

Student Housing

Market Overview
Summer 2010



Executive summary

- The number of students attending higher education institutions in the UK has steadily increased from 1.6 to 2.4 million over the past 15 years, with growth strongest for full-time postgraduate and part-time undergraduate courses.
- Since 1997, the number of full-time postgraduates has nearly doubled to a current total of 268,000. The proportion domiciled outside the UK has risen from 35% to 55% and the UK is now the world's second most popular destination for international students behind the USA.
- A slowdown in the growth of university places is expected in the short-term due to funding cuts, but over the medium-term, the number of students is forecast to continue to increase with demand from international students rising further.
- The changing nature and growing size of the student population has increased the demand for good quality, affordable, purpose-built accommodation, particularly for international postgraduate students. Recent years have seen a trend of increasing partnership between universities and the private sector to deliver such housing.
- Risks to future growth in student numbers include: the participation rate of young adults in the UK, the number of places available, the possible introduction of higher tuition fees, demographic trends and the ability of UK universities to compete in a global market for international students.
- Accommodation for students is currently dominated by the private rented sector, which accounts for over 40% of all students' housing needs. University owned and operated halls of residence accommodate around 20% of all students, with 7% residing in privately owned and operated halls. Approximately 20% of students live in the parental home with the remainder living in their own or other owner occupied houses.
- A high proportion of student housing is in poor condition and in need of refurbishment, and in some locations there is a shortage of bedspaces in halls of residence. But in the current economic climate the development pipeline of private purpose-built halls of residence is constricted and university funding cuts are expected to hit building projects particularly hard.
- Developers of purpose-built private halls of residence are experiencing a maturing market, with rental growth slowing, although remaining positive. In addition, the viability of new schemes is being affected by a combination of a lack of debt funding and difficulties obtaining planning consent.
- Student housing is emerging as an asset class and has weathered the downturn well, but after years of strong performance rental growth prospects appear to be weakening. Attention is now being shifted to buying existing assets with management potential and entering into joint ventures with the higher education institutions.
- Higher education institutions are leaders of the sustainability agenda placing it at the heart of their property development strategies and operations. Many universities are going well beyond the minimum regulatory requirements and committing to ambitious carbon reduction targets.
- There is a growing need for a collaborative approach to student housing development involving universities, planning authorities, community groups (student, residential and business) and lenders working closely together to ensure that the needs of all parties are considered.



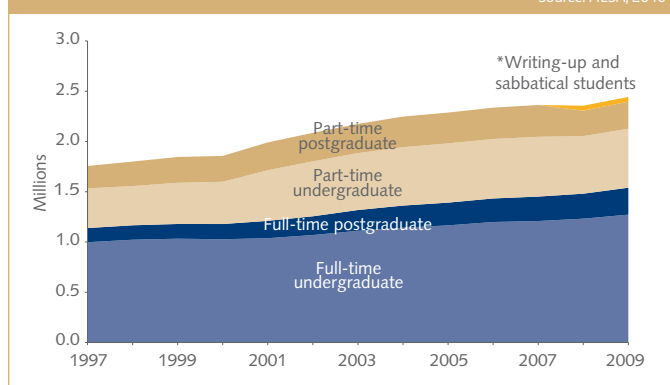
Demand for student housing

Growing numbers of home and international students

Over the past decade the total number of students in higher education in the UK has grown at an annual rate of around 3% to reach a total in 2009 of 2.4 million. Two-thirds of students are enrolled on full-time courses, of which 83% are at undergraduate level. Demand for full-time postgraduate and part-time undergraduate courses has been particularly strong since 1997, with numbers increasing by 87% and 50% respectively. The number of full-time undergraduates has meanwhile risen by a relatively modest 24% (Chart 1). Table 1 shows the UK cities with the largest populations of students in higher education.

Chart 1 - UK Student Numbers by Course Type & Level 1997-2009

Source: HESA, 2010

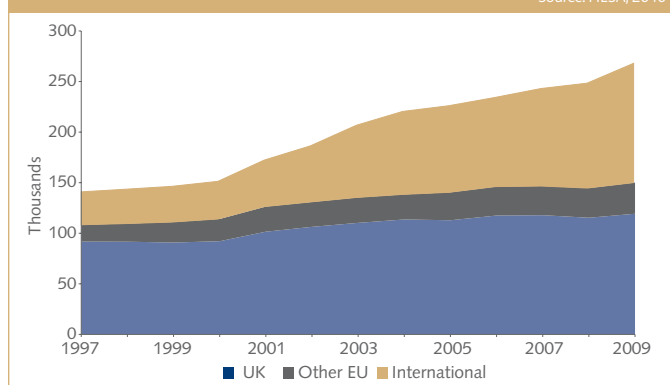


*Writing-up and sabbatical students (counted separately from 2007/08 onwards).

The UK is now the world's second most popular destination for international students after the USA, capturing 12% of the entire international student market according to UNESCO. Of all full-time postgraduates, over half (55%) are now non-UK domiciles, a significant increase on 1997 levels when they accounted for 35% of the total (Chart 2). Demand from students from outside the EU has been particularly strong, rising from 14% to 26% of all postgraduates during the same period. Table 2, overleaf, ranks the most popular destinations for non-UK domiciled students.

Chart 2 - Full-time Postgraduate Student Numbers by Domicile 1997-2009

Source: HESA, 2010



City/Urban Area	Total HE Students
London	355,770
Manchester	90,205
Birmingham	67,665
Glasgow	64,775
Bristol	63,770
Leeds	63,165
Sheffield	55,665
Nottingham	55,330
Edinburgh	53,535
Liverpool	51,775

Preferred accommodation types

The type of accommodation students occupy is highly influenced by the year of study, level of degree course, domicile and institution. For example, first year undergraduate and international postgraduate students are more likely to live in halls of residence, while most second year students rent rooms in shared houses directly from private landlords. Across all years and levels of study a significant proportion of students live in the parental home or in other owned accommodation.



Demand outlook

Demand for places accelerated through recession

Competition for university places has intensified over the past two years, partially as a result of the recession. Weaker employment prospects may have encouraged more school leavers to apply for university, while current students stay in education for longer, delaying entry into the job market. The problem is exacerbated this year by the large number of those rejected in previous years reapplying. At the same time, many of the newly unemployed are looking to retrain. In 2009, with 160,000 more applicants than places, there was clearly an imbalance of demand and supply. The latest figures for 2010 show a 16.5% increase in the number of applications for courses starting in the autumn.

Participation rate below government target

The Labour government target for half of all 18-30 year olds to access higher education by 2010 has not been met, with the current participation rate estimated at 45%. Despite a recent surge in the number of applicants, this shortfall is set to continue in the short-term with the number of university places staying at close to current levels as a result of funding cuts.

Higher tuition fees on the way?

An independent review of higher education funding and student finance led by Lord Browne is currently underway which is anticipated to recommend raising the cap on tuition fees for students above the current level of £3,225 a year. However, a rise in tuition fees would result in a rise in the size of the government's heavily subsidised student loan book. The additional cost to the taxpayer that this implies makes it likely that fees will remain at current levels, at least in the short-term.

The increased pressure higher tuition fees would place on the budgets of students (or more accurately their parents for the most part) will mean an increased focus on value for money. This will apply not only to the quality of teaching and learning, but also to social and leisure facilities and especially the type and quality of accommodation offered. The Browne review is due to deliver its findings in autumn 2010.

The demographic challenge

The UK has an ageing population due to low birth rates and increasing life expectancy. Over the next ten years, there is expected to be a fall in the number of 18-20 year-olds (the main

pool of undergraduates) of around 100,000. As a consequence, projections from the Higher Education Policy Institute (HEPI), are for the total number of students accessing higher education for the first time to decrease 2% by 2020 from 2007/08 levels. However, thereafter student numbers are expected to recover and by 2028 an increase of 8% over current levels is forecast.

Table 2 – Cities with Largest Non-UK Domiciled Student Populations

Source: HESA 07/08

City/Urban Area	Total Non-UK HE Students
London	82,280
Manchester	14,160
Edinburgh	12,050
Birmingham	11,680
Nottingham	9,815
Oxford	9,400
Newcastle	8,770
Bristol	8,695
Sheffield	8,535
Leeds	7,420

Demand from international students expected to rise

A 2004 British Council report predicted that demand from non-UK students would continue to rise at an annual growth rate of 4.7% between 2003 and 2020. This equates to a total of 511,000 places in the year 2020 (there are currently 369,000). An optimistic scenario produced a growth rate of 8% pa, which would result in a total of 870,000 international students studying in the UK by 2020. However, circumstances have moved on since 2004 and competition from overseas institutions is intensifying. As such, a scenario of stabilisation, or even a small reduction, in non-UK student numbers cannot be ruled out.

Property implications

Table 3 summarises the main property implications of the expected changes in demand for student accommodation. The changing nature and growing size of the student population has increased the demand for good quality, affordable purpose-built accommodation. An increasing focus on value for money will put more pressure on universities to make improvements to their existing stock, while a more diverse student population will result in demand for a wider variety of accommodation types and price ranges.

Table 3 – Student Population Growth Prospects and Implications for Accommodation

Level of study and Domicile	Growth Prospects	Risks	Property Implications
UK Full-time Undergraduates	Stable short-term, moderate growth medium/long-term	Participation rates, number of places available, higher tuition fees	Improvement of existing university provision, more joint ventures with private sector specialist developers, sustained demand for private rented sector, demand for a wider choice of accommodation types
UK Full-time Postgraduates	Moderate growth	Supply of undergraduates, propensity to continue study past undergraduate level, employment prospects	Sustained demand for private rented accommodation, demand for a wider choice of accommodation types
International Full-time Undergraduates / Postgraduates	Moderate growth	International competitiveness, global economic and demographic trends (income growth, population growth, participation rates, international accessibility), tuition fees, exchange rates	Increasing demand for university provision and purpose built private halls of residence at some locations

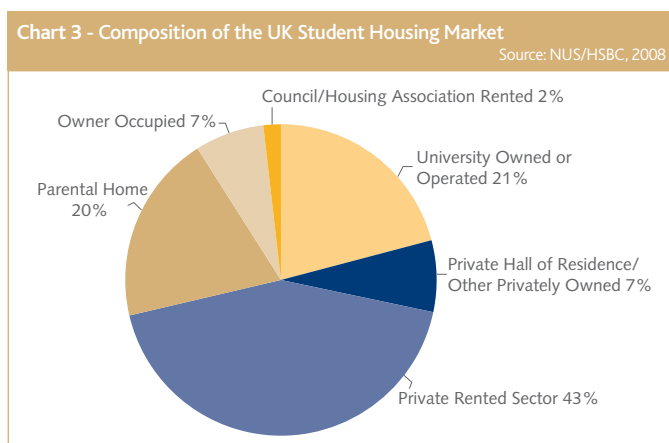
Student housing supply

Market Structure

The Private Rented Sector (PRS) is by far the largest category of student accommodation, accounting for over 40% of all student bedspaces in the UK (Chart 3). Around a fifth of students live at the parental home whilst studying. This is especially common in London where open market rental values are significantly higher than elsewhere in the UK.

University provided accommodation is the second largest sub-group accounting for 21% of total bedspaces (approximately 320,000). Comprised mainly of halls of residence on, or close to, campus it is the principle type of accommodation for full-time first year undergraduates and postgraduates.

Privately owned halls of residence have risen in prominence in recent years and now account for around 7% of the total UK market, an estimated 110,000 bedspaces. There are numerous specialist providers with the biggest concentrations of private halls found in London, the North West of England, Yorkshire and Humber and the East Midlands.



Age and quality of provision

The quality of university owned or operated stock varies greatly both within and between institutions, but overall a significant proportion has been found to be sub-standard. Recent university Estates Management Statistics (EMS) data shows that just 76% of universities' residential estate is in good condition. In Wales this figure is as low as 61%.

Similar problems exist in the private rented sector. According to a survey by Communities and Local Government (CLG), just over half of private rented accommodation in England was built before 1944 with over 40% of houses assessed as being in 'non-decent' condition.

Is there a supply shortage?

The two main groups of students occupying bedspaces in halls of residence are full-time, first-year undergraduates and postgraduates, especially non-UK domiciled. According to the HESA, in the 2008/09 academic year there were 591,000 such students attending UK HEIs. There is no single comprehensive record of vacancy rates in halls of residence in the UK, but private developers of purpose-built halls are reporting a maturing market, with rental growth prospects slowing.

Lower rental growth would suggest a balance of supply and demand, but there is much regional variation, with shortages reported in some locations. For example, the draft London Plan consultation document acknowledges a significant lack of supply in the capital and there is anecdotal evidence of acute shortages in a number of regional locations, including Southampton, Exeter, Derby, Cambridge, Teesside and Lincoln. In contrast, however, there are concerns at some locations of an oversupply, for example in areas of Leeds, Liverpool, Manchester and Nottingham.

Supply outlook

In the current economic climate the development pipeline is being constrained while university funding cuts are expected to impact upon building projects.

The rising supply of private halls of residence over the past decade was driven by cheap and abundant debt funding, strong growth in both student numbers and university funding as well as consistent growth in the wider economy. But in the wake of the banking crisis and subsequent recession each of these drivers has been adversely affected.

Amidst a weak economic recovery and continuing financial problems in the banks, developers are struggling to raise necessary finance for new development. In addition, the growth in student numbers is slowing while universities face funding cuts, which are expected to impact upon building projects.

Looking ahead, the focus for both universities and private developers is expected to turn away from broadly increasing the supply of new units, towards a more targeted approach to new development as well as improving the existing university owned provision.

Key issues for universities

Funding cuts to impact upon student housing

In December 2009 the government outlined £600m of cuts to the higher education and science research budgets, to be imposed by 2013. In the same month, an additional £315m of efficiency savings and cuts to the Higher Education Funding Council for England (HEFCE) budget for 2010/11 were announced by Lord Mandelson.

The extent of cuts varies between institutions, with the elite universities faring better than most. But overall there are expected to be job losses, fewer courses, larger class sizes and, importantly for student housing, less investment in building projects. This represents a significant challenge for universities with regard to how the existing stock will be improved and how new supply is to be delivered where shortages exist.

Improving the existing stock and approaches to estate management

A high proportion of university provided halls of residence are ageing and in poor condition while the students' expectations from accommodation is rising. Should tuition fees rise following the Browne review, there will be an increasing focus from UK students on value for money. At the same time, to compete in the global marketplace, universities will need to be able to offer high quality accommodation to international students.

With significant reductions in capital baseline funding as a result of cut-backs, universities are facing greater pressure to develop and implement high quality estate management strategies. This raises the possibility that universities will consider releasing capital from their estates or look to improve the efficiency of accommodation provision through private sector partnerships.

Sustainability

Higher education institutions are at the forefront of the sustainability agenda placing it at the heart of their property development strategies and operations. Many universities are going well beyond the minimum legal requirements and are committing to ambitious carbon reduction targets. Universities need to consider how they will achieve such targets as well as develop an understanding of the implications of the increasing range of legislative drivers that apply to the higher education sector, such as the CRC energy efficiency scheme.

Funding structures for the delivery of student accommodation

There are numerous means by which new student accommodation is currently delivered, each with distinct benefits and disadvantages. They range from direct development by a higher education institution through to third party provision, in which case the institution has little or no involvement in developing, owning or managing new accommodation (Table overleaf).

In considering funding options, Higher Education Institutions (HEIs) will normally focus on a series of key criteria.

In particular:

- Sources of funding – Can the HEI fund the development itself, either through retained funds or borrowings?
- Balance sheet treatment – Is it important for the HEI for any transaction to be on or off balance sheet?
- Rental income – How much control does the HEI want or need over future rental income?
- Management – How important is management control in relation to building maintenance and tenant support services?
- Attitudes to risk – How does the HEI view risk, especially the risk of void units? Where is the desired balance of risk between HEI and third-party?

A common approach is to create a purpose-built vehicle to maximise the investment and tax positions of the key parties. A private sector specialist will frequently build and run a hall of residence under an agreement that the university will guarantee the rental income for a fixed period, usually between 25 and 50 years. At the end of this period of ownership the building may revert back to the university.

The wider commercial property investment market has been resurgent since mid-2009, with average capital values rising by over 10%, according to Investment Property Databank (IPD). There is currently strong demand from international and equity-backed investors, especially for prime property assets with strong covenants.

Student accommodation is often able to match this requirement for bond type deals offering secure long-term incomes, with leases often benefiting from occupational guarantees and fixed rental uplifts. As a result, those institutions looking to raise funds through sale-and-leaseback type arrangements with the private sector should meet a great deal of investor interest. Some universities will be reluctant to relinquish control of their halls to private investors, but in the current climate it may become an increasingly attractive option.

Table 4 – Funding Structures - Sources of funding and level of control held by HEI and third party provider

Objectives / Criteria	1. University develops	2. University leases	3. University guarantees / underwrites	4. Partnership solution (SPV)	5. Third party provision
Source of funding	University funds	Third party funds	Third party funds	Third party funds	Third party funds
On or off balance sheet	On	On	Dependent on specific arrangement	Normally off	Off
University controls rental levels	Yes	Yes	No	Dependent on agreement	No
University of management	Full control	Normally control of 'soft' facilities management	Control can be exercised	Dependent on agreement	No
Occupancy (void) risk	With university	With university	Shared risk	Dependent on agreement	With third party

Development and investment

Development viability

The recent property market downturn has impacted upon the viability of new student housing developments, despite relatively stable income growth and lower building costs. Developers are facing difficulties raising debt funding for new schemes while planning remains a major hurdle, especially in areas where there is high demand for affordable housing provision.

Such viability concerns have meant that private developer/ investors are now targeting lower risk markets where there is a clear under-supply, such as London, focusing on proactive asset management, the acquisition of 'distressed' assets and increasingly, looking to work with universities to develop, refurbish or manage existing accommodation.

Planning

The planning system's treatment of student housing is problematic as there is little clear relevant national, regional or local guidance for planning officers or developers. With purpose-built halls increasingly seen to be competing with other forms of housing, developers are now encountering a more restrictive planning regime than in the recent past.

Requirements for developer contributions towards affordable housing provision are proving particularly challenging in some locations. For example, the current London Plan 2009 Consultation Draft states that unless there are occupational agreements in place between a university and developer, any proposed scheme will be subject to the requirements of affordable housing policy.

There is consequently a growing need for a collaborative approach to student housing development involving universities, planning authorities, community groups (residential and business) and lenders working closely together to ensure that the needs of all parties are considered.

Student housing as an asset class

Purpose-built student accommodation is emerging as a distinct asset class. There are now over 100,000 bedspaces in this sector of the market, a number which has continued to grow in spite of the property downturn of the past two years. There are numerous specialist investment funds targeting a sector which is seen as a proxy for institutional residential investment. The inclusion of student housing as a distinct segment of the IPD index would serve to improve benchmarking of investment performance, helping to further establish the sector as an asset class.

Student housing has many attractions to investors over the general residential private rented sector including lengthy overriding leases with high level of income security, a stable tenant base and high density of development as well as the potential for additional income to be gained from alternative uses out of term time. But significant drawbacks include the relative illiquidity of property assets and high facilities management costs resulting from complex operational requirements.

Where no rental guarantees or nomination agreements are in place, private halls are in direct competition with the private rented sector. The occupier market for private halls is largely limited to international students, post-graduates and returning undergraduates not looking for shared accommodation, or those prepared to pay a premium for the additional amenities offered.

Rental value growth prospects

According to data from NUS/Unipol, between 2001 and 2009, average rents for purpose-built student accommodation increased by 68%. This exceptionally strong growth is attributed to a combination of rising demand from students, an increased range of amenity and services included in a typical contract, in addition to a general improvement in accommodation standards.

But looking ahead rental growth prospects are moderating. The rate of increase in student numbers is set to slow and with the costs of attending university likely to rise, there will be a greater focus from students (and their parents) on obtaining value for money from their experience.

Competition with the private rented sector for returning second year students and postgraduates is increasing with the internet now enabling students to easily find and compare the costs of available accommodation. At the same time, more landlords are joining accreditation schemes, which should lead to improving standards.

But despite facing such headwinds, rental growth is expected to remain positive overall and continue to be stronger for private purpose-built halls than in the private rented sector. A recent Unite report anticipates rental growth of 3 - 5% pa over the next three years compared with 2 - 3% pa in the student accommodation market generally.

Conclusions

The changing nature and growing size of the student population over the past 15 years has increased the demand for good quality purpose-built accommodation. But the rate of growth is slowing and changes to higher education funding will result in both a greater focus on value for money and more pressure on institutions to make improvements to their existing stock. At the same time, an increasingly diverse student population will require a wider variety of accommodation types and price ranges.

The demand for purpose-built provision continues to exceed supply overall, but there are marked regional variations, with

notable hot-spots such as London, Bristol and Edinburgh contrasting with areas of oversupply in some northern cities. The greatest rental variations are seen in London, which is especially popular with the non-UK domiciled postgraduate students.

However, the building programmes of higher education institutions are expected to be adversely affected by forthcoming funding cuts. In addition, developers are facing difficulties raising debt funding for new schemes while planning remains a major hurdle in some areas. Meanwhile, rental growth prospects are being weighed-down upon by the lower growth of the student population, the likelihood of higher tuition fees and increasing competition from the private rented sector.

As a result of such challenges, both universities and private developers are likely to turn towards a highly targeted approach with further partnerships between public and private sector providers. Existing estate management strategies should be reviewed in the light of expected funding cuts to ensure that the current and future needs of institutions, students and regulators are met.

With the development and investment market maturing, there is a growing need for a collaborative approach to student housing development involving universities, planning authorities, community groups (student, residential and business) and lenders working more closely together.

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