



University Appeal

By Christine Perez

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Developers and owners in the fiercely competitive multifamily arena are mining for gold by segueing into student housing. Three real estate investment trusts have been formed in the last 18 months alone to focus on the emerging sector. As universities scramble to house the first wave of echo boomers — persons born between 1982 and 1995 — interest in the product type is escalating. According to projections by the U.S. Department of Education, college enrollment is expected to swell to about 18.2 million students by 2013, a 19% increase over the enrollment recorded in 2000.

By virtue of their sheer number, the 80-million-strong echo boomers — so-called because their parents are baby boomers — are having a dramatic impact on the look and feel of student housing. These kids never had to share a bedroom with their brother or sister, much less some unknown freshman from Pickrell, Neb. They're also the first "wired" generation, having grown up with easy access to personal computers and other electronic gadgets.

Experts put the value of the U.S. student housing market at about \$160 billion — with only a small fraction of properties owned by major national players.

Three new REITs aim to gain more market share. In April 2004, Austin, Texas-based American Campus Communities became the first REIT to focus on student housing when it filed a \$253 million initial public offering. Newton Square, Pa.-based GMH Communities Trust followed suit in October 2004 with a \$312 million IPO. Education Realty Trust Inc., based in Memphis, Tenn., was the third student-housing REIT to join the party with a \$304 million IPO in January 2005.

Brokers say the volume of student housing property trades doubled in 2005 over 2004 to close to \$3 billion, with average pricing up 10%. "Interest in student housing properties is skyrocketing," says Herb Chase, managing director of the multi-housing capital advisors group at Transwestern Commercial Services in Los Angeles. "Just a few years ago when we'd bring a property to market, we'd get about one-third the offers we'd get for a conventional multifamily property. Today, we're getting about 75%."

What's behind the change of heart? Growing familiarity with the new product type — and premium yields. Currently, cap rates are typically 50 to 100 basis points higher for student housing developments than traditional apartments. Specifically, cap rates range from 5% to 5.5% for student housing properties in California compared with cap rates of 4% to 5% for traditional multifamily properties throughout the state. In smaller markets nationally, cap rates for student housing are as high as 7% or 7.5%.

But as student housing becomes more widely accepted by investors, expect that gap in cap rates to tighten. In fact, it already has done so. Eighteen to 24 months ago, the gap between traditional apartments and student housing ranged from 100 to 200 basis points.

Buyers of student housing properties can expect to pay more than they would for traditional multifamily product — 10% to 25% more. In areas where land is in short supply, the premium can be as much as 50%. But they'll also collect more revenue, with rents for a three-bedroom, student-housing unit starting at \$1,200 to \$1,500 per month. The national average rent collected for a three-bedroom apartment is about \$1,160, according to Dallas-based MP/F Research, which tracks the multihousing industry.

Markets where land is in short supply — such as California, Washington, D.C., New York, Boston, Chicago, and Miami — are hot student-housing markets. Texas also is a favored market due to population and enrollment growth projections. The reason every investor isn't getting into student housing is that a lot of the major universities are in small, tertiary cities, Chase says. "Investors will buy in Atlanta, but they won't buy in Athens, Ga.," he says. "Small towns are more likely to have plenty of land and are less likely to reject new development, which drives up the potential for oversupply."

Trials and tribulations

Unlike apartments, which are leased by the unit, student-housing projects are leased by the bed, with residents getting their own private bedroom and often a bathroom — with a lock and key — but sharing kitchen, dining and living-room space with as many as five other students. Most of the units are furnished, at least in the common areas, to make life easier during hectic end-of-summer transition periods.

Atlanta-based University Partners, formed in 1998 as an offshoot of apartment developer FirstWorthing Co., based in Dallas, was among the first to get into the student housing game. The company now owns or manages about 16,000 student-housing beds, having built its portfolio through development, acquisition and, to a lesser degree, third-party on-campus assignments.

Ray Barrows, managing director at University Partners, says the leasing cycle in the student housing business poses a formidable challenge, with all tenants moving in and out during a brief period in August or September. In short, there's only one chance each year to lease up the

property. If owners hit occupancy goals, they can sit back and relax. But if they miss the mark, they're stuck with those numbers for another 12 months. Conversely, at traditional apartments leases are staggered throughout the year.

Student housing properties near larger Division I schools tend to lease earlier because they select incoming freshman classes earlier. At the University of Texas in Austin, for example, University Partners had its student properties all leased up for the current school year by March 2005. But it struggled with a property near a smaller school in California, which unexpectedly cancelled its summer classes. "We eventually filled the project up, but we got behind in the cycle as we had not anticipated the change in market conditions," Barrows says. Overall, University Partners' portfolio is 98% leased.

It also costs more to operate and maintain student housing properties, due to added amenities, such as the resort-style pools, game rooms and free high-speed Internet and cable offered at most new projects. And student housing properties have higher turnover rates and mountains of paperwork — 300 units could mean anywhere from 600 to 1,800 or more lease agreements. The contracts typically are signed by a student's parents, who agree not only to pay the rent but also be held liable for their offspring's conduct.

Despite the extra work involved, Barrows says the outlook for the student-housing sector is strong. "The number of new students coming in over the next five years is pretty staggering," he says. "Historically, the highest birth rate ever occurred in 1990, so by 2008 we'll have the largest freshman class ever seen."

Product evolves over time

Most of the current on-campus dormitories were developed in the 1960s and 1970s, when baby boomers — born between 1946 and 1964 — started showing up on the scene. These dorms typically house four students in two-bedroom units with a shared living space. Some units also include a private bathroom or two, but in many dorms, students are expected to use a common latrine.

Private developers started getting in on the action as college enrollments began to pick up in the late 1990s, both by partnering with schools to develop on-campus dorms and by competing against them, luring students off campus with a new version of student housing: spiffy apartment-style projects complete with swimming pools, game rooms, fitness facilities — and no resident advisors sitting at the front desk monitoring curfews.

Some schools responded with their own apartment-style offerings, says Dave Mitani, principal at Steinberg Architects in Los Angeles. Such was the case with California State University, Fullerton, which had a waiting list of students when it opened a new five-building, low-rise complex in the fall of 2002. Each 975 sq. ft. unit includes four private bedrooms, two bathrooms, full kitchens and living areas.

But there were drawbacks, Mitani says. "I see a big change back to dormitories," he says. "Universities found the apartment-style projects were more expensive, both to build and to operate, with increased maintenance costs for the kitchens, and it really cut down on the interaction between students."

New housing at University of California Riverside, Pentland Hills, typifies the new trend in on-campus housing: modified dorms, with suites that house six to eight students. Each same-gender unit has four double-occupancy bedrooms, two toilet rooms, two shower rooms and a living area. As with most of the modified dorms, suites feature both a small refrigerator as well as a microwave oven.

An estimated 90% of all off-campus student housing is built and owned by private companies. Larger Division I schools are more likely to fund their own on-campus projects. Smaller colleges are more likely to do a joint venture with private developers. Both on- and off-campus student housing projects are bringing in retailers, every thing from coffeehouses and convenience stores to bookstores, photocopy service centers and clothing stores.

The trend is especially prevalent in California, New York, Chicago and other areas where there's a scarcity of land. "They're much different than the old-style dorms; they're like mini-villages," Mitani says. "The idea is to create a 24-hour environment."

For example, the 27-story, 383-unit Dobie Center, located off the University of Texas campus in Austin, includes a two-story, 96,000 sq. ft. shopping mall, with a food court and movie theater. Occupancy in the retail center is 92%.

On-campus housing directors have narrowed their focus to providing housing for incoming freshman. The schools like to keep first-year students on campus because students who live on site are more likely to stay enrolled. They're also more likely to help support the college financially when the alumni department comes calling after graduation.

Understanding the nuances

To compete against the swanky off-campus offerings, universities tempt students with access to college intranets and proximity to classrooms, dining halls and other campus buildings. They also put a lot of emphasis on outdoor spaces, says John Orfield, principal at the Dallas-based architecture firm BOKA Powell LLC. "Courtyards help students come together and interact, whether they're sitting outside studying or playing Frisbee," he says.

Schools are installing wireless Internet connections in the new dorms and upgrading mechanical systems, which means cleaner air and better individual temperature controls. Interiors have higher finishes to discourage destruction, Orfield says.

Some schools are blurring the line between living and learning by throwing classrooms into the mix, especially if a dorm is geared toward a specific student set, such as engineers or athletes. BOKA-Powell designed two such classrooms at the University of Texas-Arlington's \$21 million Kalpana Chawla Hall. The residential learning concept has been well received so far, though students may think it's creepy to have their professors roaming about where they live.

The secret is out

Ryan Reid, director of student housing for CB Richard Ellis in Dallas, says all types of buyers are getting into the student housing game. "Besides institutional capital, TIC funds and private investors looking for niche plays are chasing it as well, getting involved both on the development and acquisition side," he says. Demographic trends point to strong future demand. The percentage of kids who attend college is on the rise, now standing at about 65%.

Reid advises buyers to partner with an operator who understands student housing. "Operating the product type is not drastically different, but there are nuances, such as making sure it's staffed correctly by people who can deal with both students and parents, and understanding how to turn over a 300-unit property in three weeks," Reid says.

"Investors getting in now are still a little ahead of the curve," Reid adds, "but interest in student housing is growing faster than it is for any other product type. It's an emerging niche."

Christine Perez is based in Dallas.

DEFINING STUDENT HOUSING

On-campus: Dormitory-style projects, typically owned and maintained by universities, sometimes in partnership with a private developer or operator. The average unit has two double-occupancy bedrooms with a shared living area. Some units include bathrooms; most do not include kitchen facilities.

Off-campus: Apartment-style projects, owned and maintained by private developers. Units include private bedrooms and bathrooms, with shared kitchen and living areas, and are rented by the bed, with up to six bedrooms per unit.

Conventional: Traditional multifamily developments, located near college campuses, rented by the unit and occupied primarily by students.