

Student Housing: A Study in Success

By Allison Landa

Investor interest in student housing has been strong, and for good reason. While other sectors have suffered from consumer and corporate cutbacks, college enrollment has remained resilient, if not benefited from the difficult employment market.

According to Real Capital Analytics Inc., student housing sales have experienced boom times this year, with overall sales totaling \$350 million through August. That marks a 21 percent increase over the same period last year. While private investors make up two-thirds of the acquisitions, universities themselves are getting into the game, having purchased the remaining 33 percent.

Those numbers do not surprise Greg Genovese. When it comes to investment, the president of Northern California-based Pacific Valley Realty Capital likes to keep an eye on the sector. “It’s doing better than a lot of sectors in the sense that it has continued to stay stable and the values have stayed stable,” he said. “The economy is going to be cyclical, but kids are going to go to school.”

According to Genovese, stable cash flow and strong liquidity bolster the sector. And construction loans have been available, unlike in other sectors. Another strong sign, he noted, is that universities are building their own housing. “(They’re saying), ‘We have this land and we’ll develop it ourselves.’”

Paradoxically, he added, recessionary times can drive student housing to greater success. “Historically, enrollments have gone up, not down,” he said. “During recessions, people tend to duck their heads and stay in school ... which drives the demand for student housing.”

That is not just hearsay. A 2009 National Multi Housing Council report titled “Special Student Housing Report: Has the Recession Had an Impact?” looked at freshman application data for 63 universities and found that applications and enrollment had increased at most schools during the recent recession. Housing demand rose commensurately.



Master developer Concord Eastridge completed the \$115 million first phase of Eagle Village this fall at the University of Mary Washington in Fredericksburg, Va.

Concern About Overbuilding

Susan Eastridge, CEO of development firm Concord Eastridge, says the recession resistance of student housing comes from its consistent purpose—students will always need homes—and so it does not correlate as strongly as other sectors with economic ups and downs.

And she believes student housing is evolving into a more definitive niche of commercial real estate, with a growing investor following.

The downside, though, is potential for overbuilding. “People that are in the commercial real estate business don’t like to sit out a cycle, and so you’re seeing some (continued on page 20)

Economist’s View

Real Estate Capital Markets: Alive, if Not Quite Well

By Dr. Peter Linneman

The critical question real estate investors face today is, “With 10-year Treasury rates hovering around 2.5 percent for the past two months, what if the bond market is right?” Rates have not been this low since 1954. Based upon the historical real expected return of 200 basis points, this suggests an annual expected inflation rate of just 0.5 percent over the next 10 years. Were this to occur, à la Japan, we would be shocked. As a long-term commercial real estate investor, you must make your own determination of expected in-



flation over this time horizon and cannot “outsource” this task to the bond market.

If the bond market is right and inflation is a mere 0.5 percent annually over the next decade, real estate borrowing costs will fall dramatically. If 2.5 percent is the base interest rate, then yields on commercial real estate debt will fall accordingly. This has already occurred in the multi-family sector, with 10-year debt running below 4.5 percent. But if 10-year Treasury yields remain at 2.5 percent, borrowing rates for commercial real estate will

fall to 3.5 to 4.25 percent for 60 to 70 percent loan-to-value on cash-flowing assets. Over the next three years, such low rates will allow much of the maturing debt on cash-flowing properties to be refinanced much more easily than anticipated. This is because not only will lower interest rates greatly improve interest coverage ratios but also because low long rates will push down cap rates.

How do you protect yourself? The biggest question you have to ask yourself is, “What is the absolute return I believe I need in a market like this?” The way to approach this is that if we believe the 10-year Treasury yield belongs in the 4.5 to 5 percent range, then we adjust from there. We could be wrong. The bond market disagrees, while the commodity market agrees with us.

Today’s investors must have clear views about the growth of the economy (jobs) and inflation over the next few years. In normal times, the range among sophisticated and knowledgeable investors on these variables is quite tight; today, the range is enormous. The fact that there is huge variability among potential bidders means that bids by intelligent investors can be 20 to 50 percent apart.

Hence, investors can no longer use “2 to 3 percent per year increase” and “stable cap rate” underwriting. While “micro” aspects of the property and the manager have generally determined the performance of an asset historically, macroeconomic considerations are of predominant importance today. If the economy adds three million jobs each year and inflation is 5 percent per year over the next few years, this will overshadow the relative impact of any manager, no matter how efficient. And even the most efficient manager will be wiped out should there be deflation and more lost jobs.

While no one knows what will happen with inflation and job growth, you cannot invest today without clearly articulating what your views are in this regard.

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—Peter Linneman is principal of Linneman Associates (www.linnemanassociates.com) and the Albert Sussman Professor of Real Estate Finance and Public Policy at the Wharton School of Business at the University of Pennsylvania. This article was condensed from The Linneman Letter, Fall 2010.

Student Housing a Solid Investment

traditional multi-family developers trying to get into the student housing space,” Eastridge said, citing the University of Arizona as an example. “During a good economic cycle, there was a huge amount of student housing built (there). Today, the enrollment is really good, but it’s starting to show signs of being overbuilt. They’re starting to have some stress on their lease-up.”

“As goes enrollment, there goes the demand, and when you see a dropoff in rents in student housing, they’re usually more dramatic than

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— Susan Eastridge, CEO,
Concord Eastridge

you’d see in the rest of the economy,” Genovese noted. “If there is an enrollment issue at a school, it becomes a ghost town pretty quickly.”

Eastridge expressed concern that the sector will suffer from more cases of overbuilding in the short term, with various university markets showing stress from oversaturation. However, she believes that in the long term it will prove a strong asset class provided investors get back to basics.

“I think we’re being told across the board for commercial real estate that investors and lenders are going to stay back at the fundamentals. ... That would be really good for student housing,” she said. “They need to gain more understanding that they’re underwriting housing. ... I think there’ll be appropriate scrutiny so that the space isn’t overbuilt at the end of the day.”

Challenging Factors

Another risk is the seasonal aspect of student-housing leases since they are typically nine months in duration, with significant turnover. Maintenance issues and management costs also pose a problem for investors, given the youthfulness of most tenants.

“You’re not talking about two doctors who got married and are in residence at the hospital,” Genovese said. “There are higher maintenance costs. Security is definitely an issue; universities are very security-minded, mainly because of the assaults that could happen on campus.”

Eastridge sees other differentiating factors between general multi-family investments and the student housing sector, as well. Specifically, managers of student housing often find themselves in the position of creating a home-away-from-home environment for their young residents, something with which typical managers of multi-family properties need not concern themselves.

“Your population living in privately owned apartments on or near campus has an independence factor, yet they still have to be managed,” she said. To achieve that balance, student housing operators are mimicking college and university student-life programs. “(Property managers) build in security and policy but offer a lot of social outlets for the residents. They try to create a sense of home life and bonding among the residents.”

Critical to finding success with student housing investments, though, is understanding the dynamics of a given college or university in order to develop the right business relationship, Eastridge asserted. Having a familiar relationship is particularly critical because conditions in higher education can change quickly, whether due to accreditation issues or enrollment difficulties.

Such problems are best tackled quickly from a real estate perspective. “These can really impact your supply of potential tenants for the following year,” Eastridge said. “So you really do have to understand the college or university that you’re trying to serve.”

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