COMING OF AGE

The student housing industry has evolved from mom-and-pop to upstart to professional.

By Frederick Pierce

Nearly two decades after its inception, the niche sector of student housing is finally coming of age — from a capital formation standpoint, that is. This evolution of the industry and its investor base has followed a typical and logical progression to reach where it stands today. Below is a synopsis of where we have come as an industry and what has enabled student housing to reach its current and projected increased level of expanded capital access.

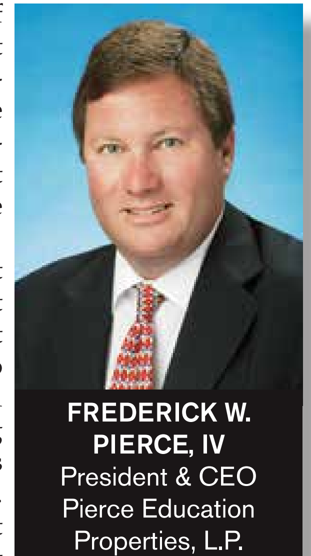
While there are a few companies with longer histories, the contemporary student housing sector really traces its roots to the mid- and late 1990s with the emergence of a small group of regional — and eventually national — companies who developed the first generation of purpose-built, off-campus, highly-amenitized student apartment complexes, most with three- and four-bedroom floor plans. Demand was fueled by a new and dynamically growing generation of college students, the children of the baby boomers, most of whom grew up with their own bedrooms and bathrooms.

Initially, the tax-exempt financing model pioneered by Capstone was popular and did not require an exit strategy due to non-profit ownership utilizing 30-year bond financing with no equity. While the tax-exempt model worked well in the late 1990s and early 2000s, it soon ran into limitations. The IRS instituted a moratorium on further creation of national non-profits with educational missions. (The Collegiate Housing Foundation and The Provident Resources Group were grandfathered in.) The rating agencies also began to scrutinize that structure and universities became concerned about credit treatment, balance sheet accounting and debt capacity issues. Thus, while this model still works today, the industry would never have reached its current size using only that financing model.

For the industry to truly proliferate, it needed scalability. That meant a conventional approach to product delivery including a growing supply of developers and a robust investment sales marketplace to provide liquidity for those mostly merchant builders. Regional and national multifamily developers — including the likes of Dinerstein (Sterling), JPI, Fairfield, Edwards, Royal and others — sniffed out the opportunity and created student housing development programs. At the same time, ACC, EdR (then Allen & O'Hara) and GMH (then College Park Communities) were growing their emerging student housing companies through acquisition, aggregation and development with an eye on the public capital markets. Moving into the middle of the 2000s, the buyer profile for purpose-built student housing was dominated by the soon-to-be REITs followed by the then-booming tenant-in-common (TIC) industry. Also, some institutional investors were opting to put the new purpose-built student housing product into their conventional multi-family portfolios, but few institutional investors at that time were specifically targeting student housing as an asset class.

The public offerings of ACC, EdR and GMH in 2004 and 2005 were a game changer. For the first time, there were public companies in the space accompanied by newly required transparency and Wall Street analysts. The other big deal was debt capital. The agencies, Fannie Mae and Freddie Mac, established student housing lending programs that still remain the primary sources of permanent debt supporting the industry, although conduit loans are also readily available. Those factors, including related industry benchmarks and performance metrics, were conditions precedent to attracting more sizeable institutional equity allocations into the space.

During the same period, the capital markets responded and a few private equity firms began to specifically target the student housing space. This included seasoned investors like the Fidelity Real Estate Group, and included new entrants to the space — many of whom are now industry stalwarts — like Harrison Street Real Estate and Blue Vista. To fully understand the gravitation of equity capital into the space, however, you need to look through the private equity firms to understand who are investing in their co-mingled funds. The majority of those investors are pension funds, foundations and endowments, who were getting their initial exposure to the student housing space through the co-mingled fund structure. There also was some foreign capital, with the most notable at that time being the Government of Singapore Investment Corp. Historically, the majority of private equity capital deployment was focused on development, given their high yield requirements (an internal rate of return with a minimum of 18 percent net at that time). The predominant buyer profile for stabilized, purpose-built student housing was still the REITs and TICs.


FREDERICK W. PIERCE, IV
President & CEO
Pierce Education Properties, L.P.

The Great Recession brought new development to a halt and also dramatically slowed student housing investment sales in 2008 and 2009. However, what that period brought about were two things. First, student housing proved itself to be a "recession-resistant" asset class. Second, as multifamily led the recovery of the national real estate market starting in 2010, student housing was right there with it. The Great Recession also changed the landscape of players in the sector and the buyer profile. The TIC industry imploded, eliminating sponsors in that sector as viable buyers. ACC acquired the large majority of GMH's assets which gave the company even more coverage of student housing markets nationally, including multiple assets in some markets. ACC then reduced its market capture of investment sales as the company pruned assets from the GMH portfolio. At the same time, prior to the Randy Churchey-led dramatic resurgence, EdR was struggling in the early part of the decade and was not active with acquisitions. That opened up acquisition opportunities for private national student housing companies, like ours and a handful of others, to capture greater market share and also pursue stabilized student apartment assets.

Today, cap rates in the national multifamily investment marketplace have compressed back to pre-Great Recession levels. Nevertheless, the multifamily sector remains the darling of the core investment universe, but yields have been driven down due to the high demand for those assets. That is fueling growing institutional investor appetite in student housing, which is increasingly viewed as an alternative place to designate a portion of their multifamily equity allocation (along with seniors housing, as well). Harrison Street has capitalized on this oppor-

tunity with its open-ended core fund. Others, including Pierce Education Properties, have successfully received separate account allocations from public pension funds interested in capturing exposure in our increasingly attractive niche sector. We are also seeing increased international interest in the student housing space (Middle East and Asia) of late, but thus far without much action.

The future will bring additional core capital into our space, which will serve to further stabilize the student housing investment market and bring justified cap rate compression to non-pedestrian assets — pedestrian assets have already compressed following the pattern of conventional multifamily properties. Even though several of the industry's larger private companies explored IPOs without success in recent years, I will not be surprised if one or two more occur in coming years. However, the most notable change from an equity capital perspective will be an increasing trend of student housing being earmarked for a dedicated portion of the multifamily allocation made by pension funds, endowments and foundations.

Frederick Pierce is President and CEO of Pierce Education Properties, L.P., a leading national student housing investment and operating company celebrating its 20th anniversary in 2015. Pierce has acquired more than $550 million in student housing communities representing more than 13,000 beds.