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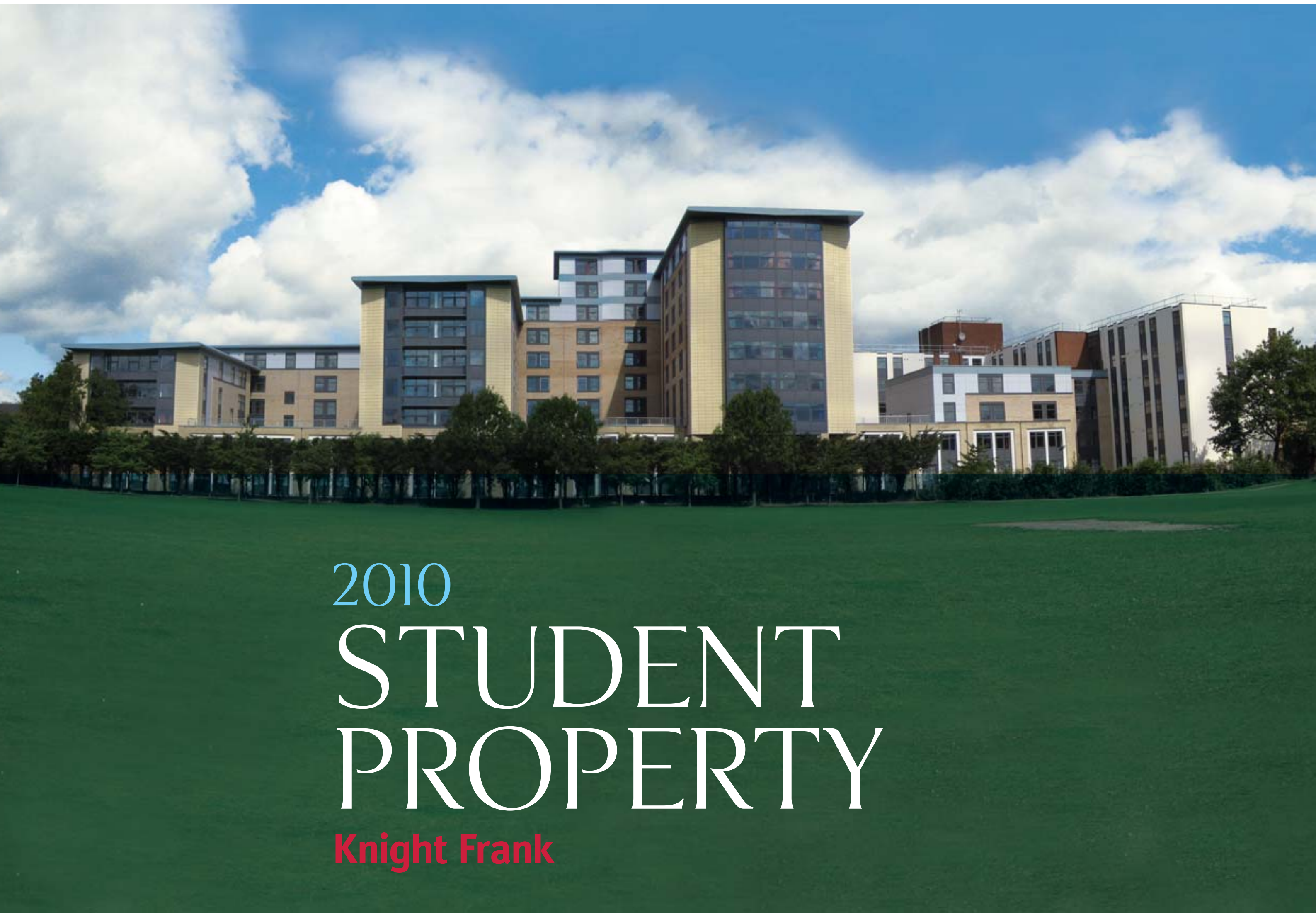


2010 STUDENT PROPERTY

Knight Frank

HIGHLIGHTS

- Rental growth in the student accommodation sector remains robust, recording growth of 5% per annum over the last six years, compared to 0.6% for commercial property. Substantially higher growth was achieved in key university towns over the last academic year.
- Demand for university places continues to rise. Preliminary figures suggest a further increase in demand for places in the 2010/11 academic year, with UCAS reporting a 12% rise in applications at its October deadline.
- As an asset class, the student accommodation sector is maturing and becoming recognised as an important element of the wider property investment market. Since mid 2009, there been increased demand for secure income producing assets and demonstrable yield compression.

2010
STUDENT PROPERTY

Demand

Student numbers continue to rise steadily. The total number of people in higher education has grown from 1.8 million in 1996-7 to approaching 2.4 million in the academic year 2009-10, reflecting an annual growth rate of over 2.5% per annum. This trend is set to continue in the academic year ahead, with early indications that the economic downturn has encouraged more people to look to higher education.

Data from UCAS revealed the number of applicants to UK universities and colleges at the end August 2009 was 613,904, compared with 557,486 at the same time last year, an increase of 10.1%. Significantly for student accommodation, the number and proportion of overseas students is also growing, with a total rise of 13.6% relative to August 2008, inclusive of a 15.4% rise in students from outside the European Union. Early indicators suggest a further increase in overseas students in the next academic year – at October UCAS had recorded a 16.6% increase in foreign applicants – with the number of applications from the Republic of Ireland up by 43% and a 27% increase recorded from Chinese students.

Aside from international students, another key segment for operators of private halls is postgraduates. Both groups tend to favour the professionally managed sector and are less price sensitive than other student categories. In 1997 these groups accounted for 11% (international) and 21% (postgraduates) of all students. Over the following ten years these proportions increased to 15% and 24% respectively.

There are conflicting trends projected for the forthcoming decade, as a rising proportion of students may be offset by the anticipated decline in the younger population. On balance, the market view is that overall student numbers are likely to remain stable and in the medium-term there is unlikely to be a substantial uplift in student places as caps remain in place. However, the expectation is that the proportions of both overseas and postgraduate students will continue to grow, underpinning future demand for private professionally managed halls.

Supply

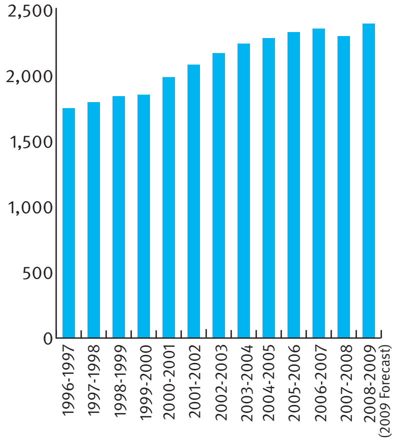
The supply of privately run purpose built student accommodation continues to be dominated by the largest four service providers – UNITE, UPP, Opal and Liberty Living. Although there has been substantial development, existing supply levels still mean the vast majority of students are not able to take the option of a privately operated room. Only 26% of London's higher education students are able to access halls, with only 3% having access to private sector halls. This is a very substantially lower proportion than is the case in major regional cities with high student populations.

While there is still a willingness amongst banks to provide finance for the development of student accommodation, the basis on which they will lend is now far more stringent. When financing new projects, there is an insistence on lower loan-to-value ratios, which now stand at c. 60-65%, down from c. 85-95% at the peak of the market. The restriction in lending comes despite the continued strong performance of student property, with lending only granted in cases where the borrower can demonstrate a strong track record in the sector.

The UNITE Group has freed up development capital, announcing its fourth joint venture project with the sale of a 75% stake in three student accommodation properties in London to the Bahrain based Oasis Capital Bank. The three properties, with an estimated value upon completion of £194 million, represent the whole of UNITE's 2010 pipeline. Subsequently, UNITE has raised a further £82 million in a share issue to acquire sites in London for future developments.

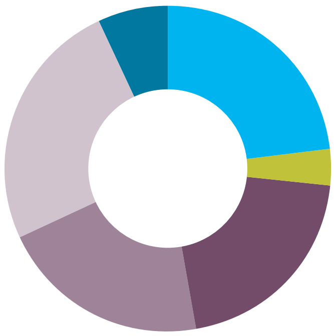
Given the substantial fall in land values since the peak of the market, developers in equity rich positions should find themselves in an advantageous position in this still undersupplied sector and will increasingly have the opportunity to acquire sites in locations previously considered too expensive for student housing. However, as the economic recovery begins to take hold new development is likely to be pushed away from core locations, especially in London, as a recovery in the office and residential markets increases competition for sites. The identification of the right location is essential for a successful student scheme.

Figure 1
Higher education student population
(000's)



Source: Higher Education Statistics Agency/ Knight Frank Research

Figure 2
Accommodation options



- Institution maintained property
- Private-sector halls
- Parental/Guardian home
- Own residence
- Other rented accommodation
- Other

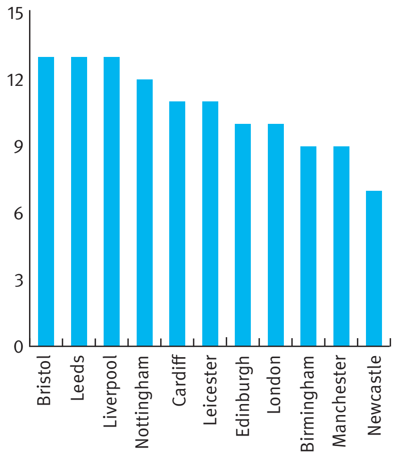
Source: Higher Education Statistics Agency

HIVE 100 East Road, Hoxton, London

Figure 3

Student accommodation rental growth analysis

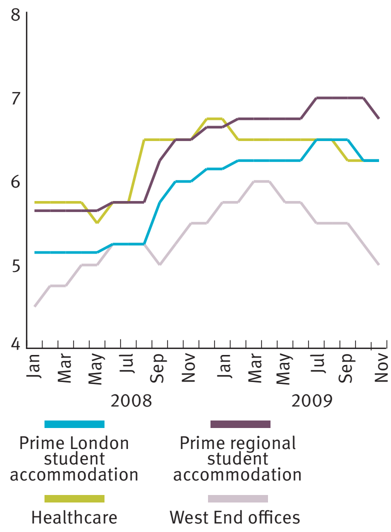
(Average % increase from 2008/9 to 2009/10)



Source: Knight Frank Research

Figure 4

Prime yields – direct let student property v other sectors (%)



Source: Knight Frank Research

Waterways, Loughborough

Rental growth prospects

Rents in the student accommodation sector grew by 5% p.a. over the six years to 2008/09, with growth considerably stronger in most markets between the 2008/09 and 2009/10 academic years. This compares with an average for all commercial property of just 0.6% p.a. in the same period. Projections for the forthcoming academic year suggest at least a further 5% increase in student rents, while commercial rents continue to decline, making the sector's robustness during the economic downturn clearly evident. It should also be noted that rental growth of this level has meant growth in real terms (i.e. in excess of inflation) and a consequent gain in real income for investors.

Occupation levels remain high for good quality, modern, purpose built accommodation in the right location. In an economic downturn there is price sensitivity, but the majority of en suite cluster schemes are approaching full occupation. Early indicators of 2010/11 rental pricing is suggesting continued rental growth of 5% in the en suite market but high-end studios, particularly in London, remain static. Regional cities still do not have a good balance of mixed product with some major student cities not having studios on offer.

The majority of key university towns reported nearly 100% occupancy for the last academic year, with private halls targeting affluent domestic students, overseas students and mature students, the latter two of which are growing in number. Amongst the established operators there has also been a growth in the retention rates of existing customers. Preliminary numbers from UCAS as at October 2009 indicates that occupational demand will remain strong in the context of wider economic volatility, while rental growth will continue at similar levels in the period to 2012.

Yields & values

The student accommodation market has had an unusual position in the turmoil of the credit crunch. Initially it was a sector which suffered far less than other property sectors as capital values held firm and positive rental growth rates were maintained. However, as the acquisition of debt became increasingly difficult to secure, the sector fell into line with the wider property market.

The sector is maturing and becoming recognised as an important element of the wider property investment market. There has been recognition of the sector by funds, particularly of opportunities where there is a long-term RPI linked lease to a reputable tenant. A yield of 6.75% was achieved on such an investment in August 2009 and subsequently, with the strengthening of the investment sector and a greater understanding of the student property market developing, yields have begun to compress again. Reflecting this the UNITE Group sold Unite House in Bristol for £21.5 million to M&G in November 2009 at a NIY of 6.07%, which highlights the lag seen in yield compression in comparison to other sectors of the commercial property market. While this is encouraging, direct let yields have drifted, as demonstrated in figure 4, and the next step is to show that the direct let investment market also has similar strength. Knight Frank predicts future growth in values, with opportunities for well located en suite cluster schemes in London and top university cities. Given the lack of product in the development pipeline, especially in the capital, there remain excellent prospects for resilient financial returns.

KNIGHT FRANK VIEW

The underlying market fundamentals are positive, with supply restricted and strong demand underpinning rental growth. Given the lack of finance currently available for development and the constrained pipeline, rents are likely to continue to rise for the foreseeable future. There is strong demand for high quality, income producing assets and it is anticipated this will continue with increased appetite from investors for direct let stock.

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