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Student Housing: An Attractive Alternative to Multifamily

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Student housing has become a prominent growing institutional real estate investment class within the last few years. Student housing, a subsector of multifamily, has been viewed by some investors as an attractive alternative to increase diversification in their multifamily portfolio. The sector possesses a strong base for demand and has shown resilience through the COVID-19 pandemic with four-year universities having increased enrollment by 11% between 2009 and 2019 while projecting only a 0.5% drop in enrollment due to COVID-19.[1] In contrast to this increase in demand, 2021 saw the lowest amount of new supply since 2011 at 27,213 new beds.[2] The student housing sector has also remained highly fragmented with the largest market player owning less than 1.6% of total market share.[3] With these attractive attributes and increasing attention to the space, ORG Portfolio Management LLC ("ORG") wanted to provide research and analysis to fully understand the sector and how it compares to market-rate traditional multifamily.

Research:

Market-rate traditional multifamily real estate buildings are classified into Class-A, Class-B and Class-C and are built as garden-style, low-rise, or high rise. Multifamily is divided into urban, suburban, workforce and affordable. The highest valued multifamily is located near transportation hubs, offices and retail. The key demand drivers are job growth and cost of ownership in the area. Tenants can be classified as rent-by-choice and rent-by-necessity. Rent-by-choice tenants are those who have the ability to purchase a residence but choose to rent. Rent-by-choice tenants typically occupy mid to high rise Class-A buildings in highly amenitized urban and suburban locations. Rent-by-necessity tenants are those who rent due to the inability to purchase a residence. These tenants typically occupy workforce or affordable housing that are classified as Class B or C multifamily units. All multifamily leases are executed on a rent per square foot basis and leases are typically twelve months.

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[1] "Digest of Education Statistics, 2020," National Center for Education Statistics (NCES) Home Page, a part of the U.S. Department of Education, accessed March 3, 2022, https://nces.ed.gov/programs/digest/d20/tables/dt20_303.70.asp.

[2] "[2022] Student Housing Research & Statistics: Realpage Analytics," RP Analytics Blog, accessed March 3, 2022, https://www.realpage.com/analytics/topics/student-housing/.

[3] Statista Research Department, 2021, "Largest U.S. Student Housing Owners by BED Volume 2020," Statista, August 18, 2021, https://www.statista.com/statistics/934592/student-housing-owners-by-number-of-beds-usa/.

Student housing has several unique characteristics that separate it from market-rate traditional multifamily. Student housing real estate is located around or on college campuses and is targeted towards undergraduate or graduate students. It is primarily rent per bed although some rents are conducted on a rent per square foot basis for graduate-level targeted properties. Due to the tenants being students, leases typically require a guarantor and leases are between nine and twelve months. The leasing cycle is focused around the academic year with all leases beginning before the start of the academic year and expiring at the end of the academic year or after the summer term and with very small periods of downtime. Turnover costs at student housing properties are generally more expensive due to the wear that students put on the units. The industry rule of thumb is that turnover costs are $150 per bed however this can differ based on the market or tenant base.

The best location for student housing is near the school's campus or near student gathering areas, and barring other factors, the closer a property is to the campus the higher rents it will be able to achieve. Student housing properties often have amenities such as pools, gyms, study areas and community spaces which are important to attract tenants. The key driver of demand for student housing is total enrollment at the school.

Student housing is more operationally intense than market-rate traditional multifamily and on average trades for a capitalization rate of 25 – 100 basis points above market-rate traditional multifamily. Institutional investors typically focus on schools that are in the "Power 5" conferences which include the SEC, Big 12, Big 10, PAC-12 and ACC. These conferences are the major athletic conferences in Division 1 sports. Schools in these conferences have the advantage of considerable amounts of television exposure, high-levels of enrollment and typically are more stable and established.

Analysis:

Market-rate traditional multifamily and student housing real estate may seem similar, however there are key differences. Student housing has unique demand drivers that differentiate it from traditional multifamily. Student housing is often located in towns and cities where the university or college is the primary economic driver of the area. While this can be seen as a risk, it is often looked at as a reliable and consistent driver of demand to the asset. Large universities and colleges rarely fail or relocate campuses. Additionally, on average colleges only have the capacity to hold 22% of college students in on-campus college housing which leaves a large student base searching for off-campus housing options.[4]

Student housing has proven to provide significant diversification from market-rate traditional multifamily during economic downturns. In a study completed in 2018, student housing had higher occupancy rates (96.5% for student housing vs 95.6% for apartments

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[4] James Anthony, "47 Essential Student Housing Statistics You Must Learn: 2021/2022 Data & Demographics," Financesonline.com (FinancesOnline.com, January 14, 2022), https://financesonline.com/student-housing statistics/#:~:text=Only%2022%25%20of%20university%20students%20in%20the%20US,by%20270%20basis%20points%20to%2

overall), higher yields and higher collections during economic downturns.[5] There are many factors that play into this.

- Students tend to stay in school longer by attending graduate programs during economic downturns due to the lack of job availability in the market.
- Leases are typically co-signed by a parent or guardian which provides an extra layer of credit protection or enhancement to the landlord.
- Universities and colleges typically don't relocate as many companies often do that may affect demand to traditional multifamily projects.
- Universities and colleges have a student base that returns every year which contributes to the steady demand for student housing. Schools in the Power 5 and other larger budgeted schools have maintained or increased enrollment and there is less concern of these schools surviving the post COVID-19 world.

While there are distinct demand and diversification benefits to student housing, it does come with additional costs. Operating a student housing property is more expensive than traditional multifamily properties. Not only are turnover costs more in student housing properties but the logistics of turning units is more challenging. All leases that are not renewing expire at the same time usually giving the owner only two to four weeks to turn all of the units to get ready for new tenants. This also means move-ins occur during a very short window before classes start. Additionally, the nature of different leasing seasons creates challenges when renting units. A student housing operator must be in tune with the market's leasing season to be successful in renting a property. Strong student housing operators are also able to lower their turn costs and decrease the leasing seasons to create an edge on the market.

The current flow of institutional capital is mainly focused on targeting the renters with the top 10% of family income. While this section of student housing is quickly becoming institutionalized, student housing is a largely fragmented industry. For example, the 25 largest owners of student housing in the United States only have an 8.1% market share in Power 5 conferences.[6] This leaves a vast opportunity for smaller student housing investors to aggregate mid-market properties across markets at attractive return profiles. ORG sees an opportunity to aggregate fragmented middle market student housing properties in growing university markets and bring institutional operations management to produce attractive returns.

Conclusion:

Student housing may seem very similar to traditional multifamily but there are clear differences in operations and performance drivers. Investments in student housing must come with knowledge of the inherent differences and requirements to properly manage a

[5] John McDermott, "Student Housing: Demand, Supply and Changing Expectations," INVESTOR MANAGEMENT SERVICES (IMS) BLOG (John McDermott https://resources.investormanagementservices.com/wp-content/uploads/2019/12/logo-300x85.png, July 9, 2019)

[6] Statista Research Department, 2021, "Largest U.S. Student Housing Owners by BED Volume 2020," Statista, August 18, 2021, https://www.statista.com/statistics/934592/student-housing-owners-by-number-of-beds-usa/.

student housing investment. While many investors may not currently look at student housing as a viable investment, there remains opportunities in a growing world of institutional multifamily investing. The fragmented market of student housing and additional yield provides opportunities for seasoned managers to find attractive risk-adjusted returns. ORG believes investments in student housing with experienced managers and operators could provide unique diversification to a multifamily portfolio.

Other Sources: CoStar, National Apartment Association, WF Investments, University Communities