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STUDENT PROPERTY 2012

Knight Frank



Expert insight

Student property has performed exceptionally well as an asset class compared to traditional investments over the last year. In fact, it has outperformed every other commercial property class and delivered consistent returns throughout the economic downturn, argues Knight Frank's Head of Student Property James Pullan.

“Student property has outperformed every other commercial property class.”



James Pullan, Head of Student Property

A key reason for this outperformance is that there is still a structural undersupply of purpose-built student accommodation in the UK. The most undersupplied market is London, and this has been the case for quite some time. The recent planning changes have actually made such development more difficult over the last year. For this reason, we believe that London remains a top investment opportunity for student accommodation.

The investment map below identifies the key locations for sector investment. We have ranked the top 20 cities we believe to have the best opportunities for student investment in 2012 based on supply-side factors as well as the quality of the university. The most attractive areas, almost by definition, have the most limited development pipeline.

Limited supply coupled with rising global interest in the UK's educational excellence points towards further strong rental growth in the sector. The Knight Frank Student Property Index highlights how the student sector compares favourably with other sectors, as we explain on page 3 opposite.

The customer base for purpose-built student accommodation in the UK includes a very high proportion of overseas students. We foresee this demand continuing to grow as global student mobility increases further still. As shown on pages 4-5, there has been a very clear trend in the growth of students travelling abroad to study over the last decade and it is expected that the number of students leaving their own country to study at university will double again by 2025.

Overseas students have a high tendency to choose purpose-built accommodation in the UK, for a variety of reasons, including security, location and facilities. Specialist providers of accommodation are certainly in a position to help support the requirements of these students.

As students demonstrate growing global mobility, lenders are increasingly international and funders are showing a rising tendency for cross-continent investment. This backdrop provides specialist UK operators with a global opportunity to export their expertise to the immature markets overseas.

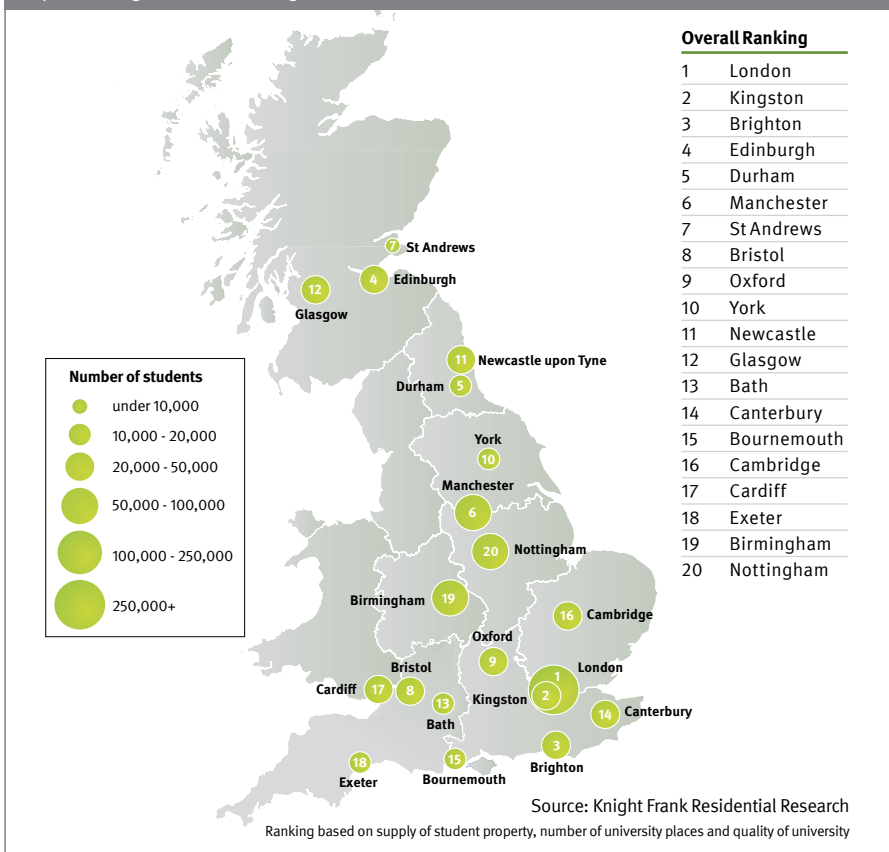
The UK higher education sector is certainly facing challenges this year. The funding changes in respect of university tuition fees are dramatic. But the impact of the changes will be similar to a graduate tax, as students will not be required to pay back loans for tuition fees until they earn more than £21,000 a year.

The regional differences in the tuition fees, as examined on pages 6-7, may well distort the market with a knock-on impact on Scottish universities.

The winners from the new tuition fees regime will be the most prestigious universities amid a “flight to quality” as students search for the very best course available for their fees. The losers will be the least prestigious institutions offering commercially unattractive degrees.

Overseas students will remain largely unaffected despite this turbulence in the UK higher education sector because they already pay tuition fees.

Table 1
Where to invest in the UK
Map illustrating overall area ranking and number of full-time students in 2010/11





Student returns in London lead the way

Total returns for investors in September 2011 were highest in London, reversing the previous year's trend and returning to the longer-term status quo where the returns in the capital outperform those in the rest of the UK according to our Student Property Accommodation Index.

Student property returns averaged 11.5% in September 2011. This is a slight easing from 13.5% in the previous year, but these returns continue to lead the market among commercial asset classes.

London

The Knight Frank Student Property Index shows that total returns for student property in London have nearly doubled. Returns in the capital climbed to 15.1% in September 2011, up from 8.4% in the previous year.

The growth in the capital has been fuelled by the particularly robust performance of the core market, and more specifically, accommodation with rents of less than £220 a week. This is also the rent bracket where rooms were filled most quickly, signalling a strong depth of demand. It is also worth noting that studio flats in London were effectively fully let. This was not the case in 2010, again underlining the demand for student accommodation in London.

The strength of the market in London is clearly demonstrated by the growth in average rents, which, as we predicted in last year's report, rose strongly. The average rent for a studio rose to £278 a week, up from £257 last year. Students with an en-suite room paid an

average of £210 a week, up from £192 in 2010/11, giving an average rise of 9.1%.

Regions

The picture for student accommodation in the regions is also robust. Although there was a slight easing in returns, they were still in double digits.

One notable feature of the regional market over the last year has been the rise in the number of post-graduate units which have been released into the market, illustrating the emphasis that developers are placing on quality and premium ranges.

Average rents for apartments and en-suite rooms in the regions rose by 4% and total returns are at 10.5%.

5%

Knight Frank forecast for like-for-like rental growth in 2012/13

Forecast

There has been a lot of focus on the new tuition fee regime which will see UK undergraduate students pay higher

university tuition fees in England and Wales for the first time, with annual charges of £9,000 for many of the top universities.

However, we believe that this new regime will have little impact on the mainstream market, as there is still an acute undersupply of student accommodation in every core market in the UK. We forecast that rental growth will continue next year, showing 5% like-for-like growth in London and the regions – closer to the longer-term trend growth after a particularly strong year. We anticipate that total returns will exceed 12%.

About the index

The Knight Frank Student Property Index monitors the performance of private sector direct let student property and is based on data covering more than 20,000 purpose-built student bedrooms in university towns across the UK. Compiled annually, the index tracks a number of key variables – rents, investment yields, and capital value – producing a total return which can be used as a comparison tool against other forms of property investment.

Figure 1
Increase in rents 2010-2011

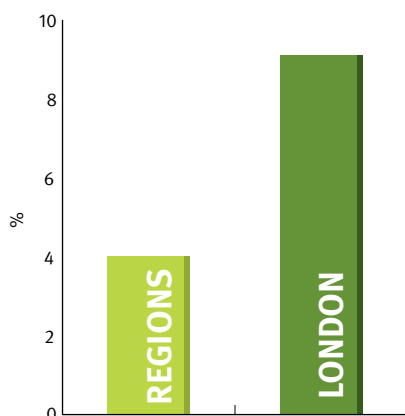


Figure 2
Total returns 2011

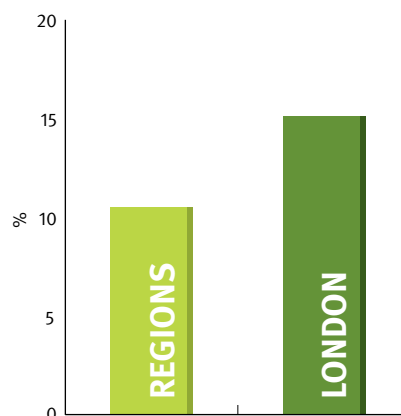
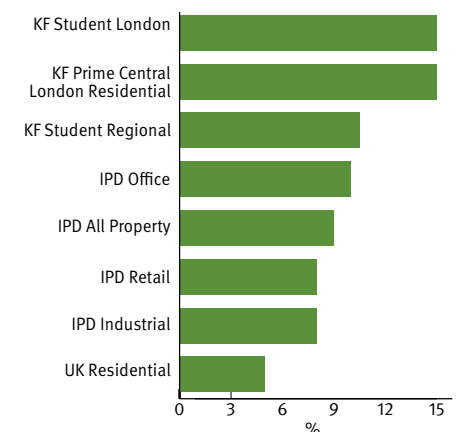


Figure 3
Total returns comparisons 2011
Year to September, end of Sept for student returns



Source: Knight Frank Residential Research / IPD

Global student mobility: a key opportunity for investors

Education is an increasingly global marketplace. Students are becoming more willing to travel abroad for the best educational opportunities, and we believe the UK is very well placed to continue to take advantage of this. The long-term trend for global mobility is not going to be hampered by short-term economic turbulence. Recognising the increasingly global nature of the knowledge economy is an investment opportunity for student accommodation providers.

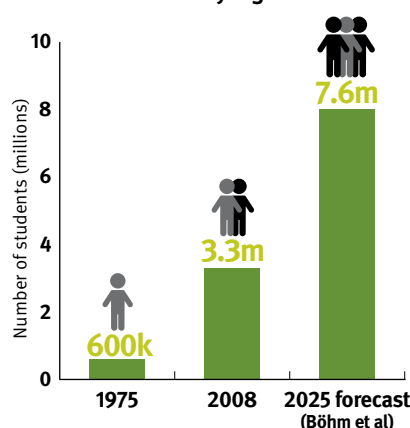
12%

Rise in non-EU students studying in the UK 2009-2010

“The number of students attending university outside their own country is forecast to more than double by 2025.”

As can be seen from figure 4, the number of students choosing to study outside their own country rose more than five-fold between 1975 and 2008 – and is forecast to more than double again in the next 14 years. European and overseas students now account for more than a sixth of the UK student population, and we believe that this will only increase in the coming years.

Figure 4
Number of students attending university outside their country – global forecast



Source: OECD, Böhm et al 2003

This means that UK students may also increasingly feel the lure of studying abroad, but we are confident that the inflow of students to the UK will far outstrip the outflow.

The UK is well placed to take advantage of this increasingly mobile student population. The UK has five of the world's top 20 universities according to the QS University rankings. France and Germany have none.

Cambridge tops the league, and it, alongside Oxford, has a global reputation to rival any Ivy League university in the US. Other top universities in the Russell Group and the 1994 Group have also stepped up their

overseas recruitment. The London School of Economics (LSE) is a highly regarded institution across the globe, and international students make up more than 65% of its population. Two-fifths of students at Imperial College London and UCL are from outside the UK.

The number of non-EU students coming to study in the UK rose by 12% in 2009 and the number of European students rose by 6%. Initial data shows that early applications from overseas students to study in the UK from September 2012 rose compared to those who applied to start their course in 2011.

Non-EU overseas students have always paid tuition fees in the UK, so the new tuition fee regime will have little impact on the number of these students coming to study here. In fact the weakness of the pound is cutting the cost of education for many of those from overseas. Chinese students are benefitting from a discount of around 20% compared to before the financial crisis in 2007, thanks to currency movements.

The international fees charged at UK universities for overseas students are also competitive on a global scale. The US has the highest fees. Annual charges for undergraduates at New York University are nearly £25,000 a year while Harvard charges around £21,000 a year. Fees at Australian universities also outstrip those in the UK, even at institutions ranked lower than their UK counterparts. Overseas fees for an undergraduate history degree at the University of Sydney are around £16,500 a year, while a similar course at Oxford costs less than £13,000.

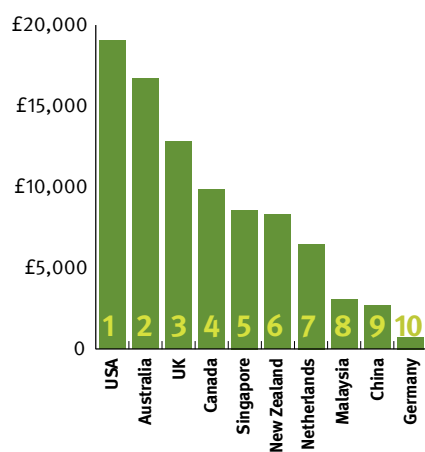
There has been speculation that other factors, such as stricter visa controls, could affect the number of students coming from overseas to study. The Home Office recently changed the rules for awarding student visas



in a bid to clamp down on the abuse of the system, demanding new English language requirements as well as tougher sponsorship requirements for colleges.

This has definitely had an impact on non-HEFCE-affiliated language colleges and courses that can sometimes act as 'feeder' courses for universities. But there has been no direct impact on HEFCE-affiliated universities, as those applying for degree courses are still very much eligible for student visas. Since investors have always focused on providing student accommodation targeting the most prestigious universities, they are unlikely to be affected by the changing visa rules.

Figure 5
Country rankings – average annual tuition fees for overseas students



Source: UK Higher Education International Unit / i-graduate

Universities are keen to attract overseas students, and have honed their marketing to best promote education in the UK. Playing host to overseas students not only enhances the student experience of those attending university by creating a 'global campus', but is beneficial in economic terms to the university as well as the UK.

Recent estimates show that the annual fees revenue from non-UK domiciled students is around £2.4 billion a year, while the total

value of exports of UK education and training are worth up to £14 billion a year to the economy.

There are few restrictions on the number of overseas students to which universities can offer places. Domestic and EU student numbers are capped. It is reasonable to assume that universities will continue to try and boost overseas students and thereby raise their income.

On a wider scale, an education in the UK is seen as an advantage in itself. There is a perception that the education on offer in the UK cannot be matched in many emerging economies at present, reflecting that students are not just investing in academic excellence but also the cultural opportunities and global recognition that universities in the UK offer.

Conclusion

Higher education in the UK is exceptionally competitive on an international scale. The country boasts some of the best universities in the world, and we see this advantage for the UK remaining.

There has been much publicity about the adverse effect of restrictions on immigration, especially student visas, but in reality this will have little direct impact on universities. It is certainly true that 'feeder' language colleges, which some students may attend before moving onto degree studies, could be hit. But we think universities will adapt, perhaps enhancing their language teaching for new students alongside their degree courses.

Universities in the UK are becoming increasingly commercial and are evolving their courses to attract the best calibre of student. We believe they will continue to step up their activities in making sure they are at the forefront of the knowledge economy. Investors in student accommodation are increasingly recognising that their assets are underpinned by long-term trends in global student mobility and further supported by the internationally recognised excellence of UK higher education.

Figure 6
Top EU student nationalities at UK universities
2009-2010

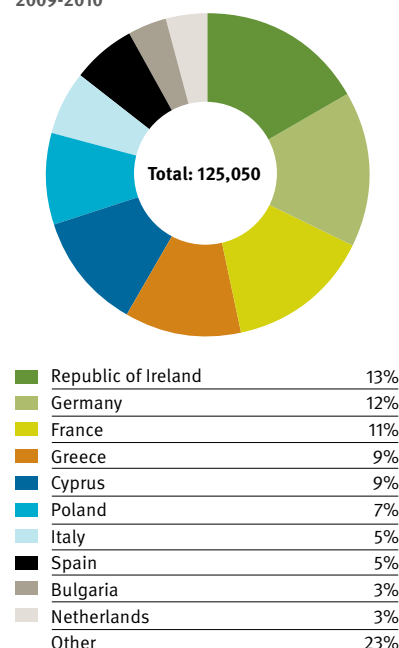
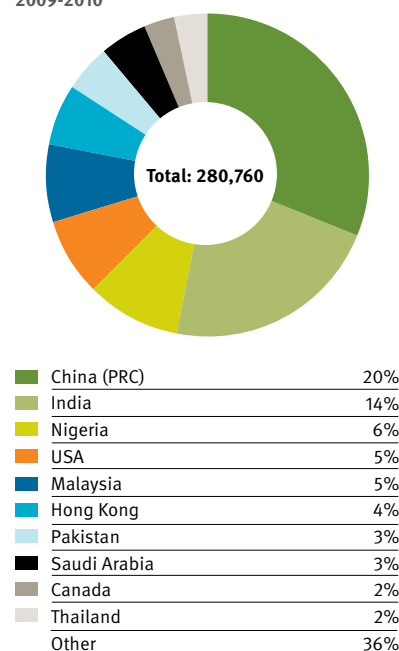


Figure 7
Top non-EU student nationalities at UK universities
2009-2010

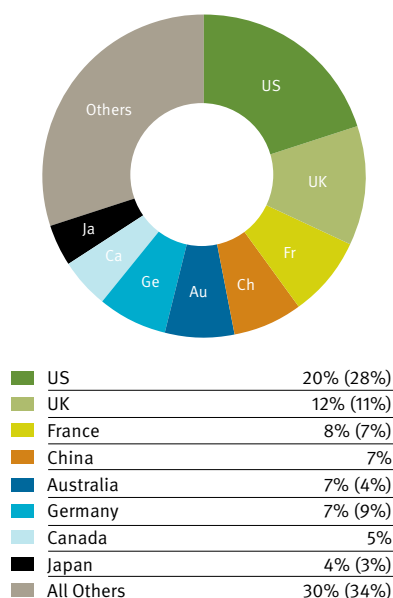


Source: UKCISA

“The UK is the world’s second largest host country, and is showing increasing market share.”

James Pullan

Figure 8
Top host countries of globally mobile students 2010
(Brackets show 2001 figures)



Source: Atlas of Student Mobility
Institution of International Education

Will tuition fees have an impact on student accommodation?

The introduction of tuition fees from October 2012 will create turmoil in the higher education sector, but will prompt a ‘flight to quality’ by students, further strengthening the position of the most prestigious universities.

From 2012, UK universities will charge between £6,000 and £9,000 a year for tuition fees, a jump up from the current “top-up” fee structure where full-time students can be charged up to £3,375 a year.

This large-scale change in the tuition fee regime was introduced in line with proposals made by Lord Browne’s review of higher education funding and comes amid deep cuts to the higher education budgets announced by the Coalition Government as they seek to repair the public finances.

Many universities have chosen to levy the highest £9,000 fee per year, including most of the top-flight universities, with only a handful pledging to charge less than this. The London School of Economics will charge £8,500 a year, while Birkbeck College will charge between £6,000 and £9,000.

But the new rules mean that most British and EU students starting a 3-year undergraduate course in September 2012 will graduate in 2015 owing tuition fees of up to £27,000. Added to the maintenance loans taken out to fund the cost of living, some could be leaving with debts of up to £50,000.

There will be some exceptions to tuition fee charges however. As table 2 below shows, Scottish students studying at Scottish universities will not be charged fees. European students are also exempt from

paying tuition fees at Scottish universities. The Welsh Assembly has voted to give Welsh students a grant to help towards funding their higher education. The maximum they will pay each year is £3,465. EU students studying in Wales will also benefit from this cap. But English students will pay tuition fees no matter where in the UK they choose to study.

The way in which the fees are structured means that graduates do not have to start paying off the loan until they are earning at least £21,000 a year. The payments will also be made on a sliding scale, so that the more students earn, the larger their monthly repayments.

There has been much attention paid to the number of applications by UK students to start their university studies in September 2012. Applicants for university places in 2010 outnumbered available places by more than 100,000. Even a sharp drop in applications will still mean that university places are hugely oversubscribed.

Initial data from UCAS showed that applications for courses which have an early deadline such as Medicine, Dentistry and Veterinary Courses, as well as all courses at Oxford and Cambridge, were down just 0.8% compared to the previous year.

Table 2

Annual tuition fees – what students must pay

Domicile of student	Studying in England	Studying in Scotland	Studying in Wales
England	Up to £9,000	Up to £9,000	Up to £9,000
Scotland	Up to £9,000	No fee	Up to £9,000
Wales	Up to £3,465	Up to £3,465	Up to £3,465
Non-EU international	Variable	Variable	Variable

Source: UCAS – based on current information



This highlights our belief that while total university application numbers may decline in 2012, applications to the best universities – those in the Russell Group and the 1994 Group – will remain strong, as will applications for the most sought-after courses.

Winners and losers

This is not to say that the new regime will not have a potentially significant impact on the wider higher education sector. While the turmoil will benefit the top-flight universities, the less prestigious institutions are most exposed to the changes that will come about because of the new student funding regime.

The new rules will engender the rise of the “student-consumer”. Given that they will be paying tens of thousands of pounds to study, students are likely to become much more discerning, viewing their education as a commercial transaction. Hence they will become more vocal about the courses they are offered, and complain if they feel that the quantity or quality of teaching is not up to scratch.

As such, we expect that some of the least prestigious universities will struggle to attract and retain students. This could lead to a few institutions at the very bottom of the league tables choosing to merge with other colleges or being taken over.

However, at the opposite end of the scale, the top universities will continue to flourish, and increase their student numbers by taking on more overseas and post-graduate students.

While there is a cap on the number of British and EU undergraduate students to which universities can offer places, there is no such

cap on non-EU overseas students. In addition, these students have always been charged fees for studying at UK universities, and so the new regime is not expected to impact the increasing popularity of studying at a British university.

In fact, the number of overseas students submitting applications to start their studies from October 2012 has risen, with a 31% increase in applications from students living in Hong Kong, and a 13% increase in Malaysian applicants.

There has also been a 22% uplift in applications from Australians, while the number of Americans wanting to attend a British university rose by 6%. The number of applications by overseas students has risen every year since the financial crisis hit in 2007 and we are confident that this trend will continue.

The rise in post-graduate students is also part of a trend, especially among top-flight universities, to boost their levels of research, for which they can attract additional funding.

Impact overview

The tuition fee exemption for European and Scottish students who clinch a place at a Scottish university from October 2012 will lead to a surge in applications for these institutions. Some commentators have suggested that the current structure is not sustainable, especially in the present financial climate, so it will be interesting to see how this situation develops.

On a wider scale, the locations where student accommodation providers choose to invest have always focused on the very

best universities, and those with a high proportion of high-net-worth overseas and post-graduate students.

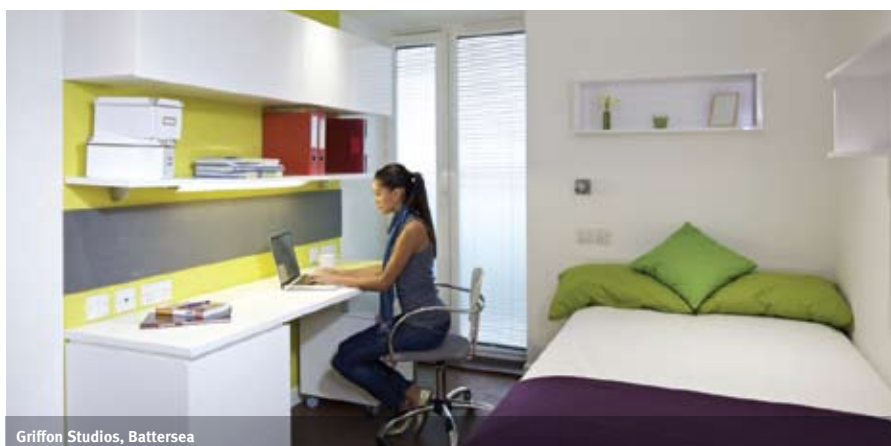
We foresee that the top quartile universities will only gain from the tuition fee changes amid a ‘flight to quality’, resulting in stiffer competition among British students for undergraduate places at these institutions. This will give the universities a wider pool of the top students to choose from, helping them to ensure the best results, burnishing their reputation as a top-class university in the years to come, and re-enforcing their attractiveness as places to invest in student accommodation.

Marketing

Marketing is the next big opportunity for student accommodation providers. At the present time the sector falls far short of the standards being set in other international sectors such as hotels. The best hotel brands are instantly recognisable, and travellers know what level of service and accommodation they can expect, and what price they will pay for it. This level of successful marketing actually adds value, especially at the top end, with visitors willing to pay a premium to stay at a hotel where they know the service will be top notch.

The differentiation in student accommodation is much less marked, and we believe developing a similar structure of branding is an opportunity for the sector to mature. Students are highly sophisticated consumers and they are particularly aware of branding in other areas of their life. Branding for accommodation could serve to give a higher level of customer penetration. Just like hotels, branding would also give instant recognition which would create product differentiation around varying price points, which we believe would only enhance the chances of achieving full occupancy with greater lettings velocity.

We also anticipate a move towards global branding in the sector, driven by an increasing volume of international students and overseas investment.



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Front page CGI of student accommodation at Goodman's Fields, London, and page 7 picture courtesy of Berkeley First. Published January 2012.

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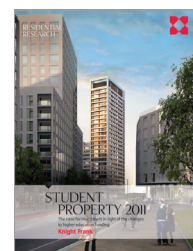
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