the past 12 months and have successfully got down to the final rounds for several of the large portfolio sales but have either been outbid by cheaper capital or we've pulled out because the pricing became too rich, perhaps reflecting the weight of foreign capital that has entered the UK market in the past 18 months. If you look at what is traded in the UK, it has principally been large pension funds, like CPP and PSP, or Russian investors who have been trading large volumes in the market.

We still believe that there are value add strategies to be deployed in the student accommodation sector in the UK - especially given the vast majority of existing stock is becoming dated and no longer fit for purpose - as student demands have shifted.

Additionally, we are very focused on certain core European markets which we believe are significantly underinvested and where value add / opportunistic return profiles can be better achieved.

Why are you looking at Europe now?

We are currently building a pipeline to deploy c.€500m of equity in the next two years, in four or five core locations in Europe.

Some of the best opportunities today exist in the Netherlands, France, Ireland, Spain and Italy, where the residential and commercial markets haven't yet fully recovered from the financial crisis and there has been a significant lack of investment in student accommodation.

Together with increasing student numbers in these core markets and increased global student mobility, there are some fantastic opportunities.

That is why we think there is more value to be had in Europe at this point in time - with Europe, in our opinion, being 3-4 years behind the UK in terms of student accommodation product.

Are there any specific locations in Europe?

We would focus principally on a phase one and phase two rollout strategy. Phase one being Spain, Ireland, Netherlands and Paris; phase two being Vienna, Italy and other smaller select opportunities. We would target locations where we can get a critical mass of between 1,200 and 1,500 beds. That is not all going to be in one asset but we wouldn't go into a location if we didn't feel we could achieve that target in a two year period.

What's the next step for private equity firms? The first generation PBSA stock clearly needs replacing. Is there a place for private equity involvement with that?

Our internal analysis shows that circa two-thirds of UK purpose-built student accommodation stock is more than ten years old, which represents a huge opportunity for us.

While that stock is well positioned and is often in the best locations, it is not fit for purpose for students of today. Around 40% of that stock doesn't have en-suite bathrooms, which today's students want, nor does it have the modern facilities and internet connectivity which have become the norm for student housing operators.

So that stock has gradually become uncompetitive and out of date. The opportunity for private equity is in the repositioning of these assets.

The investor mix is so much more diverse now than it was five years ago, could it become too saturated? Are there going to be too many people involved, leading to below par stock?

There have been some very punchy prices paid in some recent transactions, in our opinion. There has been a lot of new cheap foreign capital coming into the market in the UK, not just from large pension funds but other new entrants that have seen value in student accommodation.

Student housing is very much akin to PRS in the UK. If you were to price it similarly to residential stock, there are still opportunities in the UK, but only in select locations where either the supply of good purpose-built accommodation is lacking and / or where there is rental growth in the market.

What trends do you foresee over the next couple of years?

My three key predictions are a consolidation of the market, a couple of IPOs and some of the key UK players moving into Europe.

I think you will see a couple of large IPOs over the course of the next 18 months, subject to market conditions.

There is still room in the market for that good quality listed student accommodation stock. People understand the student housing market much better now, with much better institutional quality research and increased bank coverage.

Private Equity view: Servicing students

South Street Asset Management
Charles Kerr
Property Director

Servicing students

South Street Asset Management's Property Director, Charles Kerr explain the changes the student housing market has undergone over the last few years, South Street's ambitions for the future in the sector and why the sector is now a service business rather than just an investment.

Why did South Street Asset Management enter the student market?

When we started about six years ago, we saw there was strong demand for good quality management services in the student sector as there were very few Third Party operators in existence. We took the view that there was a gap in the market and that there was a need for an open book approach to operations at competitive rates. Currently our portfolio consists of 4,500 beds located around the country.

What are your plans for the next few years in terms of your assets and investments?

Our focus is on the bigger properties, rather than the smaller schemes. So we are looking for 300+ bed developments - that is where you get good synergies of scale and you get more economic management structures.

You have a strong brand as an operating platform. Was that a part of your plan? Have you used that to attract investment?

The key players in this market are the universities, and they will be increasingly important as they come out of owning student accommodation and rely more on the private sector to be the provider.

They are going to be looking very carefully at the different operators. You can't take your eye off the ball - if you are going to start cutting costs and cutting services, you will suffer reputational issues and it will cause you problems. Both universities and the students - the customer - are getting more discerning. The basic factors in any accommodation choice are location, rent, and not far behind that is quality of service and amenities on offer.

What changes in the market have you seen recently?

People being more realistic about what the true running costs of an asset. The market has now woken up to this and allowances for running costs are much more realistic. The new investors from the USA have had a big impact on raising the levels of service and the market is realizing that to provide a decent service running costs of over £2,000-plus per bed are now the norm. Gone are the days when people were hoodwinking investors on what running costs are achievable. You need to include all the costs including irrecoverable VAT, staffing, sinking fund allowances, and costs of building insurance and management fees.

I've also noticed that the sector over the last seven years is becoming more akin to a service sector rather than a property investment business. Fifteen years ago when I first started, it was an investment property business, very focused on making a quick buck. Now investors are looking at it as more of a long-term provider of secure income - to achieve this high service levels need to be provided.

Do you think that investors are starting to take too many risks, that they are Investing in secondary locations that might not stack up?.

Newcastle is an example of where people might suffer as developers have targeted it as a city to get involved in. I think we'll see horrendous stories from Newcastle regarding occupancy in the future - probably over the next couple of years until demand catches up again. Planning permission is being achieved too freely. A lot of developers have ploughed into that market to make a fast returns which may not materialize at least not in the short term. We know of a few buildings recently developed that have occupancy levels of only 30% to 50%.

Where do you see the market in five years?

Universities will be looking very closely at their existing portfolios and there is going to be a much bigger involvement with the private sector. A large proportion of the Universities accommodation is dated and in need of refurbishment and rebuilding especially if they are going to be able to attract the best students. How this happens I am not sure, as I do not believe the OJEU or PPP route to be the best solution.

4 DEVELOPMENT & CONSTRUCTION

Finding the right partner will de-risk construction
Addleshaw Goddard

Construction risk
Willis

Clusters versus studio flats

Development view: Britain's student housing pioneers remain in pole position
Unite Students

Prime locations for development

Planning

Q&A: Balancing the cost whilst ensuring attractiveness to students
Balfour Beatty Investment

CGI of the University of London

Addleshaw Goddard advised long-standing client, University Partnerships Programme (UPP), the leading provider of student accommodation infrastructure and support services in the UK, on its long term partnership with the University of London to redevelop the Bloomsbury campus with around 1,200 beds, one of the largest in London to date.

Finding the right partner will de-risk construction

Addleshaw Goddard
Andrew McVeigh
Joint Head of Student Accommodation

The construction crunch impacting development has taken few prisoners and spared no sector of the commercial or residential property market. A perfect storm combining a skills hangover from the financial crisis coupled with a sharp increase in both demand and the cost of materials is impacting the whole construction supply chain.

One thing that puts student housing at a greater risk than other sectors is that unlike market rented flats or commercial offices, there is a 'hard stop' date by which completion has to be done in order to coincide with the academic year. If a student housing project finishes a month too late in the summer, the owner could lose a whole year's worth of income as students head off down the road.

The root causes of dysfunction in the construction industry are widespread and could easily warrant a whole report by themselves. Some may argue that Tony Blair's policy of sending everyone to university helped to make the situation far worse for many vocations. Others would argue that the massive school and hospital building programme he initiated created thousands of jobs.

Putting politics aside however, one thing is clear: in a booming development market, finding contractors should not be a problem. Yet it is. And because of the tight spot PBSA developers find themselves in - and with the scale of many such developments - companies are finding an ever narrowing pool of contractors and sub-contractors to work with.

Throw in the curse of European procurement rules and you have a recipe for confusion and resentment across the board.

In this current sellers' market, the contractors are more resistant to competitive tendering and want to be involved much earlier in the process. This can work well from a design development perspective, but the increased popularity of two-stage tendering adds the risk that clients won't get the best deal on price. However, certainty has a lot of value too in a climate where a few days could be worth a year in revenue.

The bargaining position for contractors and sub-contractors is much improved in recent times. Under-resourced and over-stretched, the contractors are looking to make recompense for having had their margins squeezed during the downturn.

The consequence of all of this is we are seeing longer and knottier negotiations, an increase in the number of disputes - in particular where under resourced contractors are taking their teams off historic lower margin jobs and putting them on to newer higher margin ones - which in turn had lead to there still being a fair few insolvencies in the market place.

Finding a contractor to work with on a partnering approach, where trust and a long-term relationship can be established clearly has a lot of potential benefits. Many of the leading firms in this and the general residential sector have repeat partners in certain regions and this works well for all parties.

Giving contractors a hint of equity or putting them on a framework basis is often used to good effect.

Taking a similarly smart approach is also crucial for universities wishing to make better use of their own assets. Aforementioned OJEU rules ramp up the cost for developing with a public sector partner, although recent guidance from the Treasury potentially shines a ray of light for the more bullish through this murky window of discontent.

Universities typically either bring in a contractor directly or procure through a developer (who are often best placed to drive lower construction costs). Like any outsourcing, unless you have in-house capability with specific development knowledge and insight, the risks of overpaying or getting a sub-standard service are amplified.

As many universities continue to look to improve their existing stock to keep up with competitor universities to enhance the student experience and keep the student pound on campus, those who go direct to contractors without the right in-house expertise or guidance can find themselves paying way over the odds.

Front loading efforts and surrounding yourself with the right expertise

Many universities have got smarter in their approach to procurement and learnt from the journey of others.

and experience is crucial. Many universities have got smarter in their approach to procurement and learnt from the journey of others. Some are attracted to the considerable benefits to be gained through structuring their arrangements off-balance sheet not least of which are the ability to preserve the availability of the Higher Education Funding Council for England's (HEFCE) funding as they sit outside the main financial structure. They also mean that the vast majority of development and occupational risk can be passed to the private sector partner.

Clearly, universities should not want to sell off all the family silver. But where they can maintain an interest, sell a long lease and receive both a capital receipt and quality new accommodation, there is a strong argument for this approach.

Whichever route companies are taking to construction, they perhaps need to be aware of the heightened sensitivities of the market and prepare themselves accordingly.

Q&A: Construction risk

Willis
John Roberts
Construction Industry Leader

Willis' John Roberts discusses what insurance options are available to student housing developers.

What are the fundamental risks that exist for developers and investors buying into or building homes for students?

The risks are really not that much different to any other type of commercial property development. The important thing is understanding the student market, and the type of use the properties will have. It also needs to be understood that there is the potential for the property to be left vacant for long periods, such as during holiday periods like Christmas. This may require some additional considerations in respect of security, protection against frost, flood damage and fire protection. A lot of the cost associated with these typical risk factors and improvements can often be reflected in reduced insurance premiums or levels of excess.

Presumably the 'hard stop' that student developers have of needing to complete construction works in time for the academic year puts a greater pressure on the need for income insurance?

Income insurance or more accurately loss of profits or delay in start-up on new build property is readily available for this type of project but, underwriters will need to know the full details of project timelines and build-up of values, especially where project critical pieces of plant or equipment are being installed. The introduction of building information modelling (BIM) into the pre-build process often helps to ensure that any potential issues or snags can be identified prior to construction starting.

For those investors forward-funding developments, to de-risk them, how does insurance work? At what level does it need to be purchased and what considerations do the various parties need to take?

On the investor side, they are looking for a guaranteed return on his investment so will be focused on ensuring the project is being built to specification and on time. The insurance policy will have a number of specific clauses looking after his interests and can be extended to include loss of profits.

The developer will have similar interests to the investors and will want to ensure that the chosen contractor understands the technical aspects of the project and has the necessary experience and capability to deliver the project as planned. He will often be named under the insurance policy and will again have an interest in any potential delays. This is often achieved by him procuring an owner controlled insurance programme (OCIP) with the contractor and sub-contractors being named under his policy. Latent defects insurance is also a consideration here and is effective from practical completion of a project and normally lasts for up to 12 years.

The contractor will often be taking the contractual obligation under the OCIP and will negotiate with the developer to ensure that his interests are properly identified and covered. He will often have responsibility for below deductible losses so will need to ensure that his risk management and control is of a high standard.

And have you seen an increase in litigation around this area over recent years as pressure has grown over construction costs and the sector in general?

While the UK has become more litigious in recent years, this type of project is generally not considered to be high risk in terms of building technology. We are however seeing more and more cases where modular construction techniques are being used which can lead to a series of losses that occur where the same fault can be built in to multiple units in a factory environment prior to be being finally assembled on site. Pressure on construction costs and the competition to win contracts coupled with more overseas contractors coming in to the market does put pressure on margins but generally speaking, risk management and risk control techniques have improved over the decades such that most faults are discovered early. The more common type of dispute is often around slips and trips and third party liability issues.

Aside from risks around construction not being completed, what are other considerations student investors need consider and what products or processes can mitigate these?
Other considerations that need to be considered can include third party liability risks where the accommodation is part of a larger site or campus as well as the potential for reputational damage if a potential project delay causes students to have to find alternative accommodation at short notice. Insurance policies are readily available for both. A further consideration these days is the risk from a potential cyber attack being during the construction and installation of critical services which could again cause major issues to the operation and safety of a building. Again, suitable insurance policies are becoming more commonplace to help protect against cyber risks and most brokers and insurers have experts in these fields who are able to offer the necessary advice and help.

Clusters versus studio flats

Given the UK's much discussed housing crisis, PBSA has given investors a route of scaled exposure to rented housing often with solid university backing through noms agreements. Despite the surge of investment recently seen, there is still a huge opportunity to provide much needed supply. But only in the right locations. Student accommodation ranges from houses of multiple occupancy (HMOs) to the typical clustered apartment blocks and studio flats, which are less popular with some parties.

A long running argument in student housing is what type of living arrangement PBSA should offer. Often, the argument is between whether the development should offer a sense of community or privacy,

The University of Kent's Simon Westerman says: "Studios are, in my opinion, only really built to make developers rich. They don't offer the student the university experience that they should have - namely one that is social, collaborative and about a creative and dynamic community. We have a nomination agreement in Medway consisting of 1,100 beds, 100 of which are studios. We have not taken any of the studios, which sums up our views on them."

Sue McHugh, from the University of Brighton, agrees. "I think the social aspect of student accommodation is important," she says, "particularly in the first year. Studios don't really provide that interaction and sense of community. Cluster flats on the other hand do. However, students do want Wi-Fi which we provide and we also experiment with how we offer the common rooms and shared kitchens and TVs."

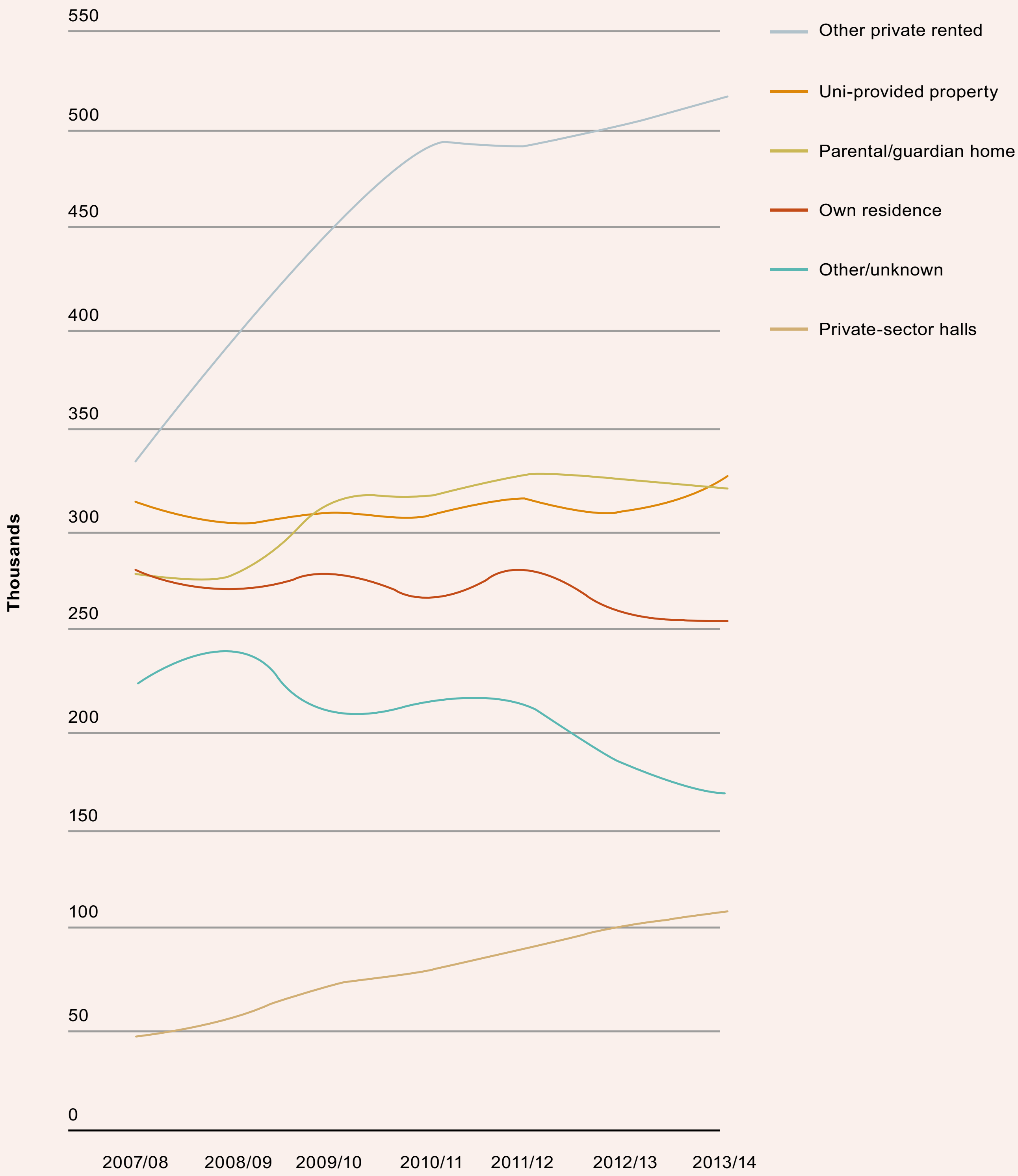
However, studios do though have a role to play, as they are an ideal fit for the more mature - but lucrative - postgraduate market. "Studios only make up about five% of supply, but people do want them, especially the post graduates. It is a niche area of the market," says Tim Mitchell from GSA.

The burden of student number increases in the UK has fallen primarily on the private rented sector, which provides over a third of all student accommodation. PRS housed 336,500 students in 2007-08 but 516,000 by 2013, bearing 83% of the growth in student numbers in that time.

The number of students in provider-supplied halls has remained roughly stable despite sharp increases in overall student numbers, indicating the static supply from providers over the last eight years.

However, the number of students in private halls has seen the second largest increase, more than doubling since 2007 and reflecting the explosion of supply in the PBSA sector in this time.

FIGURE 5: UK students by accommodation type (Source: HESA)



Development view: Britain's student housing pioneers remain in pole position

Unite Students
James Hunt
Corporate Development Director

Unite Students' corporate Development Director James Hunt joined the company in 2001 when it had 4,000 beds. Over the last 14 years that number has increased ten-fold to over 46,000. But the business still has grand plans to continue its London expansion and drive additional supply in key regional locations, as James explains.

How do you think attitudes have changed towards the sector during your time with Unite?

Most people would agree it is a fascinating sector to be a part of; a completely new sector in rude health which is now maturing. Investors have confidence in the product, universities understand it and the continued growth in investment activity underpins demand for many different types of investor.

From an investment and development point of view, people understand the sector better and are more comfortable allocating large amounts of money to it.

Are we seeing a much broader supply of capital now?

There has been a fairly wide range of capital sources coming into the market for some time. We have enjoyed a longstanding relationship with GIC across our London-focused LSAV fund (London Student Accommodation Venture). It is fair to say that the broader economic climate has heightened appetite for PBSA from investors across the board.

Although there is been a lot of media fanfare around North American investment of late, much of the original institutional investment into Britain has come from Europe. The original investors into our USAF fund back in 2006 were a mix of English, European and Scandinavian institutions.

Are there unintended risks which could rise from the huge amounts of capital coming into the market?

As a long-term investor, more liquidity in the sector is a good thing. The concern is that large inflows of capital coming in increase the difficulty of buying investment stock. This may push people to look further up the risk curve. The danger arises when you start to see odd development projects coming forward which could sully the reputation of the sector due to them being in the wrong location or being the wrong product.

What are the right locations then and what innovation is taking place in terms of development?

We've tried to innovate - particularly in London - on price points, focusing on slightly further afield locations characterised by strong transport links and amenities. These have included a couple of schemes in Stratford, which we committed to pre-Olympics, and a scheme under development in Wembley. Providing a high quality product in accessible locations adjacent to huge regeneration schemes is a win-win for all parties: it offers an extra level of diversity to the place while ensuring our residents have a pre-existing community to be part of away from their university.

The key thing for me is that we are providing something very attractive at a far lower price point than the majority of rents, which tend to be in excess of £200 per week. Many have concentrated solely on the top end of market, but we think we can offer something different that appeals to British students in the capital. It is important that we don't risk our sector developing the reputation of only appealing to those with the deepest pockets.

We've seen a lot of yield compression over last few years. How much scope do you think there is for more yield compression, both in London and in the regions over the next few years?

It is likely that property will see further yield compression, but not as acutely as we've witnessed over the last 12 months. I think most people accept this on the basis that the sector is far more liquid and accepted as a bona fide asset class rather than an alternative one.

How much of a worry is some of the rhetoric coming from the government currently around visas?

It is not particularly helpful, but if our business had been focused solely on international students we would perhaps be more concerned than we are. Certainly when we talk to universities, they don't find the rhetoric productive by any stretch

Investors have confidence in the product, universities understand it and the continued growth in investment activity underpins demand for many different types of investor.

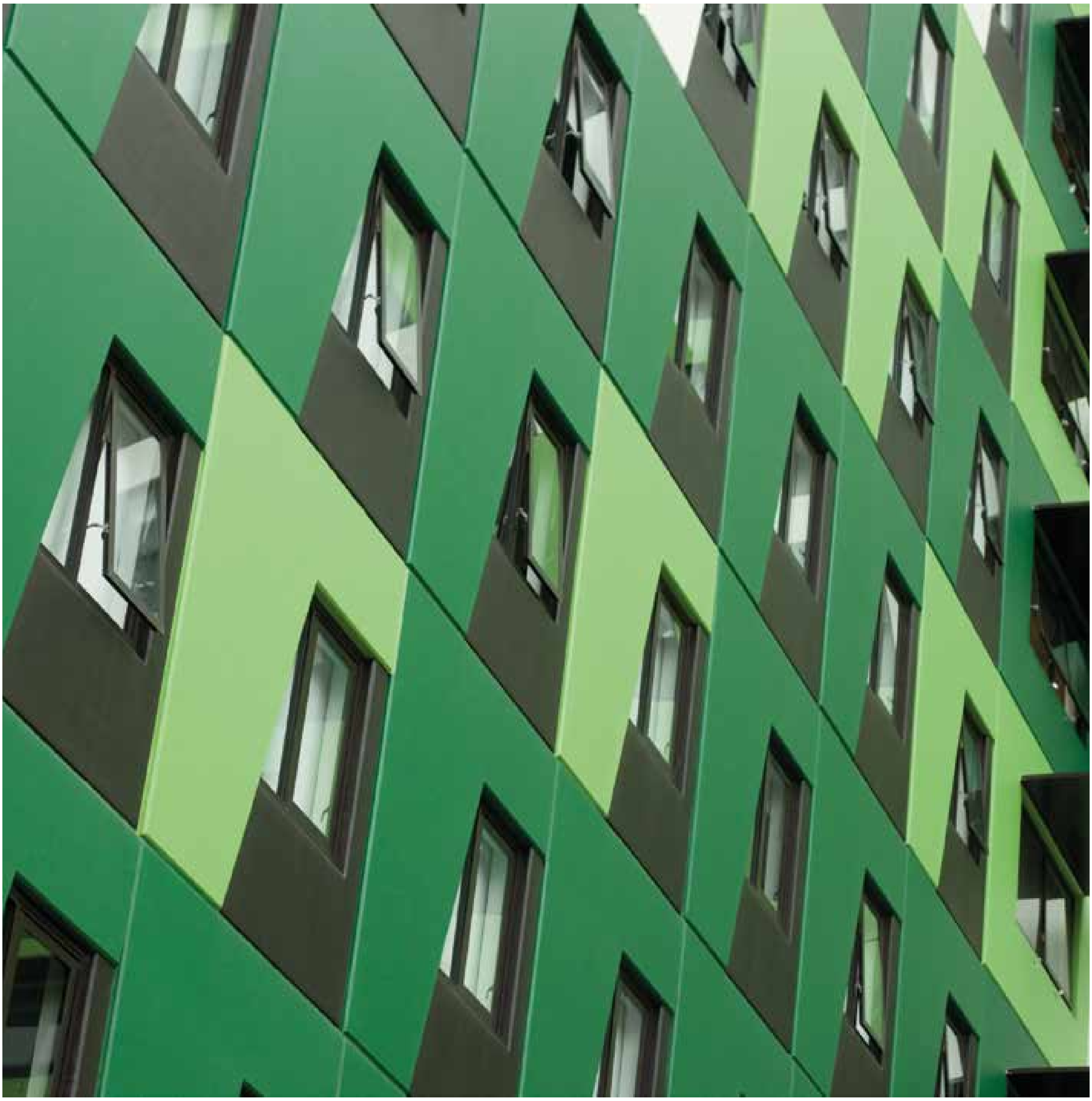
of the imagination, but the broad overall principle is that the sector will continue to see growth. Rather than spending time criticising policy, what I think we need to do is effectively promote the economic benefits of education as an export.

And finally, where do you think we'll be in five years?

I think the sector will go through a consolidation phase where the number of serious long-term players becomes clear. We are already seeing recent (new) investors contemplate selling their portfolio's and realise their returns.

For us, I think we will be bigger and have every opportunity to go from strength to strength. What will hopefully set us apart is the strength of brand. It is about a long-term operational business - rather than a property-play. Our brand is underpinned by the quality of our operations and management. It is what sets us apart from our competitors and allows us to create 'homes for success', the right environment for students to achieve their ambitions.

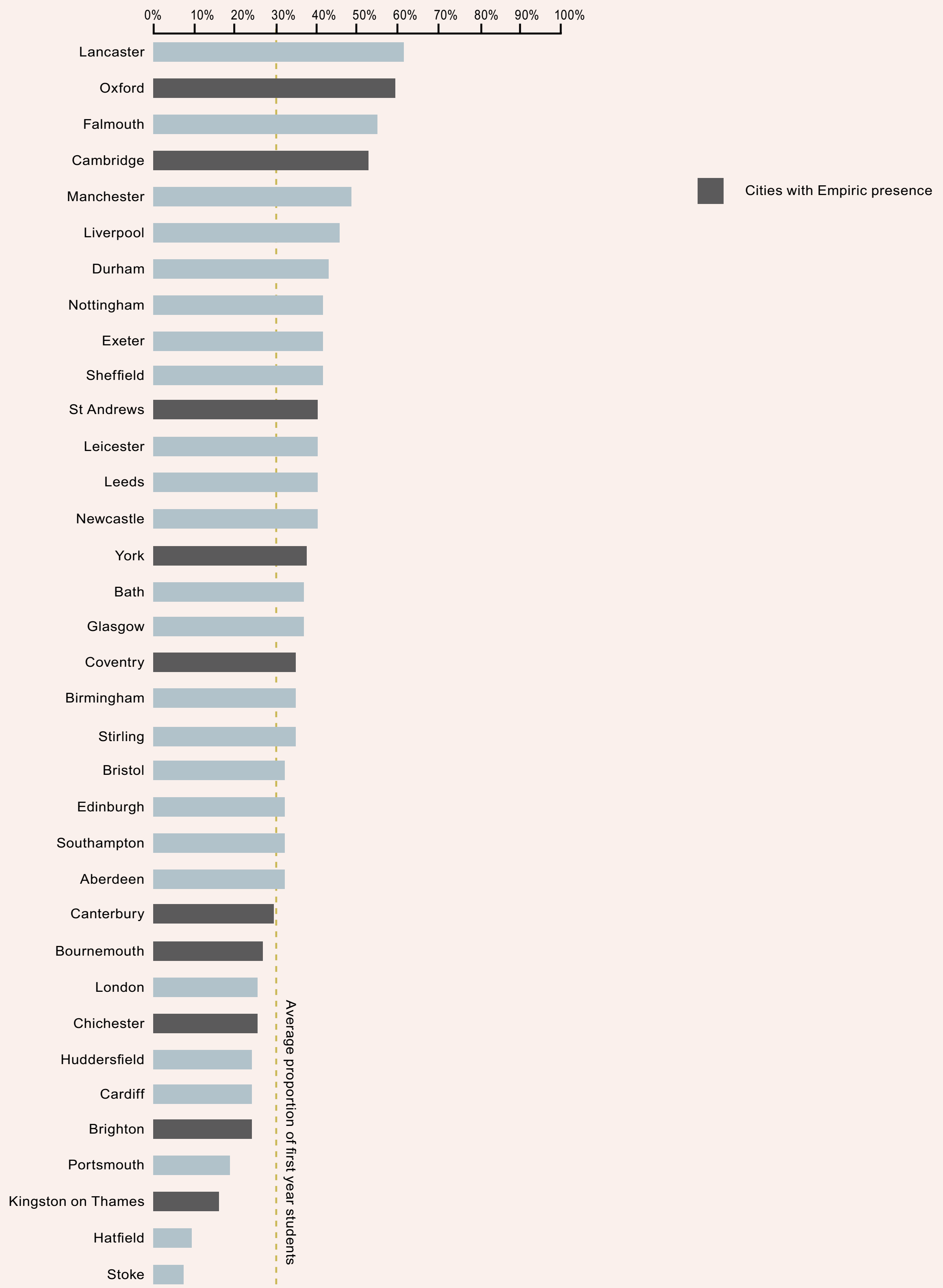
I think the sector will go through a consolidation phase where the number of serious long-term players becomes clear.



Prime locations for development

Picking the right location is key for developers and investors if they are to secure the high occupancy rates, and therefore stable incomes, that make PBSA an attractive asset. This applies to not only just which city or town, but the location within that town.

FIGURE 6: Proportion of students by city with access to PBSA (Source: Empiric)



Planning

In common with the rest of the real estate world gaining planning permission from variable local authorities can pose problems for PBSA developers and investors.

Community Infrastructure Levy

The Community Infrastructure Levy (CIL) was a planning charge introduced as part of the Planning Act 2008 to help local authorities deliver infrastructure to support development in their area.

No national rate for CIL has been set by local authorities, but most new developments which create net additional floor space of 100 square metres or more or creates a new dwelling, is potentially liable for the levy.

The British Property Federation released a July 2015 manifesto criticising the tactical use of CIL by some councils to stop purpose-built student accommodation developments going up.

The manifesto goes on to point out that a secondary impact of constraining PBSA supply is that it will place further pressure on the already squeezed housing markets, as students will be forced into the traditional private rented sector. It is estimated by the report that PBSA across the UK could release 77,000 homes back on to the market.

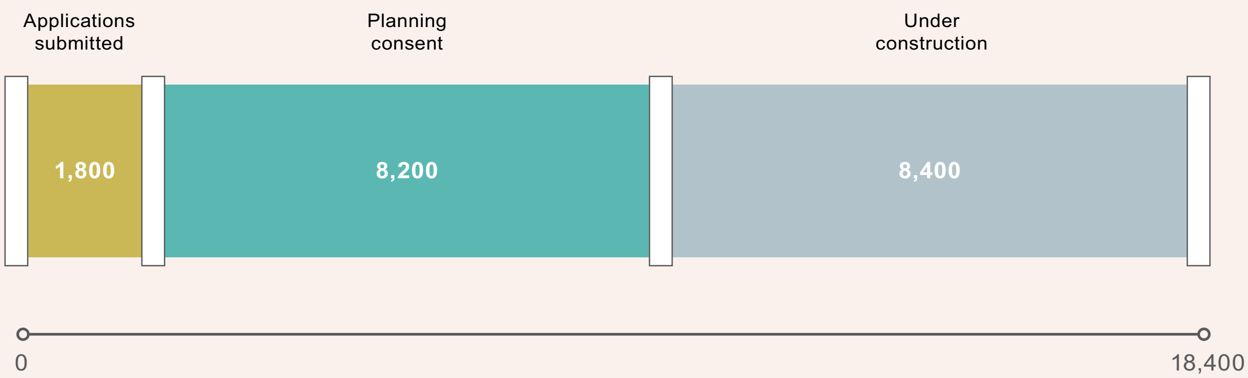
Local authorities

A common frustration is the fact that some local authorities are not amenable to student housing.

"Planning applications for purpose-built student accommodation are not welcomed with open arms by many local councils. The CIL is really a crude instrument that can be used to make student housing less attractive as it creates viability issues. Does a hotel have to supply affordable housing? I'm not against localism per se, but it quickly becomes NIMBYism, with residents saying we don't want a student block near us. It can be draining to win the argument with the planners, local authorities are under resourced and under pressure to update planning policy to address national and local issues, housing in particular, which can create delays in the process," says McLaren Property's Stuart Black.

However, with the forecast future increases in student numbers and pressure on the housing market increasing, along with the growing prevalence of Article 4 directions limiting the proportion of student HMOs in university towns and cities undergoing rapid growth such as Plymouth and Lincoln, there is huge potential for developers to work with universities in persuading councils of the benefits of PBSA.

FIGURE 7: Total London pipeline of PBSA (Source: JLL)



Q&A: Balancing the cost whilst ensuring attractiveness to students

Balfour Beatty
Ian Woosey
Business Development Director

Balfour Beatty Investment's Ian Woosey discusses keeping construction costs down, why central London is becoming less viable for student schemes and Balfour Beatty's plans for the future.

How do Balfour Beatty go about appoint a construction contractor given you have an in-house team?

We have our construction team in-house but we select the contractor dependent on the individual project.

If we are working with the university in a partnering capacity, we jointly appoint a design team to develop the proposals. Ultimately, what we look for is that they would be employed on a fixed-price capacity.

If it is a development project where we are buying the site subject to planning, then we'll run the planning process ourselves and then nominate a design team to the contactor when we've got planning approval. We involve the contractor all the way down the line as we have a target cost in our appraisal and we have to try and deliver on that. It is important to keep the contractor as part of the team all the way through, to make sure you've got a handle on the costs.

Are there any specific methods you can use to keep costs down?

We rely on the contractor having a seat at the table, so for example at a design meeting the contractor is represented. We like to keep the contractor included so that when we get planning permission, we've kept control of the budget.

The things that drive up costs are external planning specifications, internal fixture and fitting specifications. Something like floor area is a big driver of costs. Student accommodation costs £1700-1800 per square metre, so too many unnecessary square metres will drive the cost up. But you have to balance that equation to make sure you have enough amenity space and communal areas to make sure it is an attractive product for students.

Do you find planning regulations like section 106 and CIL slow things down? Does that vary from local authority to local authority?

Every local authority is different.

We just got planning permission in Glasgow for a 500-bed scheme within six months. That was from application to consent. That is a good result. But on the other hand, there was a university project on the south coast where the university got turned down with their outlying consent.

That local authority is one of the poorest at processing applications.

It has dragged on for nearly a year and we are no nearer to getting permission.

> *I can see the UK and the US growing in equal terms, albeit the procurement is different in different districts.*

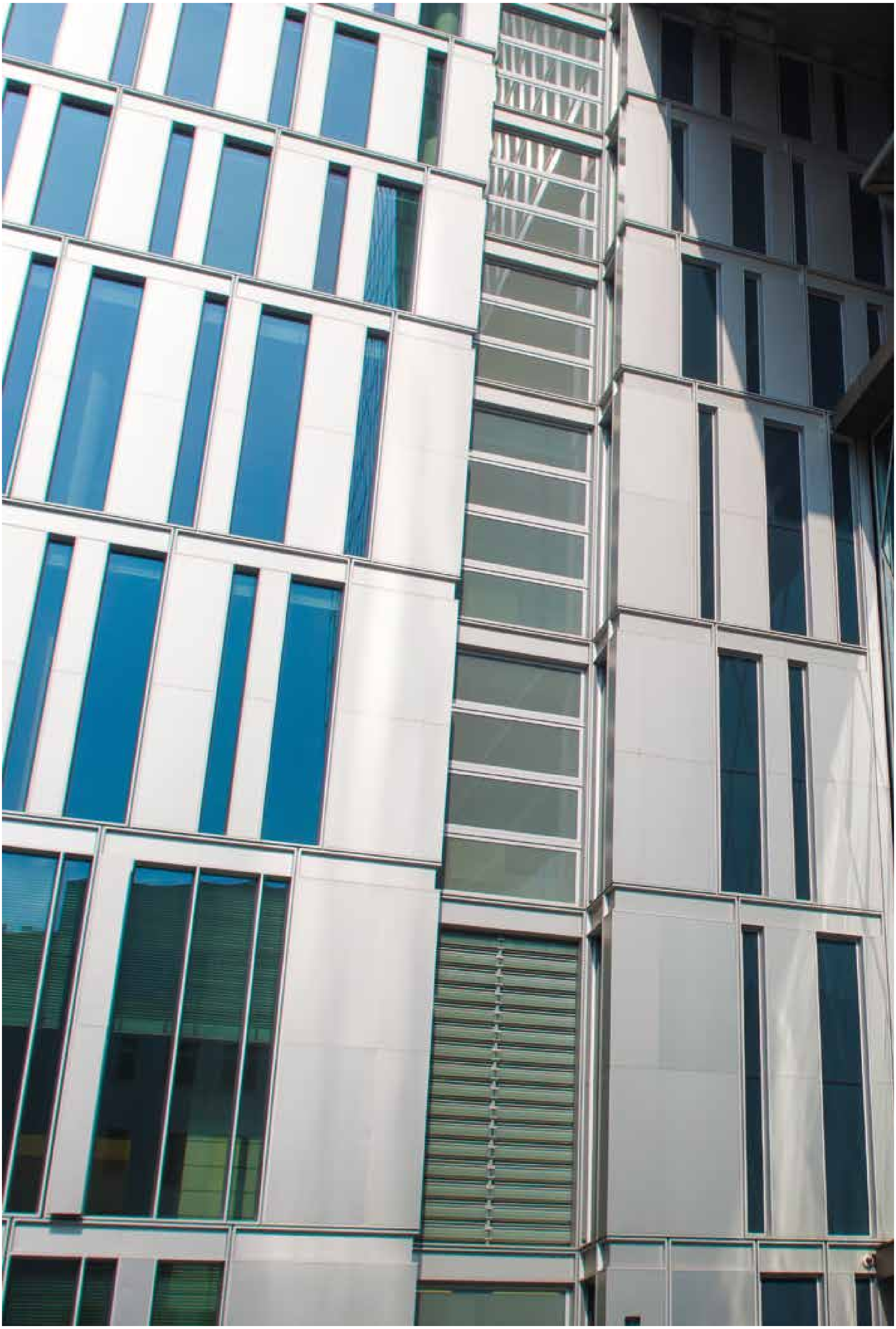
On the regulations side, CIL in London is having an effect. Some boroughs in London are looking to penalise student accommodation by putting high CIL rates on to it.

For £50 a square metre for a new build scheme I've been told - that represents an additional 25% of the costs just in CIL. It is restricting new developments, and that is what boroughs are looking to use CIL for.

Balfour invests in student housing in the US, UK and Australia. Which region will you focus the most on in the next few years?

I'd still look to continue to grow our presence in the UK market by selecting the right deal at the right time, and continuing to do a couple of deals a year for the next three of four years.

Saying that, the US market is massive. There are 160 universities in the UK, compared to over 2,000 in the US. So it is a much bigger market but each state has different funding requirements. I can see the UK and the US growing in equal terms, albeit the procurement is different in different districts.



5 FINANCING

Types of financing

Q&A: A long-term player
Royal Bank of Scotland plc

Q&A: Crunching the numbers
Laxfield Capital

Q&A: Lending to developers
Investec SPF

The Arch, Liverpool

Advising an institutional client and investor on the launch of a student accommodation ‘club’ fund and it’s subsequent acquisition from the Downing Group of a majority stake in a c.£200m portfolio of student accommodation in the UK, with the Downing Group retaining an equity interest in the portfolio in conjunction with it’s role as asset manager.

Types of financing

Institutional investors

Institutional investors such as insurers and pension funds are attracted by the long-term, predictable nature of student housing. With record low fixed-income returns and strong historical data, PBSA has shown itself to be largely counter-cyclical while delivering consistent outperformance versus commercial property and bonds. For many, it has provided an opportunity to create exposure to UK housing through an aggregated wrapper providing a large amount of upfront scale.

Private equity

For private equity, the main investment rationale is capital value growth rather than income. In 2012, when confidence in student accommodation wavered slightly over fears of higher tuition fees, private equity players took the opportunity to invest. Private equity's next play in the student market may involve buying the first generation stock of PBSA. While taking on this stock carries risks, it may offer the equity returns that private equity seeks.

Non-listed Open-ended funds

Non-listed open-ended funds, typically structured as unit offshore unit trusts, have a long term investment objective and life span which provides them with greater scope to adjust their objectives to adapt to the market and the level of commitments sought from investors. Once a student accommodation scheme becomes stabilised, it becomes an income rather than value-added play for an open needed fund, giving investors the chance to build a portfolio and manage the chance to manage a product over the long-term. The major funds have appeared to offer excellent returns. Unite's UK Student Accommodation Fund (USAF) has delivered an average 15% per annum over the last half a decade, with gross assets held now totalling £2b.

Closed-ended funds

Private closed-ended funds, typically structured as onshore or offshore limited partnerships or unit trusts, have a shorter life span than open-ended funds (5-8 years) and generally a cap on the level of commitments that can be raised from investors. However, given the long-term nature of PBSA, the short-term nature of closed-ended funds means that there comes a point when the manager and its investors must decide what to do with the fund and it's assets. This is can be a challenging time for all parties however there are a range of options available including extension of the term, restructuring to an open-ended fund or conversion into a REIT or the establishment of fund II. Closed-ended funds are for short-term players only but are well known to real estate investors across the globe, providing different opportunities and investment profiles for investors compared to an open-ended fund.

Real estate Investment trusts (REITs)

REITs are a relatively new entrant to the UK market having been created in 2007. As an investment vehicle, the main attraction is the tax benefit derived from the structure coupled with the obligations on the manager to distribute 90% of income to investors. Some have suggested this can limit the amount of development that a REIT can do. However, REITs give a listed product that is far more tradable than funds. GCP Student Living and Empiric Student Property REIT are two REITs currently active in the UK market.

Banks

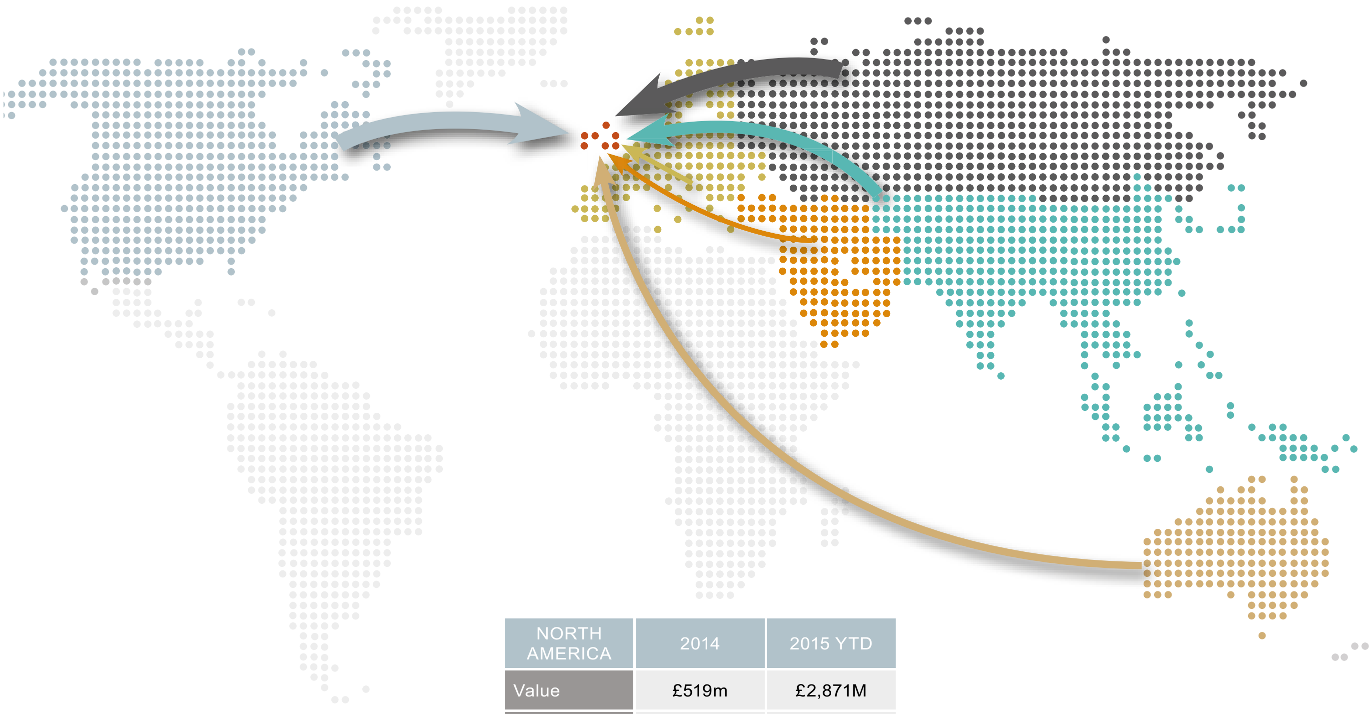
Banks used to be the main lenders to PBSA. However their market share has fallen after the global financial crisis and the introduction of regulations such as Basel III that have restricted the ability of banks to lend long-term. In turn new investors have come in and become more centric to the market. Some banks still lend to the market to fund development. But many are now starting to row back from development over fears of an oversupply in some locations.

FIGURE 8: Mapping UK investment flows (Source: Savills)

UK	2014	2015 YTD
Value	£1,455m	£416m
Beds	29,744	8,600
Deals	85	44

EUROPE	2014	2015 YTD
Value	£21m	-
Beds	600	-
Deals	33	-

RUSSIA	2014	2015 YTD
Value	-	£718m
Beds	-	3,300
Deals	-	4



NORTH AMERICA	2014	2015 YTD
Value	£519m	£2,871M
Beds	6,300	33,200
Deals	15	12

MIDDLE EAST	2014	2015 YTD
Value	£40m	£148m
Beds	500	1,200
Deals	2	6

ASIA	2014	2015 YTD
Value	£77m	£57m
Beds	1,900	1,900
Deals	1	6

AUSTRALIA	2014	2015 YTD
Value	£256m	£35m
Beds	3,700	600
Deals	1	1

Q&A: A long-term player

Royal Bank of Scotland plc
Phil Hooper
Head of Residential, Real Estate Finance

RBS has a significant interest in PBSA and Phil Hooper believes there may be opportunities for further collaboration between private developers and universities as they seek to upgrade their housing stock.

What's your current exposure to student housing?

We have a significant commitment to the sector and lend on both the investment and development side. I would estimate we fund around 15% of the reported total beds in the market. Our appetite to lend on any scheme is always driven by the fundamentals of the transaction: the management team, the asset characteristic and the financial structure.

Do you just offer senior debt, or do you look at junior debt too?

For the right property and the right location we will look to provide higher leverage beyond the senior debt to enable our clients' equity to work harder. If we go higher on the risk curve, the track record and experience of the management team are paramount

What loan tenors do you offer?

Most of our deals fall in the range of 3-5 year tenors. We can look at deals for shorter periods but anything longer tends to sit better with the institutional market.

The foreign investment is a reflection of the fact that the UK is seen as a safe haven.

To what degree does having a nomination agreement alter the lenders view? Some lenders only lend to schemes with direct-let.

Nomination agreements are much rarer today as most universities prefer not to commit to them. Sometimes developers will use them if there is a question mark over the viability or the size of the scheme.

The risk analysis covers the same main points whether there is a nomination agreement or not, such as how the asset will be operated, the strength of the institution, the dynamics of the location and the attractiveness of the asset relative to others in the same area.

A nomination agreement from a strong university can improve the risk proposition, however the direct-let market is generally really strong and we have appetite to finance both models.

There is the sense that London is becoming unviable. Where else in the country is safe and where is riskier?

The market is better served now than it was but it is not possible to generalise - it is all about the micro dynamics of the specific locations. It is about understanding the market the scheme is going to service, the foreign and domestic demand for that university, the competing schemes in the area. Would this scheme appeal to more than one institution for instance?

Physically visiting the site really brings it to life and you can understand what that site will look like when it is built.

We've seen a lot of investment into the UK market, which might reach £6b by the end of the year. Is that sustainable or will it slow down?

The foreign investment is a reflection of the fact that the UK is seen as a safe haven. Those who have bought up stock already will likely get a good deal as constraints over the land supply, and cumbersome planning regulations should restrict the supply of new schemes. This may lead to more rental growth in the longer term, which will maximise returns.

The platforms that have come to market have seen an opportunity to deploy a meaningful amount of capital against a proven asset class providing an income stream linked to inflation and that is not going to change with an interest rate rise. I think that any constraint in the short term will be more likely to come from the supply side.

Where do you think the student market will be in five years?

I think we'll see schemes targeted at lower affordability levels, and more domestic students seeking to live in purpose-built stock. We'll see more differentiation in the level of service offered in purpose-built schemes and premium schemes will truly be premium. The universities are likely to continue their drive to improve their accommodation offering and there might be opportunity to collaborate with the private sector in refurbishing existing stock or developing new schemes.

It will also become more important to pick the right sponsor and the right operator. And I think the debt market will be more sophisticated.

Q&A: Crunching the numbers

Laxfield Capital
Alexandra Lanni
Head of Transactions

Laxfield Capital's Head of Transactions Alexandra Lanni gives an overview of what's been driving the recent investment into student housing and what lenders really look at when assessing a deal's viability.

What has driven the recent spate of investment into student housing in your view?

I think a key driver has been the increasing institutionalisation of the sector. I think people like UPP, Unite and Urbanest have been around for a long period of time but over the last 5 years, the sector has been attractive from a planning and returns perspective, so the sector has attracted more investment in building new stock. I think that is partly why we've seen so much investment activity but also because the market - and the way in which these assets are run - has matured.

Are there any other reasons? Student housing is pretty mature now as an asset compared to, for example, PRS in the UK?

At a fundamental level, I think some investors in student accommodation also see it as a bit of a proxy to residential real estate exposure.

So some of the larger-ticket institutional players, who have wanted to access in a much more comprehensive way to the as yet not well established PRS market in the UK, have been seeing student housing as another easy to gain a similar exposure.

Plus, people are confident about the asset class from a "recession-proofing" perspective. That comes from the insolvency of a few high profile portfolios such as Opal.

When all the underlying Opal assets were acquired well, it gave a lot of confidence to the investor and lender market that the student sector is sustainable even through a cycle.

When lenders are considering risks, what is going to make people cautious?

It is difficult to give broad parameters because every deal is different.

At the heart of it is understanding who you are lending the money to.

These assets are living, breathing businesses, so the operators have to be very competent in the same way you have to be run a hotel.

For example, a central London asset might look superb on a first look, but at the practical level, it just doesn't cut it as a suitable investment for a variety of reasons, such as their planned operations, relationships with students or universities and overall the management of the operational business just doesn't stack up.

In terms of where the money has been coming from, there is obviously been a lot from North America, from Europe, and an increasing amount from Asia and the Middle East. Is there anyone left to come in and invest?

One of the most recent entrants is the Russian investor LetterOne. They've acquired quite a number of assets from McLaren, Apache Capital and others. However, the acquisition market has been dominated by North American and Canadian investment from the likes of Greystar and CPPIB.

How much of a premium do lenders put on the brand of the operator? The view of someone like Urbanest is that there is a premium to their product. Is that important to you?

In terms of the lending margins, some of the larger, more sophisticated, well established operators do get a better deal, whether that is in the latitude that they're afforded in how they operate their assets or the pricing that they command.

Q&A: Lending to developers

Investec SPF
Mark Bladon
Structured Property Finance Team

Investec's Mark Bladon, property lender, discusses the bank's lending strategies into the student housing market and key risks the sector faces.

What types of schemes, in terms of size and structures, do you look at?
We typically see 250 to 400-bed schemes as our ideal scheme size. If a client was developing more than 500 beds then we'd want so see part of the property subject to a nominations or lease agreement, but otherwise we've always funded on a direct-let basis.

How does your offering of senior debt fit in with the other debt options on the table for developers?
To my mind a developer has three options. You can go to a high street bank which will typically lend you 60-65% of the cost and probably charge 4 to 6 IRR on their debt. Alternatively you can come to a specialist bank like Investec and we'll lend 60-75% of cost and charge a 7 to 9 IRR.
The final alternative - which tends to be more for the newer entrant to the sector or one without a particularly strong balance sheet, is to go down the debt fund route. They will typically lend 85-90% of cost but will look for a 10-12 IRR on their money.

Has student housing been mispriced?
About 18 months ago when yields were at 6.5- 7% in the regions, and 5-5.5% in London, they looked high compared to other commercial property sectors. Now they have come in by 100-150 basis points they look about right.

Will we see further yield compression?
Possibly. We have recently had a couple of valuations completed in prime regional cities at 6.25%, with the expectation that this will reduce to 6% for a stabilized asset. For me, if you have a brand new student building located close to the university in a major regional city, and you are a well-established operator, then this still seems a bit too high. In these instances, we could see another 25-50 basis point yield compression. However I think London at 4.5-4.75% feels right.

If yields compress more will your approach to the market change?
We wouldn't necessarily exit, but we'd be a bit more selective. We could also reduce our leverage if we felt that forecast rents were too high, or yields too low.

How hard do you look at the assumed rents when predicting cash flows?
We look very hard at the rents. A couple of pounds a week can be a strong influence on where the student chooses to stay. Our valuers can provide us with rents for all competing schemes and we benchmark against these.

An area of risk that concerns me at the moment is rising land values.

What do you consider to be a risk to student housing as an asset class?
An area of risk that concerns me at the moment is rising land values. We are getting feedback from clients with substantial resources, experience and infrastructure that they are bidding hard for sites, and are not coming close to winning. If they are being out-bid, with all their advantages of economies of scale, it is hard to see how the final purchaser is able to make the numbers stack up.

We've seen lots of investment from North America and Europe - are you seeing new investors from the Middle East and Asia or do you expect to?
It wouldn't surprise me to see more capital inflows from other parts of the world. If you can invest your money in an asset like student housing in a location with proven demand and the potential to increase rents annually, and generate a 6% yield, then this has to be an attractive asset.
In five years where do you see the market?
I would expect to see more consolidation as some of the smaller players get priced out or taken over. In terms of risk, at some point less experienced developer/operators may struggle to fully let schemes at rents based on higher land value appraisals. This could lead to defaults if they are debt-funded. I don't think this will necessarily destabilise the market, as I would expect the bigger players to purchase any distressed assets, albeit at a discount.
Overall I think Student Accommodation will continue to be a stable institutional asset and I think PBSA will continue to grow and replace HMOs in terms of where students chose to live.

6 THE FUTURE OF STUDENT ACCOMMODATION

Demand

International students numbers

Potential risks to future demand

Paying the rent

Q&A: Working with the private sector
University of York

Working in harmony
University of Hertfordshire

Demand

FIGURE 9: Number of students accepted per year, 2006-2015 (Source: UCAS)

STUDENT ADMISSIONS BY YEAR TO UK UNIVERSITIES	
Year	**Admissions**
2006	390,890
2007	413,430
2008	456,625
2009	481,855
2010	487,330
2011	492,030
2012	464,910
2013	495,595
2014	512,370
2015	511,730

Student acceptances have consistently grown, apart from a drop in 2012 when higher tuition fees came in. In 2013 the numbers rebounded as they had done after previous fee hikes.

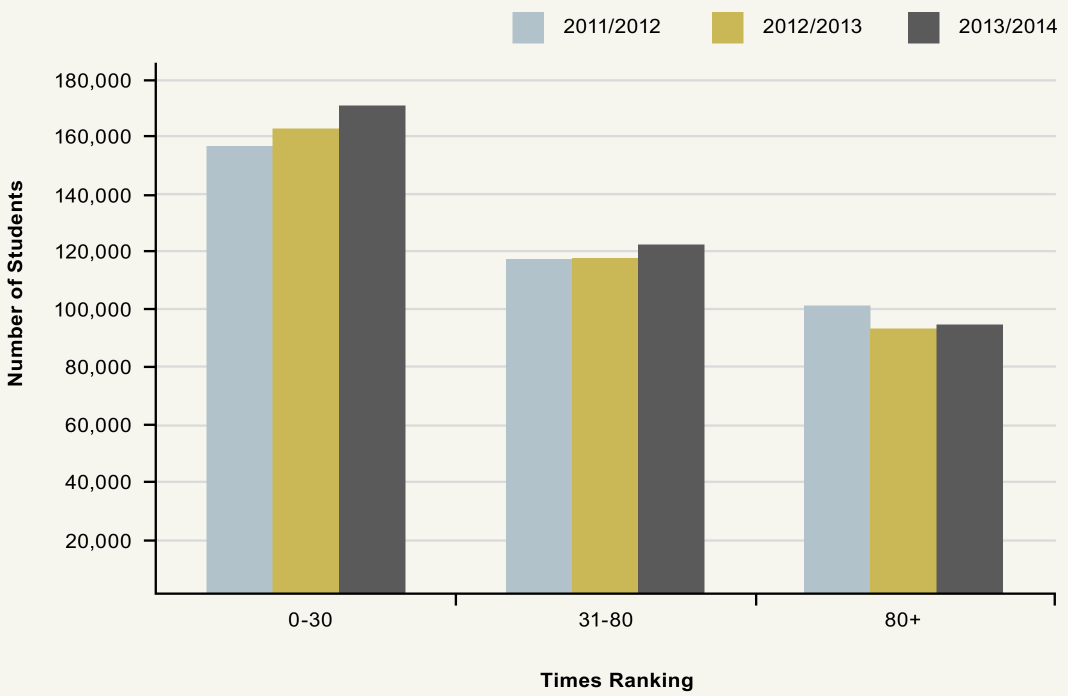
Looking ahead, student numbers are likely to rise even further. The lifting of the cap on student numbers from 2015 means universities can now accept an unlimited number of students.

"Universities will accept more students, and then build the infrastructure to cope," says Simon Westerman, director of commercial services at the University of Kent.

An effect that will likely arise from this is that universities will have less balance sheet capacity to build the extra accommodation likely needed to cope with a greater number of students, providing an excellent opportunity for investors and developers to tap into the student housing market.

However, critics have argued that students may start to think twice about degrees at second-rate universities with heightening fears about student debt. With degrees no longer the state-funded luxury they were for baby boomers, spending 20 years paying back the cost of three may not be so appealing for Generation Z.

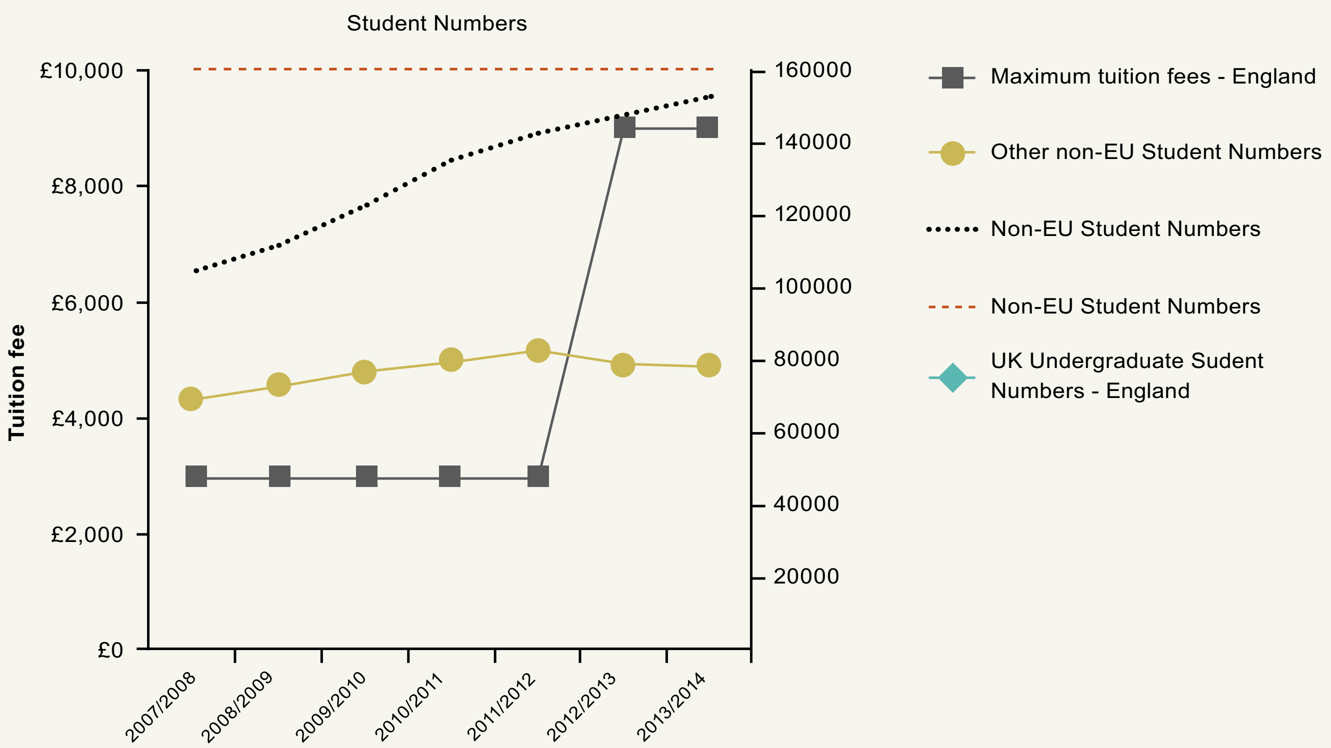
FIGURE 10: Top and mid-tier universities are seeing the most demand (Source: HESA)



For now though, with demand holding up, higher fees mean universities can boost their revenues. UK and EU students can now be charged higher fees of up to £9,000 a year.

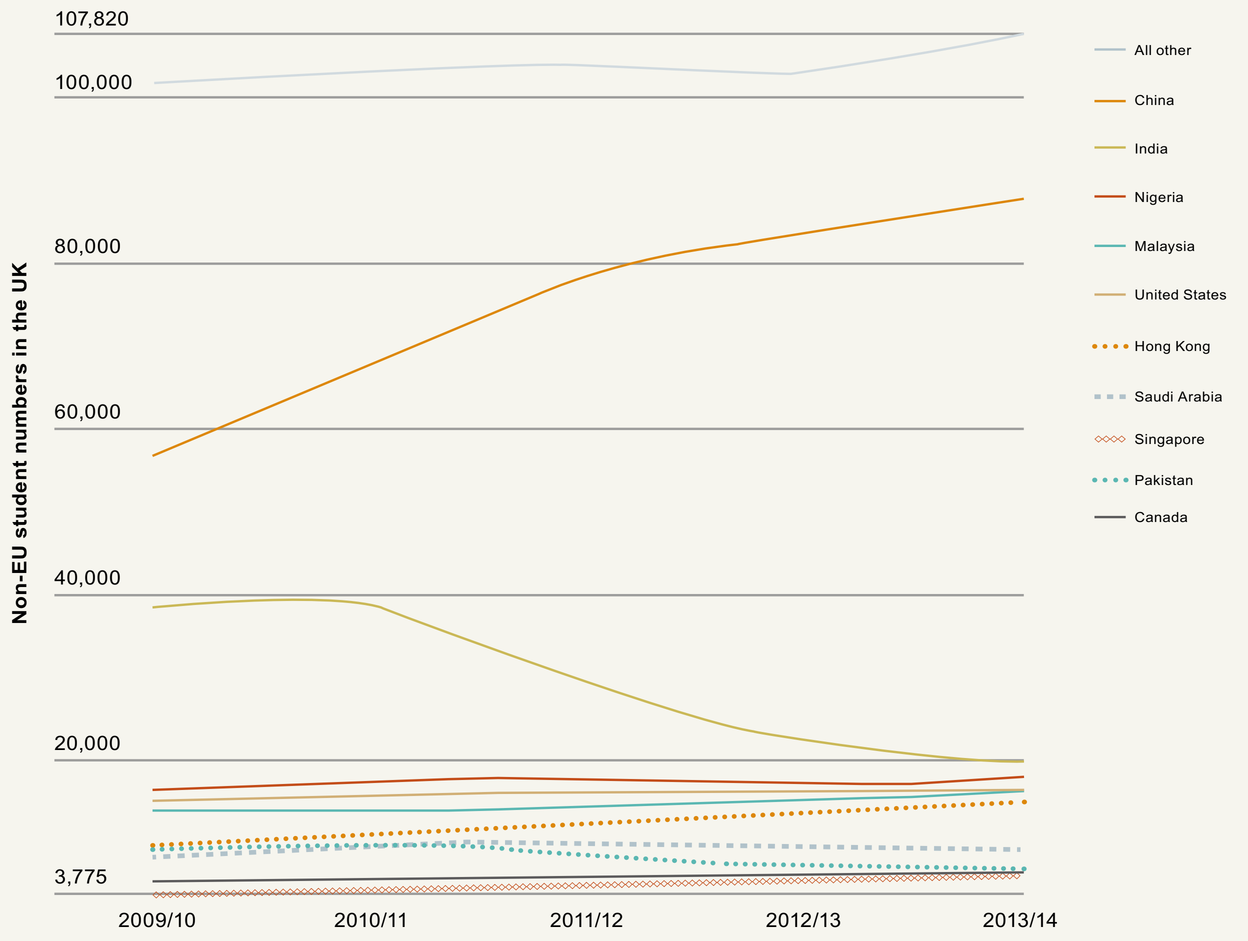
But for universities the truly lucrative markets are international non-EU students and postgraduates. These market segments can be charged higher fees than EU and UK students with some courses costing overseas students as much as £35,000 a year. Postgraduate students can pay as much as £38,000 a year.

FIGURE 11: Student numbers vs Tuition fees (Source: HESA and House of Commons Library)



International student numbers

FIGURE 12: Composition of non-EU student numbers in the UK (Source: HESA)



International student numbers have risen by a third in the UK over the last eight years, with growth coming primarily from the increase in Chinese students.

The increase of over a third in Chinese students - over 30,000 in absolute terms - represents by far the biggest increase of any nationality, with the double-digit growth in Hong Kong and Malaysian student numbers being strong in percentage terms but paling in comparison in absolute terms.

However, offsetting the growth in Chinese student numbers has been the sharp fall in Indian and Pakistani student numbers after the 2012 visa reforms, with Indian student numbers halving in the space of three years.

The universities that have seen the largest growth in international student numbers in absolute terms between 2009 and 2013 have tended to be those with the strongest reputations, with a mix of Russell Group universities and universities in London.

The top two universities with the largest overseas student cohorts in 2013 are the same as the top two in 2009: UCL and Manchester. However, UCL's growth of 3,550 - more than double that of Manchester's 1,700 - has seen UCL overtake Manchester as the university with the most international students.

Absolute growth has been strongest in regional universities and those of Scotland, with Glasgow, Edinburgh, Liverpool and Coventry making up the rest of the top five for overseas student growth and building on already strong international numbers.

It is worth contrasting these absolute numbers with percentage growth, which shows that the sharpest relative increases in international students have occurred almost exclusively in universities outside of London.

This partly comes as a result of some of these universities having comparatively few overseas students in 2009 - for example, the obvious outlier of Trinity University saw an increase from 70 international students to 1,300 over this period.

However, for many of these universities substantial percentage increases came on top of already strong international cohorts: Glasgow and Liverpool have seen near doubling of their overseas numbers from 3,700 to 7,000, and 3,250 to 6,200 respectively. Even in absolute terms these gains equal or outstrip some of those seen in the capital.

The common idea is that overseas student attendance is London-centric is a misconception. Though the top ranking university for international students is University College London, with 11,850 overseas students, it is the only London university in the top five: joined by Manchester, Edinburgh, Warwick and Sheffield, with Manchester's 11,605 international students nearly matching UCL's numbers.

Where the misconception does bear fruit - and where it possibly arises from - is in the proportions of international students within London universities. Seven of the top ten universities by percentage of international students are in London, with London Business School and the LSE's student populations both being over two-thirds international while SOAS, Imperial, UCL and City are each over 40% international.

This emphasises the growing trend of universities outside of London attracting students from overseas on the basis of reputation and recruitment efforts.

The international/domestic split graph above displays typical ranges across the spectrum of UK universities to give an idea of general compositions.

UCL also has proportionally the most international populace of all universities, with over a third of students being from overseas, and is roughly equally split between non-EU and EU students.

However, the typical balance in most universities is a strongly domestic student population, with the number of non-EU students being double or more that of the number of students from the EU. The graph displays the primarily domestic focus of less well-known universities and former polytechnics in the UK, with Plymouth and Manchester Metropolitan's student populations being less than 5% international.

FIGURE 13: Top 20 absolute increases in international student numbers 2009-2013 (Source: HESA)

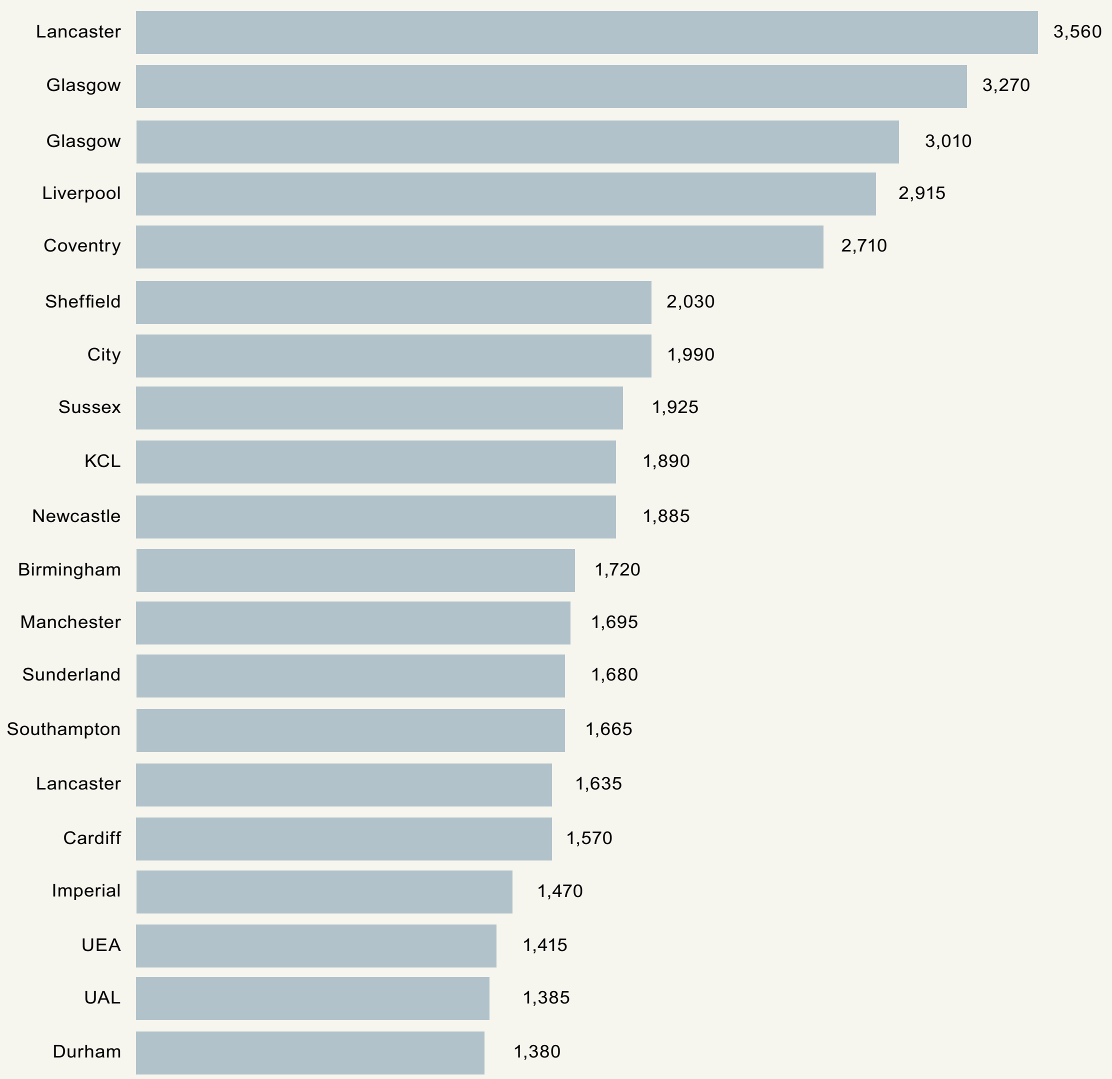


FIGURE 14: Top 20 percentage increases in international student numbers 2009-2013 (Source: HESA)

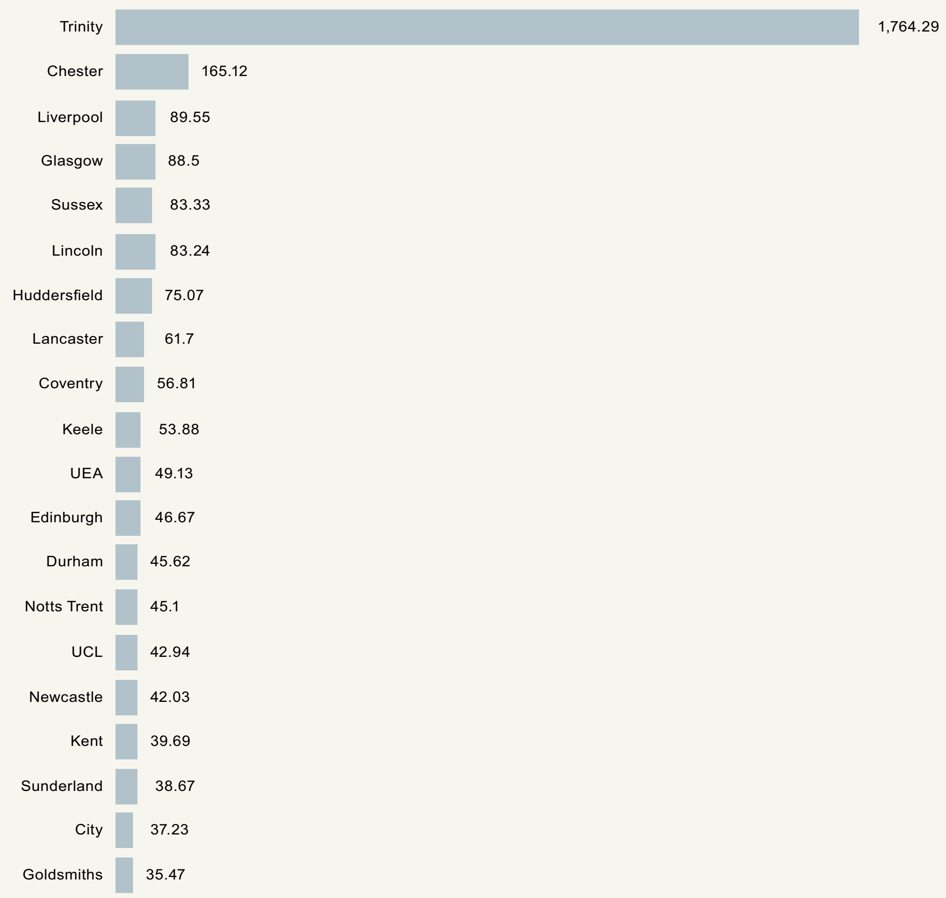


FIGURE 15: International/domestic composition of universities by ventile, 2013/14 (Source: HESA)

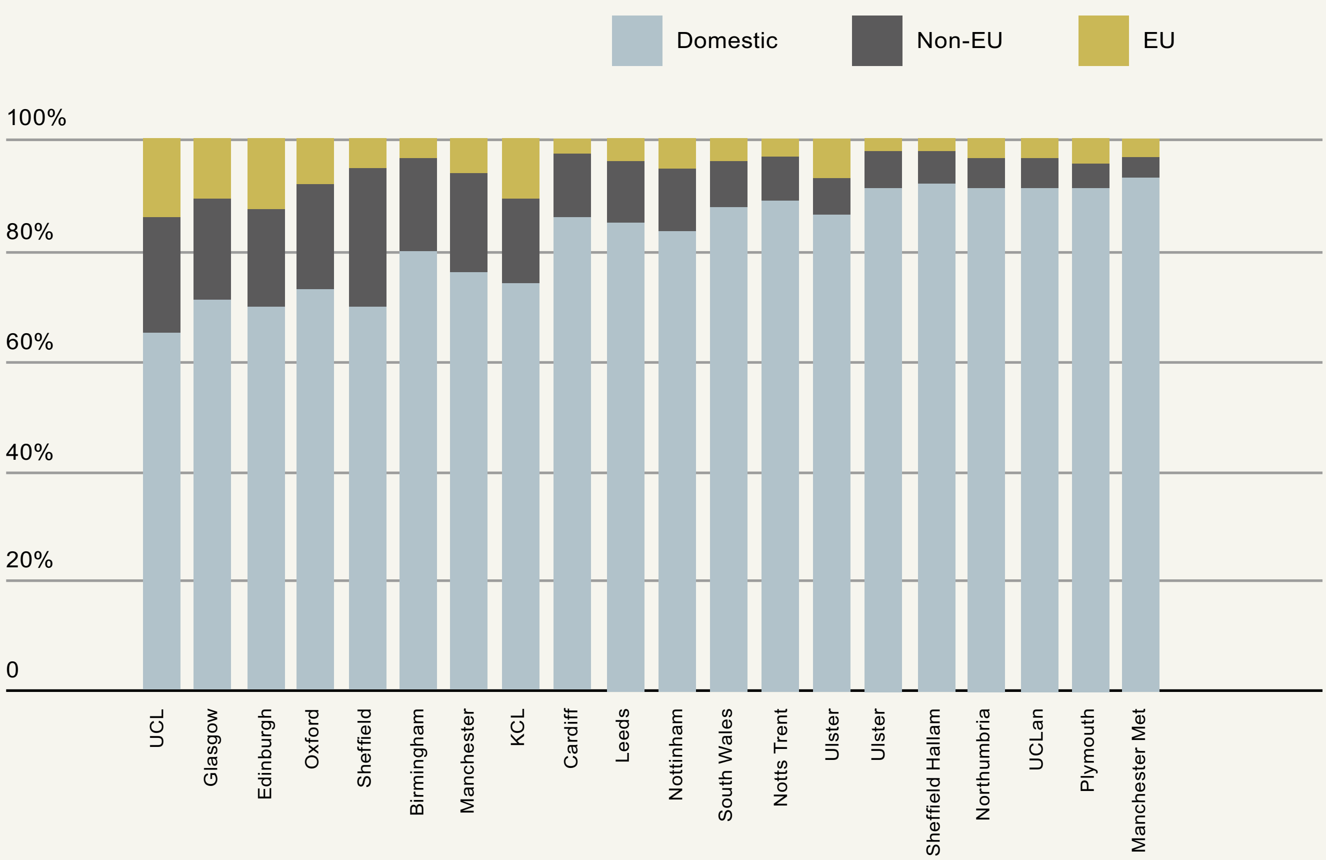
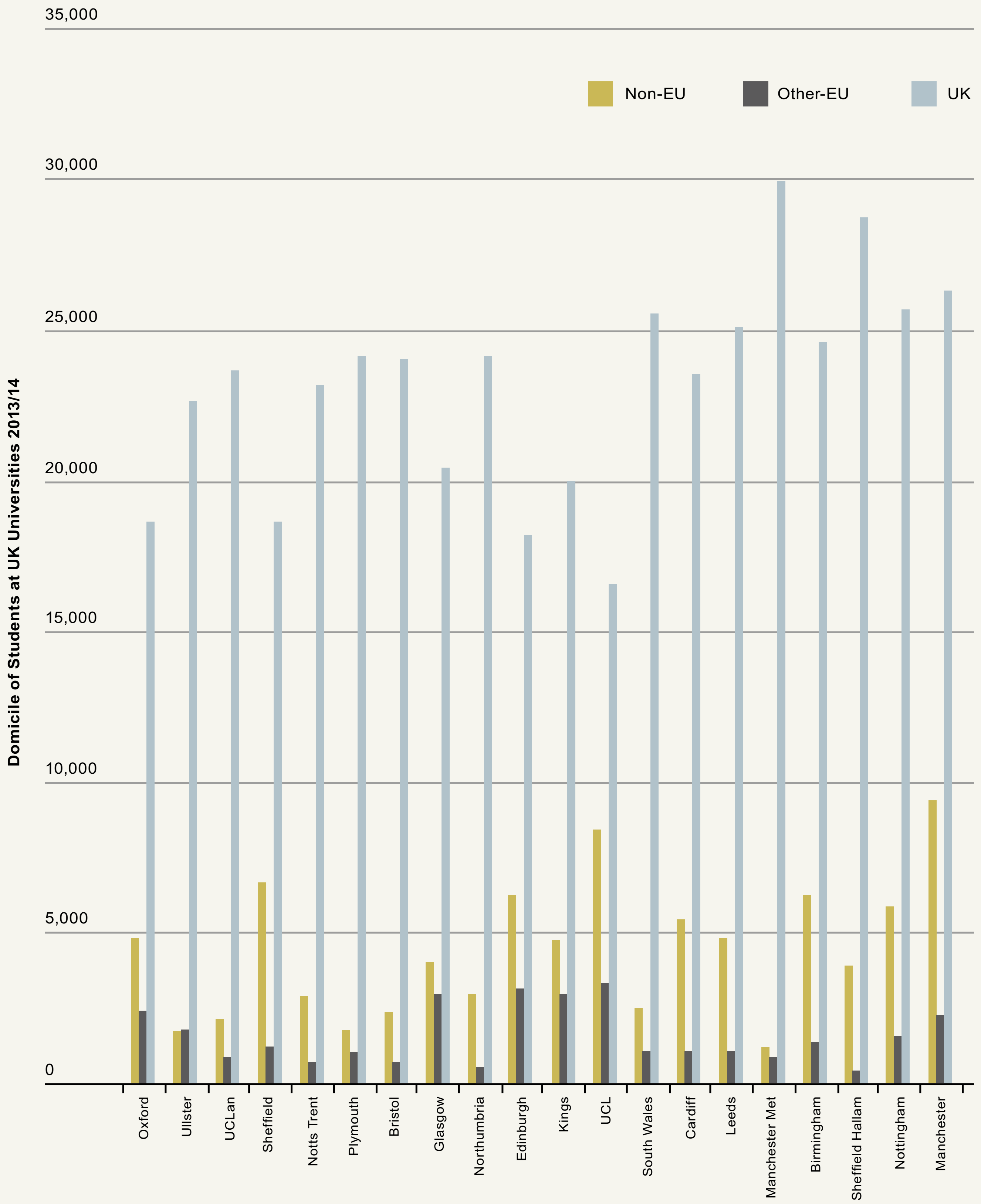


FIGURE 16: Domicile of students by institution at top 20 universities for international students, 2013/14 (Source: HESA)



Potential risks to future demand

Immigration laws and UK visa policy

Tougher immigration rules for international students announced by the UK office in July 2015 have been seen as making it more difficult for international students to study at UK institutions. For example, changes include that, from November 2015, overseas students will now need to prove that they have sufficient levels of savings to cover their costs for nine months.

The long-term effects of these changes are impossible to predict, but certainly UK universities may at the very least suffer reputational issues.

“The UK’s visa policy has a significant bearing of the profile of UK universities for overseas students,” says L&G IM’s head of transactions Adam Kerr. “When London Metropolitan had a clampdown a few years ago, there was anecdotal evidence that it did a huge amount of damage to the general reputation of UK universities.”

GSA Europe’s chief executive Tim Mitchell agrees: “The challenge will be in the lower ranking institutions, where applications and quality of applicant could suffer if international and domestic students begin to see courses as expensive and restrictive in terms of future work opportunity. UK students will consider studying elsewhere in Europe, given the increasing choice of English-taught degrees and lower cost of study.”

If international students see the UK as a closed shop, numbers may drop. As previously mentioned, there is already evidence that this has occurred for Indian and Pakistani students, who are more dependent on government assistance and loans and as such are more sensitive to higher entry costs and more reliant on the prospect of work after graduation in their country of study.

While the strongest universities will continue to grow unchallenged, if students feel they may be kicked out and not have the chance to lay down roots with British employers we could be undermining our own growth prospects as a nation. While certain elements of what has been said by politicians may be little more than rhetoric, there are worrying undertones to it which must not be ignored.

Birth rate

A medium-term risk to student numbers is a supply-side issue. Due to the declining birth-rate in the late 1990s and early 2000s - with ONS data showing annual births decreased from a peak of 706,000 in 1990 to a trough of 594,000 in 2001 - the base number of domestic 18 year olds available to apply for admission to higher education will remain historically low until the mid-2020s. The flipside of this is that, provided demand levels remain similar, in the long-term domestic HE application rates are likely to sharply increase and remain stable from 2025 onwards.

Paying the rent

There is no doubt that student accommodation has got pricier in recent years with many warning about an oversupply of premium apartments. However, student demand even for prime accommodation remains evident.

“Many sector analysts have pointed out that when students leave home for the first time, many parents are prepared to fund the most expensive band of accommodation for their offspring,” says University of Kent’s director of commercial services Simon Westerman.

“We analyse our supply and demand data annually,” he adds. “For 2015 entry, we can see that the demand for bed stock under £4.5k comes only from 19% of applicants, although 22% of our beds are in this price band. Just under 30% of our bedstock is between £5k and £6k, but the demand for this type of accommodation comes from over 37% of applicants.

“And for bedrooms over £6k, 39% of applicants choose top end accommodation, even though it comprises 33% of our stock.”

However, this desire for premium accommodation is not seen across the board, says Sue McHugh at the University of Brighton.

“What most of our students really want is mid-range, good quality but affordable student housing, as our students - both home and international - tend to come from fairly average financial backgrounds,” she says. “However, the private sector is much more focused on the higher rent housing options like studios, which are more profitable.”

Universities can experience swings in demand that catch them by surprise, meaning that wiser developers and investors should look to hedge their bets.

Simon Westerman from the University of Kent explains: “Applications this year have shown what is either an interesting anomaly or perhaps the start of a trend. When we sent out the offers of accommodation, 251 students requested to change - and most of them wanted to downgrade. However, this was mitigated by those looking to upgrade during clearing allocation, taking up the residue of higher quality bedstock.”

Q&A: Working with the private sector

University of York
Jeremy Lindley
Finance Director

The University of York's Finance Director Jeremy Lindley discusses what York looks for when working with the private sector.

How has the market evolved over the last decade?

Ten years ago student housing wasn't really an asset class. Any accommodation built was something universities did with individual funders, such as UPP, who themselves were largely funded by Barclays bank. So it was a very bilateral arrangement. Nowadays, it is a market in its own right. As a university you can tender for the accommodation that you want, and a variety of developers will provide credible solutions to the problems you are facing and want to address.

What's the split at York University between students housed on campus in purpose-built blocks and in community PRS houses?

On-campus, about a third of it is provided by third parties - either by UPP or through a 50:50 LLP partnership between the university and provider. Two thirds of our on-campus accommodation is still provided by us.
That campus accommodation is predominantly for either undergraduate or postgraduate first years. The remainder of the student accommodation is largely provided by the private sector market in York, most of it the traditional HMO type arrangement. But increasingly private providers are building their own purpose-built accommodation.

What nomination agreements do you have, and how do you structure them?

We have no nomination agreements with off-campus providers. On campus we have one with UPP. We also have three joint ventures with private providers, which are on long-term leases but the university owns half of the venture and is involved in the operational management of accommodation and provision of welfare services.
However, we are considering whether we ought to have more nomination agreements in the future.

Is there scope for universities to profit from housing, either by partnering with private investors to finance on-campus housing, or by using surplus assets which could be leased to a private provider without selling?

Many universities, including York, have wholly-university-owned student accommodation. The issue is: would we sell that on? Is it of an age where a private provider would be interested if we did sell it on? If we do, can we generate a return on that? That is one consideration.
The other is that if you want new-build accommodation, if you've got spare land then having accommodation on your campus - certainly for the University of York, where we have nine colleges - then it is advantageous, because it is easier for University to support the initial welfare needs of first years in a safer college environment. And there is a hybrid, which York has, where we have joint ventures with private providers where we own half the vehicle. In those instances we can support the first years and share half of the surpluses.

What do you look for from private sector providers ?

We like to see that they've built and operated them before and that they understand their expectations of surplus, as often that expectation goes back to student rents. For us ensuring affordability for students is critical: it is essential to making sure that accommodation is available for students. But also with students now paying tuition fees it is part of the overall package that is offered to students. So understanding the rental expectations and surplus expectations of a partner is important.

What does the private sector get wrong in your view?

They are not always sufficiently sophisticated in terms of what their expectations are. They have an undue focus on studio flats, mainly because they believe they can get significant premiums from providing those to students through higher rents, but often they overbuild those and then have to let them out much more cheaply. Also they fail to recognise that many overseas students are sponsored students who aren't particularly rich and are still looking for economic accommodation.

Turning to the wider market, what effect will the caps on visas have on international students, and the long-term attractiveness of UK universities? Obviously there is competition from Europe and the US for international students.

The visa changes for Tier 4 students have had an adverse impact on student number flows to the UK. I can't see that changing in the short-term, albeit I'd hope that it wouldn't get any worse than it is now.
International students can choose universities all over the world for English-language courses. Anywhere from Australia, New Zealand, Canada, the US, but also increasingly in Continental Europe which have an increasing number of undergraduate and postgraduate degrees taught in English. And those countries are alive to the opportunity to generate resources, and certainly the US is the biggest risk to the UK at the moment as it historically hasn't sought to recruit international students. It is doing that now, but its level of penetration is materially lower

(around 4-5%), so certainly it would be a big risk if they rose to the circa 20% of the UK and Australia. What I'd like to see is the government recognise that students aren't migrants to the UK. They are transitory, they come here for an education and then they go home.

Are there any other risks the market faces?

I think the other risk is the removal of student number control. The UK government used to strongly control the number of students going to each university. That stopped this year, and I think you will find while the overall number of students will rise, some universities will be challenged by that as many students may now gravitate to higher reputation universities.

Working in harmony

University of Hertfordshire
Andrew May
Director of Estates

'The University of Hertfordshire's Director of Estates, Andrew May discusses how private sector investment can make a real difference to delivering good quality student accommodation.

Choosing a university is one of the most important decisions a person can make and we are acutely aware that student accommodation is key to delivering an excellent student experience. As the cap on student numbers is lifted and a free market emerges, having excellent and well-maintained accommodation is going to be a driver for all universities, and it is one area in which estate teams across the UK's universities are continuing to find innovative and different models to ensure investment.

The numbers give a clear picture of the scale and budgets needed to maintain and improve student accommodation. You have about 1.6m students and about 350,000 beds provided by universities and the private sector. Of this, approximately 100,000 are provided by the private sector. If 25% of the remaining 250,000 beds needed replacing, that would be 60,000 beds. At, say, £50,000 per bed, that would be £3b. That would be before you even consider growth in the market, refurbishment of existing stock, estates transfers and private sector development.

The biggest challenge today is the cost of construction and the value of land. Producing affordable accommodation is a high priority for all institutions. It is clear that there is massive scope for private sector investment into this asset. Universities are very restricted in terms of their own capital outlay, and government funding is essentially unavailable.

Having recently undergone a project to modernize student accommodation at the University of Hertfordshire, I know that there is not a 'one-size-fits all' for the sector. Sometimes they will use their own resources, surpluses, or even borrow themselves. Other times they will want to use their own resources for investment in their core business of learning, teaching and research. Sometimes they will want to partner with the private sector to provide a joint solution and other times they are willing to allow the private sector to provide the managed accommodation themselves.

Where a university wishes to partner with the private sector the project should have buy in at every level of the university (from the chair or board down), and the project should be key to the university's strategic plan. It should also be de-risked from a planning and built-environment perspective and achieve sufficient risk transfer to ensure the transaction remains off balance sheet. The university should also seriously consider taking a stake in any investment vehicle created in order to closely manage and monitor the student experience - which is what it is all about.

PPP deals are very sophisticated and complex transactions that help universities to manage risk when building and operating student accommodation - which isn't the core business for any university. The core business is learning, teaching and research - but of course there is a need to provide both.

I work closely with the Association of University Directors of Estates (AUDE) and every year we speak to 2,000 students for a report on the student experience. In this year's report of all students surveyed, 85% said they are learning, socialising and living in clean and well maintained university buildings which is encouraging as it shows that we are providing student accommodation that is affordable, fit for purpose and appreciated by students.

7 THE FUTURE OF HIGHER EDUCATION

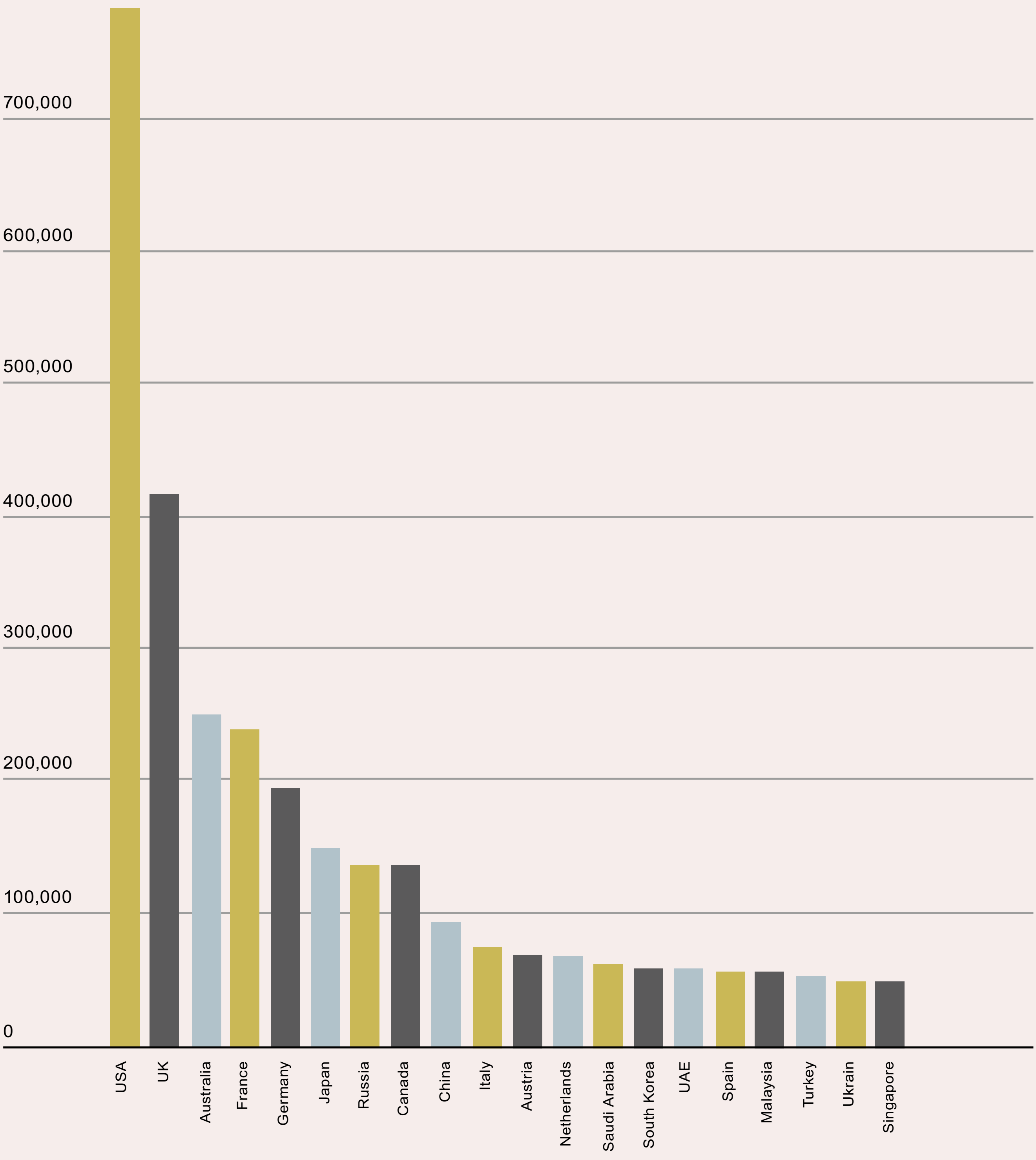
Increased competition

Q&A: The global competition
Global Student Accommodation (GSA)

Last word: Hungry investors haven't satiated their desire for student housing
JLL

Increased competition

FIGURE 17: Global international students by country, 2013/14 (Source: UNESCO Institute of Statistics)



One of the long-term threats to the UK higher education sector is the growing competition from nations seeking to expand their own tertiary education sectors.

According to the International Consultants for Education and Fairs (ICEF), internationally mobile student numbers have more than doubled in fifteen years, from 2.1m in 2000 to 5m in 2014.

With numbers projected to continue growing, more countries are competing to attract international students and the growth that comes with their presence, with international students contributing over $27b (£17b) to the US economy and £10.7b to the UK economy in 2012.

Nations with already established university sectors, such as Australia, the US and Germany, have made a point of targeting international students in specific countries - in particular focusing on attracting students from Asia.

Germany is already a top five destination for international students, receiving 5% of international students - just shy of 200,000 in 2013, according to UNESCO - but is aiming to reach 350,000 international students by 2020, appealing to students with low/no tuition fees and cheap student visas of just €60, along with post-graduation residency rights for a year.

Australia, with 250,000 international students and 6% of overseas students, similarly has low visa costs and allows students to stay for 18 months after graduation.

The United States, top with its 800,000 overseas students totalling 18% of global overseas student numbers, has made easing student visa requirements a priority, and has worked to encourage student exchanges with countries such as China, Indonesia and Vietnam, while also offering a three year post-study visa.

Developing nations such as China, by comparison, are focusing more on establishing reputations for their higher education sectors through investment. Since 1998 the Chinese government has invested heavily in 39 universities as part of Project 985, which has sought to establish the 39 as world-class universities and attract 500,000 international students to China by 2020.

Singapore has worked to encourage world-class universities to establish joint institutions in the city-state with government funding and fee subsidies, with the aim of establishing itself as a regional hub for tertiary education.

Malaysia has done likewise, focusing on overseas universities establishing branch campuses and setting particular study areas as core recruitment subjects for targeting international students, such as advanced engineering and health sciences, while also promoting itself to students as a ‘regional centre of educational excellence’ from an Islamic perspective. Malaysia was on track to reach its target of 150,000 international students by this year, with 135,000 students by the end of 2013 (up from 80,000 in 2010).

The United Arab Emirates has also sought to establish itself as a regional HE power through a similar strategy, with 32 of the world’s 230 international branch campuses - 19 within the Dubai International Academic Village - and a particular emphasis on attracting high-quality institutions with ‘free zones’, which allow providers working within them to operate without regulation. The UAE has consistently tallied double-digit growth in student numbers over the last few years, with over 42,000 international students by the end of 2013.

Though the UK’s share of international students globally increased from 10 to 13% between 2000 and 2012, these figures came before the aforementioned changes to the visa system for foreign students in the UK.

The increase in competition from countries seeking to establish themselves as ‘regional hubs’ in areas that provide significant numbers of overseas students for the UK is a threat, given the growing trend identified by the ICEF of ‘intra-regional’ mobility for international students. More students are leaving their home countries but staying in their home regions.

The appeal of study at an international university’s branch campus or a regional university with a growing international reputation will be higher for students dependent on scholarships or those not wealthy enough to meet the UK’s heightened visa requirements.

The extra dimension of the increasingly competitive higher education sectors of developing nations is that students may be more likely to stay in their own countries. The number of students going abroad from South Korea has been in consistent decline since 2012, with more of those going abroad going to regional destinations and more students choosing to remain in Korea against the backdrop of declining purchasing power for Korean families and the stronger reputation of Korean universities - a potential warning of how demand could change in other nations providing high numbers of international students.

While the reputation of British universities will ensure demand will likely always be present for overseas study in the UK, the increase in competition globally is likely to be a long-term threat to the UK’s share of international students as more universities abroad begin to catch up with the quality of British HE: particularly if visas present high barriers to entry for foreign students, potentially cutting the British market off from the growing global middle class.

Q&A: The global competition

Global Student Accommodation (GSA)
Aaron Maskrey
Head of Business Information and Research

GSA's Head of Business Information and Research Aaron Maskrey explains how global competition in the higher education market is heating up and how accommodation has to vary by region to cater for varying tastes.

How competitive is the global market for attracting international students in higher education?

Higher education is a very competitive arena, especially when it comes to the international student market. Countries are really competing for internationally mobile students, due to the significant benefit these students bring to the economy . A good example is in Australia, where higher education is now their second largest export behind coal, helped in part by the friendlier student visa policy.

What about other rising powers like China? How do they approach the sector?

China and India are looking to scale up. China wants 500,000 international students by 2020 and is aiming to invest $360b into its own domestic higher education.

India plans to be a top five global science power by 2020, which is quite an ambitious target. To achieve this, they'd have to build and operate 500 new universities over the next five years. Japan's also implementing an internationalisation plan in higher education, which involves introducing English-speaking curriculums at various universities, with the aim of boosting international student numbers. Most nations have either developed or are now in the process of developing strategies to expand their domestic higher education provision.

In terms of global competitiveness what does this mean for the mature, competitive markets like the UK's?

There will always be demand for the top tier institutions based in mature markets, such as Oxford and Yale. However, the next tier of universities is the level that will likely have to adjust and become more international. One of the ways these institutions have looked to achieve this, is by moving closer to the source of demand (primarily in Asia) through international branch campuses. New York University in Abu Dhabi is a good example of this.

From the perspective of GSA, do people care about your housing brand if they are really motivated by the university's brand?

GSA has two key customers - students and universities. From a student perspective, the initial core decisions regarding their time in tertiary education are what to study, where will they study and finally what their accommodation will be.

We want to position GSA to become a highly recognised and trusted global brand - similar to the top international hotel brands - and we believe that we have the experience, knowledge and vision to achieve this. Holiday makers aren't going to think of hotels as their first order for a reason to go somewhere, but once decided upon their destination, they will seek out a trusted brand for accommodation. Trust is a crucial element in student accommodation, whether dealing with universities, parents, or our residents. On the university side we've developed relationships with international universities in multiple markets to become their preferred and trusted source of accommodation.

In terms of how your global product has evolved, does it vary between countries, in what you offer?

As GSA's leadership team has over 20 years' experience in providing purpose-built student accommodation, many of the key learnings and operational efficiencies can carry over to the international market. However, we do tailor our product to fit in with different cultures and expectations. For example, we heavily invest in research and conduct a full analysis on the local market, which can take over a year to complete, before designing a tailored product in a new territory. We work to achieve an in-depth understanding of local regulations and customs, clients' interests, demands, habits, and also what they expect from the communal space.

In Dubai for example, we offer a slightly varied product than what is typically offered in London, as our student residences will offer a pool, gym and fewer studio style rooms. The Dubai scheme we are about to launch is primarily twin-share to reflect the majority of international student demand originating from India and Pakistan, who are typically cost driven and happy to share a room

Most nations have either developed or are now in the process of developing strategies to expand their domestic higher education provision.

Higher education is a very competitive arena, especially when it comes to the international student market.

with classmates and other students. On the other hand in Japan students will typically want a different style of accommodation, one that is very private but has communal spas. So the product does change, but from carrying over our previous 20 years' worth of knowledge and experience we can always ensure that we deliver an excellent product and student experience regardless of the market

In which regions are you looking to operate in at the moment?

In Europe we are primarily seeking to expand our operations throughout Dublin but have also been looking at various opportunities in Germany.
In the Middle East we are about to open our first property in Dubai in January 2016, after which we'll look for more opportunities to expand within the Emirate.
We have also been immersing ourselves in the Tokyo market for the past two years and are currently managing a property at the Otsuma Womens University, with the aim to expand operations further in the near future.

Are you developing or just buying up existing stock?

We have a dynamic strategy that allows us the flexibility to enter a market in the most effective way possible. For example, this year we've taken over an existing student accommodation site in Dublin called Broadstone Hall that is currently being refurbished. But we also have schemes in Dublin that are organic - acquiring land and developing from scratch- such as our Mill Street development. We have also built our Dubai Student Residences from the ground up.
Our Asia Pacific team(managed out of Hong Kong) is looking at exploring several opportunities throughout South East Asia.

Will your fund provide the capital for these projects?

Typically, funding these projects will be a mix of our managed funds and 3rd party capital.

Looking broadly at the UK market, where are you seeing the money flowing from and how's that changed over the last few years?

A lot of the investment has come from North America recently, but there is strong appetite from the Middle East for UK student accommodation, specifically over the past eighteen months. Far East institutions from Singapore, China, Japan, and Korea are also looking to invest more into the UK. So there is a lot of global appetite for the asset class within the UK. In fact, although the UK student market is less than 1/9 of the size of the US market, it has received over $6.3b worth of investment volume during 2015, compared to just $3b in the US.

Last Word: Hungry investors haven't satiated their desire for student housing

JLL
Philip Hillman
Chairman - Alternatives

Having led the Student Housing and Higher Education Team for 25 years, advising on student accommodation projects for a wide range of universities, developers, operators, lenders and investors, Phillip has been involved in most of the major student accommodation transactions in the sector over the past 10 years.

Over the two years prior to 2015 we saw transactions of around £2b per year, and by the year-end we estimate 2015 to have seen record deal flow exceeding £5b.

Put in context, with university-owned beds totally around 300,000 at a value of c.£15b and around 220,000 purpose-built beds of similar value, that means around 30% of the market's value has been traded this year.

This constitutes a major recapitalisation of the sector; a bigger push into alternative asset classes by investors and a soaring appetite from many international players, which is still largely going unsatisfied.

With so much activity, PBSA is extremely transparent, which is helpful for investors and making everyone more confident in valuations. Occupancy levels have remained firm after the blip of 2012 and with international students set to double over the next few years, there is huge potential in the UK and European markets.

Some companies have swapped private equity funding for institutional capital - as it is much cheaper - but what we've seen through many sales processes JLL has run is that many more deals could be done if we had the stock.

When we sold Carlyle's Pure portfolio for £535m in March 2015 to LetterOne, a trio of Russianbaires, we received 14 bids around the £500m mark. When we sold the Westbourne portfolio for £540m there were 10 bids. And when we sold Ahli UK Student Accommodation Fund for £270m in first half of 2015 there were around six bids.

What this tells us is that there is a lot capital flowing around.

Many were rightly concerned in the last cycle around debt levels. But we have had relatively low levels of debt: some have paid effectively in cash and then refinanced later; institutional investors have been leveraged at around 30-40%; with a few who will leverage at 60%. The days of 80% loan-to-values as we saw when Roundhill bought Nido are behind us. There is a lot more debt around - but with the rise of insurance companies and other 'alternative' lenders, combined with a number of bond issues; finance has never been cheaper. Yet we are not seeing any heavy gearing mainly because of the type of party dominating the market.

Looking forward, the sector will enjoy ongoing success even if transactions levels and value gains plateau out.

Clearly the lack of stock and availability of finance mean that the backdrop for development should be simple. And while much is going on, investors are going to have to be that bit more savvy - and they are. Much of the focus is around the Russell Group universities and there is a sense that some operators who don't offer a top-tier service may fall away as competition increases.

In London, developers are having a difficult time competing on the open market with commercial and residential developers. It is tough to find sites in central London zones and this is why the likes of Unite and Balfour Beatty are in areas like Wembley and Holloway.

The onerous policy we have around the community infrastructure levy (CIL) is also a huge burden as it disproportionately favours commercial development over student housing.

What CIL fails to take into account is the rising land cost or genuine fundamentals of the asset. So it costs more to build and in many cases, makes doing so unviable.

In the provinces, many people are looking at development and we are concerned that the pipeline is quite substantial, and that only an exceptional scheme can work in many places. If you've got the best location then you are fine, but as should be obvious, students are very footloose.

We could see transactions levels upwards of £2b again in 2016...

Above all, companies need to remember not to get blinded by future yield projections: projects have to wash their face today. London net initial yields have probably gone from 6.25% down to around 4.5%, which is more in line with PRS and commercial. In the provinces there are down from around 6.5-7% to 5.5%.

A large part of this is the "portfolio factor" - where prices are bumped up because a company wants to make a strategic entrance into the sector and will pay for that opportunity. It is hard to separate out that premium, as the majority of deals in 2015 were portfolio trades. That premium has certainly been in excess of 10-15% previously, although it will not be that high now.

It is however, something that many will be looking at both in PDSA and PRS, however subjective the final number may be.

Looking forward, the sector will enjoy ongoing success even if transactions levels and value gains plateau out. We can expect solid yet stable rental growth of around 3-4% with good levels of occupancy. In as much as any asset can be "counter-cyclical", PBSA is - it is certainly less affected by the fundamentals of global economics as City offices or retail, which are both notorious volatile.

We could see transactions levels upwards of £2b again in 2016 and my only worry is that some investors may think this is a great bandwagon to ride to a former polytechnic city and not get the returns they hope for. People need to remember that operator expertise is key, and some there don't have it and will fall by the wayside.

Sincere thanks to all of those who were interviewed and contributed to the production of this report.

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