



June 29, 2011

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Student Housing a Surprising Bright Spot for Developers, Investors

Those Willing to Do Their Homework Will Find Growth and Opportunity In Improving Market for On- And Off-Campus Apartments

With development near a standstill for most new office, industrial and retail space, institutional capital has increasingly turned its focus on a few distinct property niches benefitting from advantageous demographic and business trends, such as medical offices, data centers and self-storage facilities. More recently, student housing, a specialized niche within multifamily, has generated particularly strong buzz among developers and their financiers.

"Student housing is certainly the darling of commercial real estate now, and probably the most liquid sector right now. We're going to see a continuing trend toward more development," said Travis Prince, senior associate with the Jackman Prince group of Marcus & Millichap in Tampa, FL, which specializes in student housing advisor and brokerage. "The veteran national operators with strong sponsors who came through the downturn relatively unscathed are getting more active, and there are also a number of local players with good relationships with their universities, a good understanding of their markets and the ability to get smaller-scale development done."

An influx of institutional debt and equity capital has led to the uptick in development activity. Pension funds, life companies and government-sponsored enterprises Fannie Mae and Freddie Mac are all eager to lend, in some cases, quite aggressively, noted Alexander Goldfarb and James Milam of Sandler O'Neill in a recent research note. While sponsorship is critical, the sector's attractiveness is bringing new faces, and possibly new platforms and private company IPOs, said the analysts, who are bullish on the sector.

On the down side lurks the always ominous risk of underwriting and future supply gone wild. "While banks are showing restraint on development for now, we do not expect this trend to last, and thus believe that supply will come back," the Sandler O'Neill analysts wrote.

The sparse development funding for now will offer more chances for publicly traded student housing REITs such as Education Realty Trust (NYSE: EDR), American Campus Communities (NYSE: ACC) and Campus Crest Communities (NYSE: CCG), -- already armed with an equity advantage over merchant developers, to repack their construction pipelines.

Experienced private market operators like Greystar, Campus Apartments, Capstone Companies, Opus Development, and regional firms such as Houston-based Dinerstein Companies are also lining up debt and equity sponsors and have announced or broken ground on thousands of new units in recent months.

"There's a tremendous amount of traditional as well as non-traditional equity that has come courting the strong student housing operators," Prince said. "The sponsor is driving everything with ample amounts of debt and equity. Developers have told me that they've actually been able to bid lenders against each other on certain student housing projects -- and at very, very competitive terms."

REITs Hold The Equity Grenades

Ted Rollins, CEO of Campus Crest Communities, and Mike Hartnett, chief investment officer acknowledged the "surprising" amount of institutional money now trained on the student sector, as well as the quick move by local and regional developers to jump into the market.

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"When Mike and I started the business seven years ago, student housing was not as well accepted institutionally," Rollins said. "The current investor focus on the multifamily business is driving capital flows to the student sector in search of yield. It's become a viable product type to finance."

Lower income volatility coupled with barriers such as shorter time windows to lease units, and the need for intensive hands-on property management, are qualities that Goldfarb and Milam believe will attract even more institutional capital to campus dwellings.

Banks are more amenable to providing financing for strong campus housing projects within walking or biking distance of major campuses. But the willingness to underwrite new development has its limits. Securing debt remains difficult to impossible for many poorly located projects, Rollins said.

"A lot of the private market's access to debt capital for construction loans is still somewhat constrained, held back by bank terms and the amount of equity required," he said. "We're actually seeing people coming to us as a capital source for both debt and equity."

Relatively limited competition in the highly fragmented student housing market should continue to create opportunities for investors, according to a recent white paper by Credit Suisse's Customized Fund Investment Group (CFIG).

"The off-campus student housing market has seen a significant increase in demand from enrollment growth at public universities," Credit Suisse said. "A second driver of demand is a lack of university capital and expertise to build or manage new on-campus facilities. Attractive student housing opportunities are likely to be found among cities that have large student populations like Austin, Charlotte, Chapel Hill and Philadelphia."

Apartments continue to trade at premiums to student housing, but the spread is narrowing. While capitalization rates have compressed rapidly on conventional multifamily transactions, especially in the coveted higher-end product in top markets, cap rates in student housing deals have remained typically 50 to 100 basis points higher, averaging in the upper 7% range.

Distance to Campus Is Key

Attractive Class A infill assets within a short walk of campus in first-tier markets are seeing prices bid up and cap rates pushed down, however. On the flipside, deals in secondary and tertiary markets on properties too far from campus see less interest and fewer trades.

"From what we hear from buyers, there may be a 150-200 basis-point spread between a Class A deal next to campus and a C or B deal two or three miles away," Prince said. "You can easily go to an 8 or 9 cap on those deals."

While the flight to quality has been the main point of conversation, some real value-add plays are available for investors swooping in at a very low per-bed basis on a lender-or servicer-controlled deal where the property has underperformed and the buyer sees an opportunity to turn it around over the next leasing season or two, he said.

Industry observers said the publicly traded REITs, which offer vertically integrated solutions for the complex process of developing, leasing and managing student properties, will continue to be major players in the student housing space

"A lot of experience goes into successfully running student housing and it's a very specific science. It's not for the novice; you need a seasoned operator that understands how these properties get leased, the nuances of how to find quality tenants, and how to maintain a property that has good buzz versus one that has negative vibes," said Ronald M. Dickerman, founder and president of Madison International Realty, a New York-based real estate private equity company.

Madison announced this week it has acquired an 80% equity interest in a portfolio of two Class A student

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housing communities totaling 898 units in Gainesville and Tallahassee, FL for \$30 million. Madison partnered with Collier Companies, the third largest private student housing operator in the U.S., who is keeping a sizable equity interest in the deal, Dickerman said.

"For us, the winning formula in student housing is finding the best-quality properties as close to campus as possible, near the biggest universities with a housing supply/demand imbalance," Dickerman said.

One full-service operator with an eye toward growth is Campus Crest Communities, which went public last year and has developed \$500 million in student housing to date. The REIT is actively conducting due diligence on 80 potential development sites and has more than \$130 million in wholly owned or joint-venture projects slated for occupancy in the 2011-12 academic year, including developments at Indiana and Perdue universities in Fort Wayne, IN; Austin Peay State University in Clarksville, TN; University of Missouri in Columbia, MO; University of North Texas in Denton and Valdosta State in Georgia.

Campus Crest targets sites near the campuses of high-growth colleges and universities in strong secondary markets. The REIT offers property and asset management, development and construction and wholesale supply services.

The company's marketing efforts emphasize its high-end units and the stark contrast with the no-frills campus residences of the past, with their often cramped quarters and lack of privacy.

Today's developments, often gated communities with amenities such as game rooms, spas, sports facilities and coffee bars, more resemble upscale apartments, sporting separate bedroom suites, bathrooms and spacious kitchens.

Corigin, a private holding company in New York, developed and master-leased five NYU student properties housing some 2,400 students near NYU during the last real estate cycle. While demand has remained strong, opportunities for developers to deliver new units in Manhattan are few and far between, noted Ryan Freedman, Corigin chief executive.

In a constrained urban environment, developers have to look carefully at the highest and best use of an asset, which is rarely student housing and more often standard multifamily, which requires less hands-on management.

"If you look at the portfolios of a lot of the public companies, you see that the great majority of student properties lie outside core urban environments. We do look to expand development, but we very high barrier to entry, so it will be a slow expansion."

Not so with another REIT, Austin-based student housing developer American Campus Communities, Inc., which has been the most active of the REIT developers. ACC announced recently it has broken ground on four owned projects in Arizona, New Mexico, Georgia and Texas totaling 3,249 beds at a combined cost of about \$156.6 million. All the properties are located on or near campus and are expected to be ready for occupancy for the fall semester of 2012.

Private companies have been in the hunt as well. Greystar Student Living, the student housing platform of the Dallas-based multifamily owner, developer and manager, was recently awarded management of Circle West Campus a new, 477-bed development of studios, one, two, and four-bedroom apartments within walking distance to The University of Texas at Austin.

The property will have upscale amenities such as a resort-style pool, tanning beds, a community study café and lounge, rec rooms with TVs, a poker table and gaming systems like Xbox 360. The first units are expected to be ready for occupancy in June 2012.