June 2015

TIAA-CREF Asset Management

Investing in education

Shaping a U.S. student housing investment strategy

Martha Peyton, Ph.D.
Managing Director
Edward F. Pierzak, Ph.D.
Managing Director

Not too long ago, the student housing sector was considered a niche sector, dominated by mom-and-pop operators with local or regional footprints. Because of its perceived lack of scale, student housing failed to pique institutional investor interest until roughly a decade ago. In 2004, the National Multi Housing Council (NMHC) hosted its inaugural student housing conference and published Student Housing 101: Where are the Opportunities? Since that time, the NMHC has ramped up its efforts to educate investors and promote student housing investment. Today, student housing is a well-accepted investment strategy for many institutions.

Fragmented industry

Despite increased interest from and participation by institutional investors, student housing is still a fragmented industry. Student Housing Business compiles lists of the top 25 owners and managers of student housing properties. In 2014, the top three owners were publicly-traded REITs: American Campus Communities (ACC), EdR and Campus Crest Communities. With more than 100,000 beds, ACC is the top owner of student housing. It has more than three times the number of beds than its next competitor; the multiple grows to more than 20 when comparing the first- and last-ranked companies on the list. An owner would need to control only about 6,000 beds to make the list and about 11,000 beds to break into the top 10.

The current state of the U.S. student housing industry offers investors an opportunity to amass market share and realize competitive advantages, but investors need to be cognizant of the size of the market. Transaction volumes for apartments and student housing from Real Capital Analytics (RCA) can help gauge the relative depth of each sector. From 2005 to 2014, apartment transaction volume averaged more than $75 billion per year. In comparison, student housing transaction volume averaged roughly $2.4 billion, or only 3 percent of the apartment average, over the same time period.

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Select differences between traditional apartments and student housing

	Traditional apartments	Student housing
Target markets	Focus on major (primary) markets	Focus on university
Demand driver	Employment (growth)	Enrollment (growth)
Rentable unit	By-the-unit	By-the-unit, or by-the-bed
Furnished	Typically unfurnished	Typically furnished
Bed-to-bath ratio	Variable	1:1 strongly preferred
Leasing season	Year-round; some seasonality	Academic year
Lease term	Typically 12 months, but flexible	11.5 months (but pay for 12.0 months)
Lease guarantor	Tenant	Tenant and parents
Turnover	On average, 55% to 60%	Nearly 100%

Sources: TIAA-CREF; Green Street Advisors

Similar but not the same

Student housing has come a long way in the past 25 years. Many individuals older than 40 years of age remember their college dormitories as utilitarian structures that resembled military barracks with communal bathrooms. Today's student housing offers high-end amenities such as private bedrooms and bathrooms, swimming pools, fitness centers, and state-of-the-art internet connectivity. These housing options offer accommodations that easily rival, or maybe even exceed, the comforts found in many students' family homes. Although student housing often is compared to traditional apartments, there are significant differences, as shown in the table above.

Of note, the target markets for traditional apartment investment are not necessarily the same as those for student housing. TIAA's target market process for apartments, for example, identifies markets with strong historical outperformance, favorable current and forward-looking prospects, and ample liquidity. The process tends to identify major metro areas across the United States. In contrast, selection of student housing markets focuses on "the university." As a result, locations can vary widely, including primary, secondary, tertiary and even rural markets. Student housing has the potential to offer diversification from several perspectives, including location, demand drivers and event risk.

As with any real estate investment, location matters for student housing investment. Housing locations are either on-campus or off-campus. On-campus housing tends to be owned/controlled either by the university or by public-private partnerships where the university enters a joint venture with an operator. Off-campus opportunities tend to be the realm of private investors. Ideal locations are within walking distance to campus, athletic facilities and/or entertainment districts. Proximity to an established transportation line may be an acceptable alternative to walkability in some markets. For off-campus housing, distance to the university plays a key role; in general, the closer to campus, the better.

With lease turnover approaching 100 percent annually, the lease-up cycle for a student housing property is critical. Failure to meet leasing goals by the start of the academic year will all but guarantee suboptimal results for the year. The lease-up cycle can be likened to a cruise ship getting ready to sail. Once the ship sails, its occupancy is set; it cannot take on more passengers. Similarly, once the school year starts, a student housing property effectively is finished with leasing; it may be able only to improve its occupancy on the margin during the academic year. Also, just as a cruise ship takes considerable time to turn around, image problems at a student housing property can take considerable time to mitigate. As a result, student housing is management intensive and requires specialized, competent property operators.

Data from RCA show student housing properties have traded at higher cap rates than the broader apartment category over the past 10 years; the cap rate spread has averaged 45 basis points. This positive spread is appealing at first blush, but it is no free lunch. Student housing cap rates generally are higher than apartment cap rates because of student housing's higher debt costs, increased operational risk from the relatively short and unforgiving lease-up cycle, and more-intensive property management. In some cases, however, student housing cap rates can be lower than those of traditional apartments, particularly when the university is the dominant driver of the local economy.

Making the case

A conceptual case for investing in student housing in the United States can be built by examining a handful of factors. These include the role of education in the United States, the demand for postsecondary education, trends in educational costs and student debt, the rise of competitive educational outlets, and the decline in fiscal support for higher education from state and local governments.

- A comparison of unemployment rates and median annual earnings in the table below shows education pays in the United States.
- U.S. postsecondary degree-granting institutions are experiencing healthy enrollment trends. The Projections of Education Statistics to 2022 estimates enrollments are expected to increase by roughly 14 percent from 2011 to 2022. Foreign student enrollment trends also are expected to continue to be strong. The 2014 Open Doors Report on International Educational Exchange indicated foreign enrollment in U.S. universities and colleges reached a record high of 886,052 students in the 2013–2014 academic year; an 8.1 percent increase over the previous year.
- The rising costs of higher education have well outpaced inflation over the past 30 years; college tuition and fees increased at an average annual rate of 5.7 percent, while inflation increased at an average pace of 2.9 percent. According to the National Center for Education Statistics, average undergraduate tuition, room and board costs at public and private U.S. degree-granting institutions in 2013 were $15,022 and $34,483, respectively. At less than half the cost of private institutions, public universities offer a cost-effective solution to higher education. Nonetheless, costs also may prove to be a headwind to demand for higher education.

- Education-related student debt has moved in lockstep with rising tuition and fees, breaking the $1 trillion barrier in 2011 and is now higher than auto, credit card or home-equity debt balances. According to The Institute for College Access & Success, graduating seniors with student loans had an average balance of roughly $29,000 in 2012. Rising education costs and debt are causing many to question the value proposition of a college education. While there is a general belief that the top-tier universities offer an attractive return on investment, returns from lower-tier universities are murkier.

Unemployment rates and median weekly and annual earnings across educational attainment levels (2013)

Educational attainment	Median weekly earnings	Median annual earnings	Unemployment rate
Professional degree	$1,714	$89,128	2.3%
Master's degree	$1,329	$69,108	3.4%
Bachelor's degree	$1,108	$57,616	4.0%
Associate's degree	$777	$40,404	5.4%
High school diploma	$651	$33,852	7.5%
Less than high school diploma	$472	$24,544	11.0%

Sources: Bureau of Labor Statistics, Current Population Survey, as of March 2014; TIAA-CREF

- Online education is a relatively new, affordable delivery mechanism for education that has the potential to change the higher education landscape. To date, for-profit universities have not necessarily been threats, but other formats sponsored by leading U.S. universities and/or their faculty could present formidable challenges. Some analysts believe a parallel can be drawn between online education and online retailing, where online education becomes a disruptive force in higher education.
- State and local governments were affected significantly by the Great Recession. Although they are recovering, the recession brought about material changes in state fiscal support for higher education. Less money for public universities means limited funds for student housing; this creates an opportunity for private investors at public universities. Many private universities have not faced the same funding issues as public institutions and often tend to be less transparent with their housing plans; this makes them less attractive targets for private investors.

Shaping a strategy

So, what does it all mean? The factors from the conceptual case suggest an opportunity exists in student housing. Specifically, they support a strategy that targets student housing properties located at large, top-tier, public universities—an approach that tends to be followed by the publicly-traded REITs investing in the sector. Employing this strategy greatly simplifies the scope of the target selection process. Recall that target selection is institution-focused rather than market-focused for student housing. In the United States, there are more than 4,700 postsecondary degree-granting institutions. After screening for four-year public universities with full-time enrollment greater than 15,000 students, the list of schools is reduced to less than 200 institutions. Further screens that focus on factors such as freshman acceptance rates and favorable university housing characteristics can reduce the number of targeted institutions to well below 100. Implementation of this strategy and screening process allows an investor to create a focused and well-defined student housing investment universe.

TIAA CREF
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C23367
141009489

(06/15)