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The student housing crisis: A national emergency

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Introduction

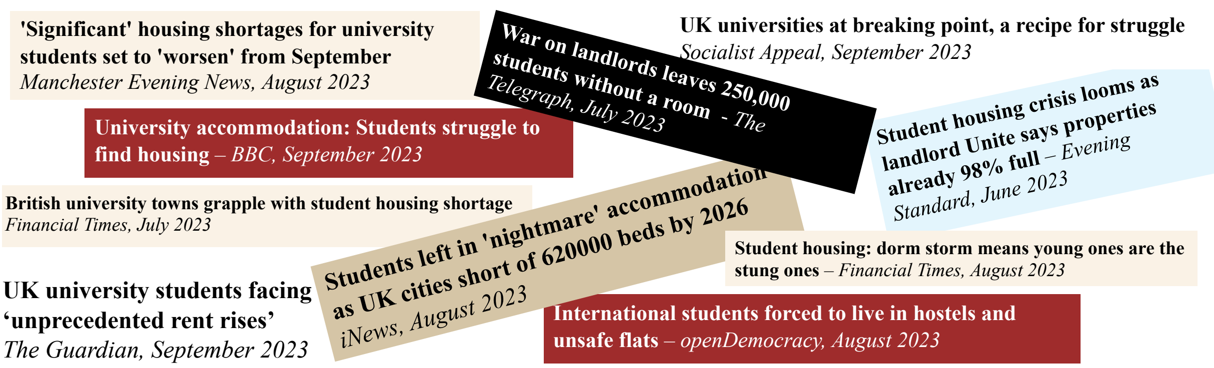
The case for student accommodation in the U.K. is exemplified by the recent experience of David Seivright, a bright and ambitious 18-year-old teenager, who received final confirmation of acceptance for an undergraduate programme at the University of Kent in 2021. Unbeknownst to David, who was excited at the prospect of college, were the challenges he would have had to overcome to secure a bed in his future university town. And David was not alone in this struggle.

In recent years, a growing number of students have been desperate to find suitable and affordable accommodation. The shortage is so acute that pupils' adversities in the media became a national sport, commonly referred to as the "UK student housing crisis". "Devastated UK students forced to live in neighbouring cities in university accommodation crisis", an article from The Guardian wrote in 2022. "Undergrads could start the term in hotel rooms …or in completely different cities" titled the Daily Mail in August this year. These headlines reflect the grim reality facing students from Glasgow to Bristol, from London to Manchester where a worsening demand-supply imbalance is pushing rents higher without solving the underlying shortage of suitable accommodations. And there lies the investment thesis for student housing in Great Britain in a nutshell.

Estimates show that the shortfall of student beds across the UK's top 20 university towns and cities increased to 240,000 in 2023, an unprecedented level amounting to a crisis in housing. The gap is causing negative effects at multiple levels, including much longer commutes, higher rents, deprivation, and even mental health issues in the most extreme cases. Thus, economically disadvantaged students have to sometimes defer their degree programmes or abandon them altogether due to the lack of suitable accommodation. The new phenomenon of couch surfing by students descriptively demonstrates the dire situation some pupils are facing. Should the emergency continue or worsen, the international reputation of UK higher education, an economic powerhouse whose exports amount to roughly £23bn per year, may also take a knock.

How did the situation escalate this far? And most importantly, what can the investment management industry do to alleviate the problem? These are the two main questions addressed in this paper.

EXHIBIT 1: Student housing press review points to a severe shortage



Source: Various media outlets, 2023

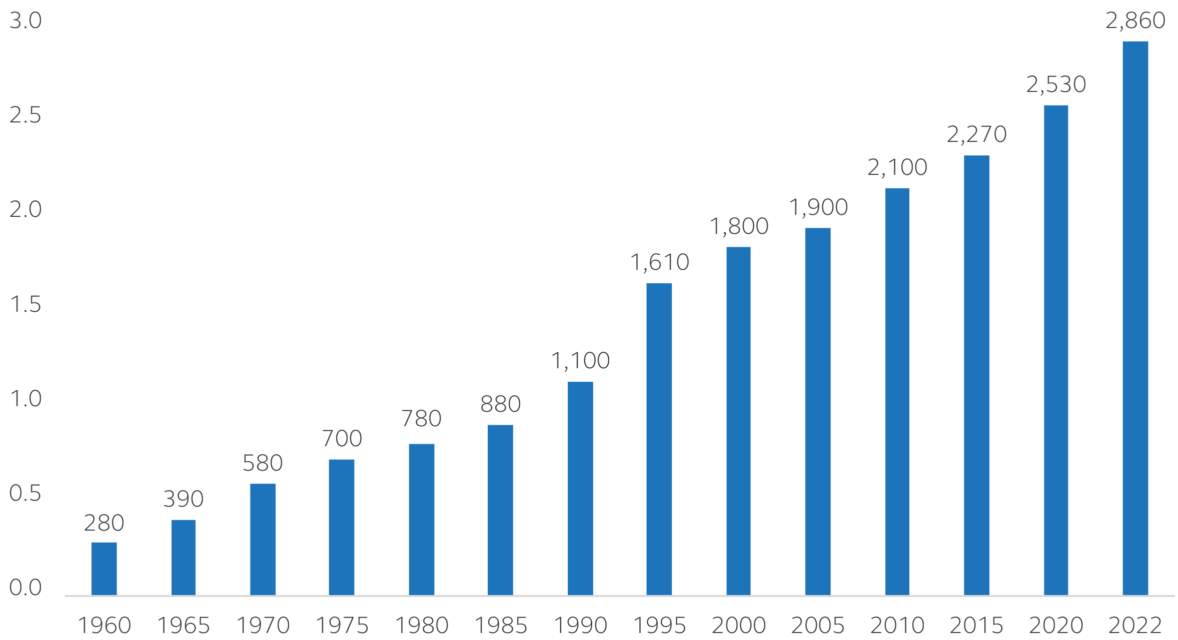
High education demand has boomed… and is yet to slow down

There are several factors that have led to the current student housing crisis in the UK. A key driver of the abysmal state of student living is the steady expansion in the student population which has constantly grown over the past decades. In post-war Britain there were fewer university students than in most other Western European countries. Higher education was considered a path only a small elite group could follow and afford. In those days, the number of the "chosen few" was below 200,000 people, of which women accounted for merely a quarter.

A structural change occurred during the 1960s when parliament and public opinion embraced the principal that an inclusive (rather than elitist) higher education model was a desirable goal to pursue. By expanding the university provision, Parliament argued that society at large would benefit from the spreading of knowledge, the uplift of labour force skills, and the advancement of the economy. The new golden rule was to build a larger and fairer tertiary education system where all applicants with appropriate attainment and ability who wished to attend it should find a place. Those years marked the birth of the mass higher education model we have today, which revolves around a centralised admissions service and a national financial support system. These reforms allowed a larger set of young people to attend university, attracted by the prospects of a professional career and higher relative wages.

EXHIBIT 2: The remarkable rise of UK higher education student population

Higher education student population in the UK over 1960 -2022, thousand people



Note: 2022 figure includes alternative providers
Source: HESA, London School of Economics, 2023

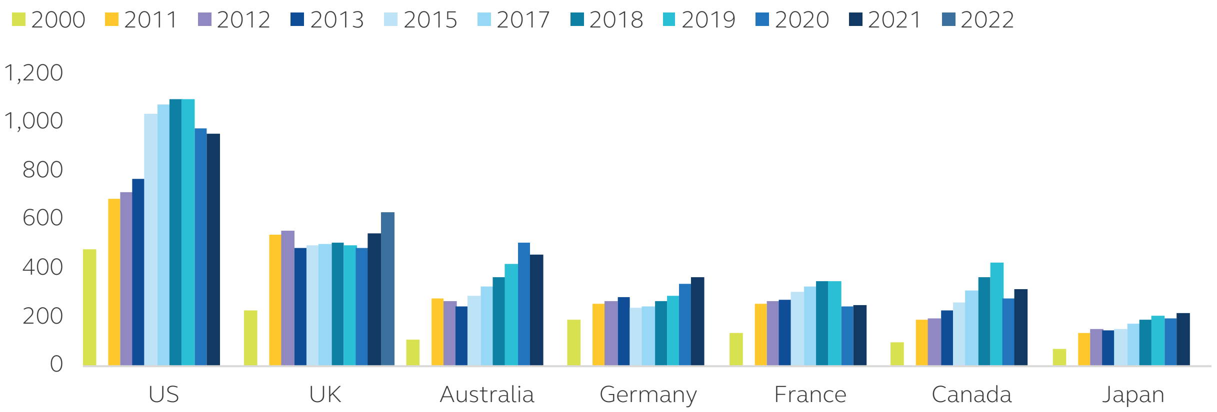
Since then, the increase of the student body has been remarkable. Participants in UK universities reached a new all-time high in 2022, when the total number of enrollments jumped to a record 2.86 million, driven by an increase in both domestic and international students, which accounted for 76% and 24% of the total respectively.

The growth in foreign intakes have been particularly strong over the last decade. Brexit and the COVID-19 pandemic notwithstanding, concerns over a trend reversal due to higher fees, travel restrictions and coronavirus prevention measures were soon blown away as applications from international students continued to surprise on the upside.

Estimates for future demand shows the growth trajectory is likely to continue as the number of people between 15 to 19 years of age is forecast to rise by 400,000 people from 3.1 to 3.5 million between 2020 and 2035 in the UK, according to official figures from the Office of National Statistics (ONS). Meanwhile, demand from overseas is also set to increase, amid favourable socio-demographic trends in developing markets - China, India and Nigeria are the top three domiciles of international students in the UK - and expanding global student mobility. In other words, there exist all the ingredients for the student housing crisis to spread more broadly in the years ahead, should the new supply of beds not ramp up accordingly.

EXHIBIT 3: The UK has the second largest number of student population after the U.S.

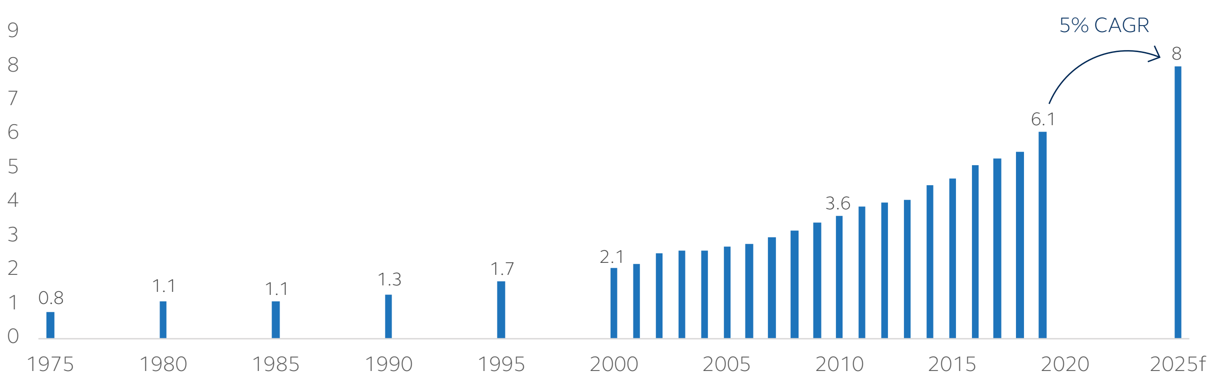
Evolution of foreign students intake over 2000-2022, thousands



2022 data available from the UK only
Source: PMA, 2023

EXHIBIT 4: Global student mobility is rising

Global international mobile students, millions



Source: OECD, 2022

Student accommodation supply is coming up short

Roughly a quarter of UK full-time university students live at home with their families. The rest require accommodation, which traditionally was provided by universities and private landlords. But both have struggled to develop enough stock to keep up with the growing demand, causing a significant shortage across the country, opening up opportunities for private operators and real estate investors.

Today, there are about 280 higher education institutions in the UK[1], which cumulatively provide for 310,000 student beds (14% of the total full time student population)[2], usually on-campus halls catering for first-year students. Grappling with financial constraints and lack of control over local development planning, many of these universities have gradually abdicated from the challenge of developing new accommodations or modernising existing ones. In fact, the tuition fees universities receive from domestic students have been capped since 2017 and declined significantly in real terms. The spike in inflation that occurred last year meant that this source of finance is now barely sufficient to cover the provision of the courses, with nothing left for the construction of new development projects.

Some institutions whose prestige allures international students, who pay much higher tuition fees, have their balance sheets in better shape and thus the luxury to modernise and expand their estate. Among these, Manchester University has recently unveiled plans for a major redevelopment of one of its campuses, including the creation of high-quality, purpose-built student accommodation with up to 3,300 new beds.

But even the universities with their books in order are unable to keep up with the insatiable demand for higher education. Institutions have become increasingly dependent on privately owned purpose-built student accommodation (PBSA). This segment of the market accounts for 390,000 student beds in the UK (or 18% of the total full time student population)[2], and its share is set to rise further. In fact, private operators are responsible for between 75% to 85% of the additional new stock brought to the market each year, according to industry brokers. More than half of the private stock is leased to those universities that don't have enough beds to cater for the rising number of students, particularly for new undergraduates. Some of these "nomination agreement" contracts are long-term, and some others are renewed by universities each summer. In either case, these provide private operators with a secure income and educational institutions with flexible additional stock. The remaining share of privately owned beds, roughly 40%, are marketed and let directly by operators to students, mostly international.

Whether developed by universities or private operators, the provision of new student beds is falling as elevated building costs, rising interest rates, and tightening planning requirements put a strain on the construction pipeline. On the one hand, universities, operators, and student groups are advocating for additional student houses that may ease the dearth of accommodation. On the other hand, however, these demands do not always align with the planning policy of local authorities, or with the desire of resident communities concerned about the clustering of students in particular neighbourhoods.

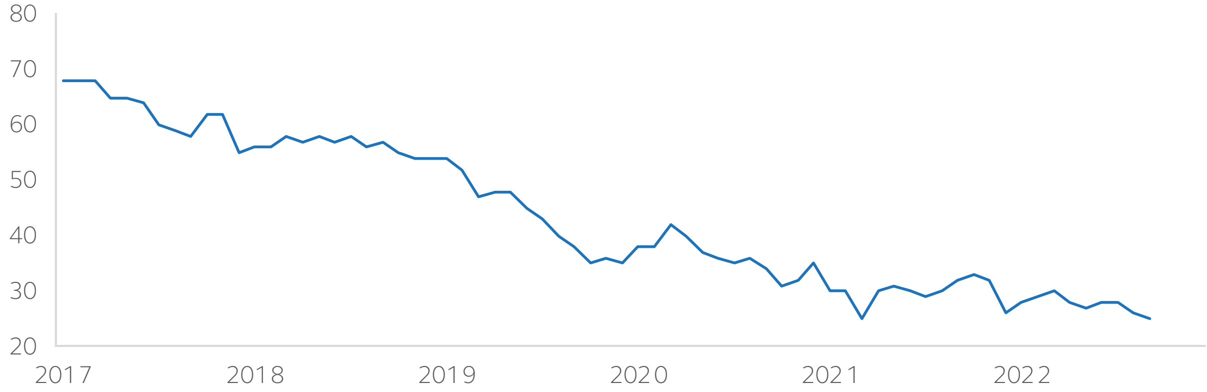
The reconciliation of these diverging interests can be a lengthy process that ultimately weighs on the cost and feasibility of each new project. In Manchester, Durham, and Edinburgh for example, residents, politicians, and other local organisations have come together to campaign against the construction of new PBSA schemes, claiming an oversized student population would harm community cohesion and public order. To prevent other episodes of social tension, some planning authorities have started to set more stringent requirements for the development of new student housing, including banning entire sub-markets deemed saturated. That said, many local authorities recognise the severity of the situation as well as the importance of attracting students to their regions as a future workforce. They are actively working with developers seeking to direct them towards specific neighbourhoods which are perceived fit for purpose, in need of regeneration, and associated with low social sensitivity with the local populations.

[1] Source: HESA, July 2023

[2] Source: Company reports, J.P. Morgan, Principal Real Estate, July 2023

EXHIBIT 5: The provision of new beds is falling

Number of student beds submitted for planning in the UK, 10-month rolling average, thousand beds



Source: StuRents, 2023

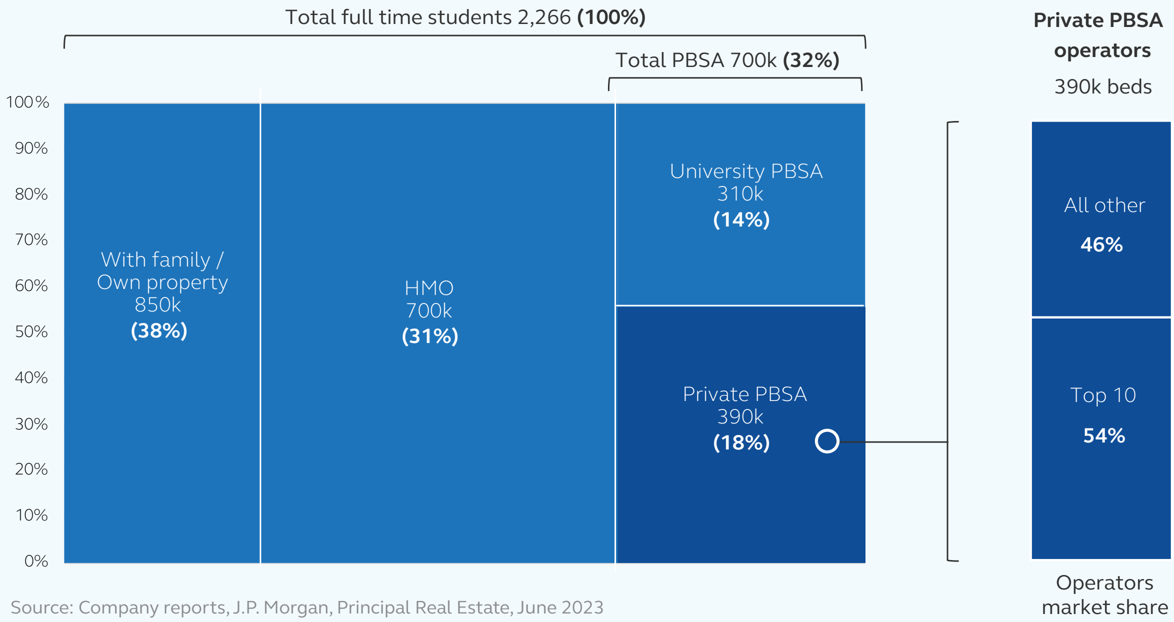
Meanwhile, private landlords' stock, a segment of the market that provides beds for roughly 35% of the total university student population through the provision of houses converted into student digs (or houses in multiple occupancy, HMOs), is on a declining trajectory. This structural trend has multiple causes and has the potential to extend the severity of the student housing crisis, even assuming a very conservative scenario in which the demand for beds will remain stable over the coming years. First, many landlords are leaving the market by selling their properties to owner-occupiers amid rising mortgage rates, new costly regulatory requirements, and tax changes (see call-out box). Second, too few new properties are coming on to the rental market as buy-to-let mortgages, so convenient during the ultra-low interest rates era, have lost some of their appeal. Third, a share of the private rented stock is drifting away from being rented to students amid attractive alternatives for landlords such as short-term letting via online marketplaces or renting to young professionals who are increasingly finding it harder to purchase their first homes.

Rent reform act and the impact on student housing

The UK parliament is currently discussing a new legislation known under the name of the Renters (Reform) Bill. The bill has been conceived to achieve a more balanced relationship between landlords and tenants by providing more rights to both parties. According to the whitepaper issued by the UK parliament, one of the central provisions of the bill is the elimination of section 21, commonly known as "no-fault" evictions. Landlords will no longer be able to evict tenants without a valid reason. Additionally, fixed-term tenancies, commonly used by private landlords when letting to students, will be ended and all tenants will transition to a unified system of periodic tenancies. Although the PBSA sector is likely to be exempted from this specific provision of the Bill, it will still apply to the private rented sector (or HMOs). The potential damage to this part of the market that caters for the lion share of the student population can be significant, and risk exacerbating the already severe student housing crisis. At present, students' tenancies commence every September at the start of the academic year and terminate in July. This recurrence allows landlords to manage their lettings in advance, usually five to eight months, and students to secure a place to live before their cycle of study begins. Should the new provision be approved as it stands, it would change this current arrangement, allowing students to terminate their contract upon one month's notice at any point of the academic year, causing inconsistent timing requirements between demand and supply, that could potentially leave some of the stock vacant.

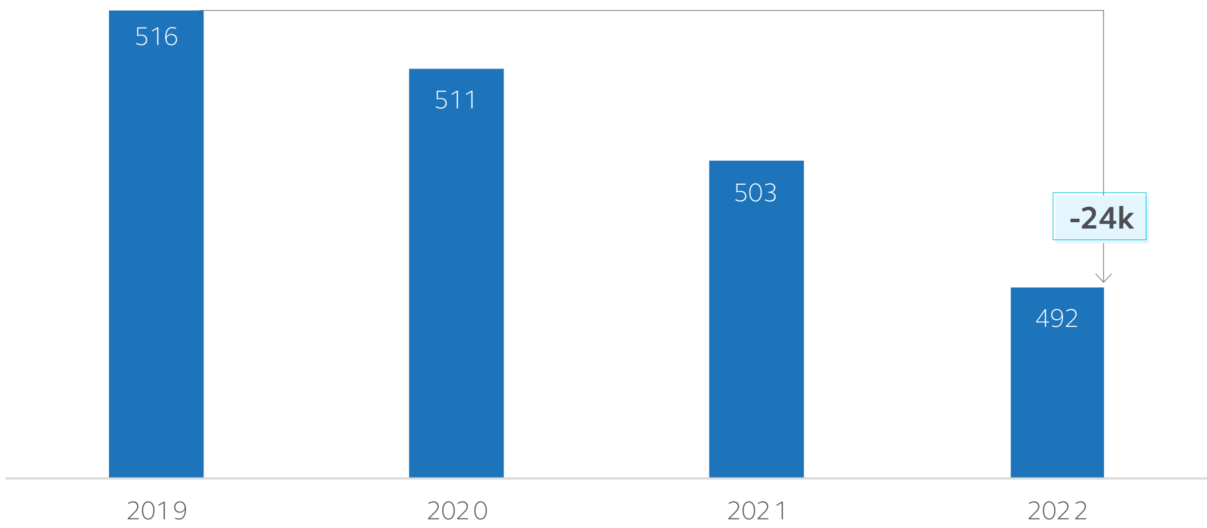
HMOs contributes for the lion share of student beds

Student accommodation sector breakdown (No. of beds and share of total)



Source: Company reports, J.P. Morgan, Principal Real Estate, June 2023

EXHIBIT 6: Decline in HMOs stock
HMOs total number of dwellings, England, thousands



Source: Department for Levelling Up, Housing and Communities, 2023

The dislocation between supply and demand of student housing will not remain evenly distributed across all UK geographies, given the fluctuations in university applications, changes in university courses, and variations of student life ranking. However, given its structural demand profile, we believe the sector will remain a well-positioned real estate asset class underpinned by very strong income drivers and cash flow. For example, Unite Plc, the UK market leader with 70,000 student beds across 157 PBSA assets in 23 university cities, has already reached full occupancy for the academic year ending in July 2024, despite its average rent going up by seven percent over the year prior.

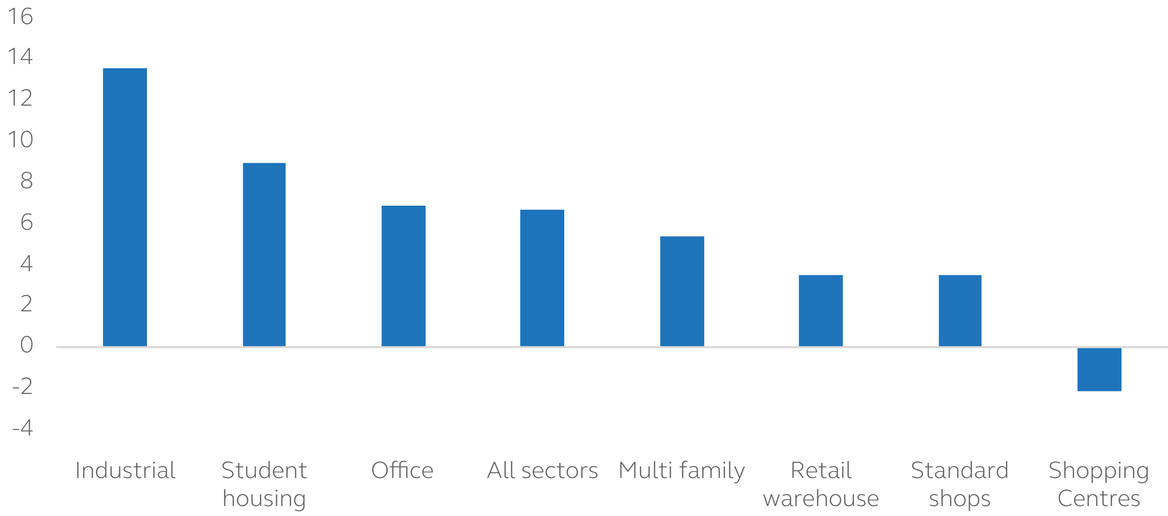
CONCLUSION:

A resilient property type with great long-term fundamentals

The structural demand for higher education in the UK makes student housing a compelling investment opportunity. The sector is significantly undersupplied, and the shortage of beds is likely to worsen further over the next decade, amid favourable demographic trends, growing university participation rate and increasing global mobility of international students. Meanwhile, the supply of new PBSA is likely to remain constrained and the stock of private housing rental for students to dwindle, due to new regulations, more stringent local development planning, high lending charges and elevated building costs.

Given this backdrop, the sector has seen a significant growth in recent years, lured some of the world's largest investors, and delivered above average returns. According to the MSCI Index, the benchmark for the performance of direct private real estate investments, student housing was the second best-performing asset class in the UK over the last ten years, trailing only industrial. PBSA recorded an average annual total return of 9% from 2013 to 2022, which is 230bps above the UK commercial real estate average over the same period.

EXHIBIT 7: Student housing was the second-best performing real estate asset class in the UK
Average annual total return over the last ten years, %, 2013-2022



Source: MSCI, 2023

Positive underlying fundamentals and the diversification benefits student housing has to offer compared to traditional property types which are more closely linked to the economic cycle have drawn an increasingly large pool of capital to the sector. Thus, the share of PBSA of the total UK real estate transaction volume has increased from 1% in 2010, to 7% in 2015, and 15% in 2022, when it reached the record annual amount of $11bn.

In our view, PBSA investment strategies will continue to offer investors with attractive risk-adjusted returns, especially under the current uncertain economic outlook. We recommend investors to work with players who have a proven track record in the field, able to source suitable plots of land for the development of new modern student accommodation assets in supply-constrained submarkets. Compared to core strategies, new development projects enable investors to potentially realise a strong yield on cost, ensuring a favourable spread over standing assets and contributing to alleviate the nationwide student housing crisis.

Risk Considerations

Past performance is no guarantee of future results. Investing involves risk, including possible loss of principal. Potential investors should be aware of the risks inherent to owning and investing in real estate, including: value fluctuations, capital market pricing volatility, liquidity risks, leverage, credit risk, occupancy risk and legal risk. All these risks can lead to a decline in the value of the real estate, a decline in the income produced by the real estate and declines in the value or total loss in value of securities derived from investments in real estate. Inflation and other economic cycles and conditions are difficult to predict and there Is no guarantee that any inflation mitigation/protection strategy will be successful. International investing involves greater risks such as currency fluctuations, political/social instability, and differing accounting standards.

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