

# The ABCs of Student Housing

Developers and investors can earn high marks in this multifamily niche. **By Sibley Fleming**

**FAST TRACK:** Ambling University Development was awarded the contract to build the \$80 million North Georgia College and State University in Dahlonega, Ga. in the first quarter of this year. The project is slated for completion next fall.



**S**tudents of all ages are headed back to school until the recession blows over, and investors are taking copious notes. Some 62% of colleges and universities reported an increase in admission applications for the 2008-2009 school year, the most recent information available, according to the National Association for College Admission.

But public universities only have beds to house 25% of the U.S. student populations. Demand from the remaining 11.2 million students left to find alternate housing creates significant investment and development opportunities, says Oliver Swan, chief investment officer at

New York-based Campus Habitat.

Despite that healthy demand, investors and developers need more than an elementary education in real estate to find and exploit student housing opportunities in a debt-constrained marketplace. For starters, unlike other commercial real estate sectors investing in student housing is not done market by market, but rather on a university-by-university basis.

“What’s going on in universities is a very important metric when you’re looking at a deal,” says Dorothy Jackman, vice president of investments in the Tampa office of brokerage Marcus & Millichap.

In February, for example, Jackman’s office sold The University Courtyards in Tallahassee for \$4.1 million, about \$3 million below the asking price and at a capitalization rate of 15.58%. Built in 2000, the Class-A property comprises 384 beds and serves Florida A&M University (FAMU), which enjoys a current enrollment of more than 12,000 students.

At the time of sale the property was 100% occupied, so why such a steep discount? When Marcus & Millichap took on the listing in September 2008, it was a lender-controlled asset and listed at a cap rate of 8% based on cash flow.

However, the brokerage firm soon

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realized that Freddie Mac could not get comfortable with the loan because it had only been 65% occupied prior to fall 2008, a brief period of full occupancy.

The poor performance evidenced in the trailing 12 months of operating data was in part due to a loss of confidence by students in FAMU, which had been placed on probation from June 2007 through June 2008 by the Southern Association of Colleges and Schools. The school’s accrediting body cited “significant problems” in FAMU’s finances and administration.

According to Jackman, this deal illustrates the importance of ascertaining the current and future plans of the university that a prospective student housing investment will serve. A number of critical questions need to be answered: Does the university have space to add dorms? Does it plan to decrease enrollment? Will it impose or rescind a requirement that freshmen or sophomores live on campus? How is the market absorbing and reacting to the various product types already in operation?

“It’s certainly recommended that you go and talk to both the off-campus and on-campus directors at the university,” says Jackman. “If they’ve got empty dorms, you can pretty much count on the fact that they’re going to employ some kind of [rule] that requires that those dorms get filled.”

### Rising demand, fewer dollars

With little money available for construction loans, most investors are turning to acquisitions. That’s not to say that there’s no money to build student housing projects from the ground up, however. Over the past 12 months, for instance, real estate investment banking firm NAI Bluestone Real Estate Capital

has financed roughly \$80 million in student housing projects.

That figure includes a \$44 million senior construction loan closed in August on behalf of Norfolk Housing LLC for The District at ODU in Norfolk, Va. The project will be a four-story, 307-unit, 909-bed student housing facility within walking distance of Old Dominion University, which is experiencing a housing deficit of 2,500 to 5,000 bedrooms. The property is already under construction and slated for completion in June 2010 to help meet the demands of increased enrollment.

To get the deal done, NAI Bluestone secured a \$44 million, variable-rate bond representing 65% of the asset’s value. The construction-term interest rate is less than 4% and will convert to a 10-year, permanent mortgage with a fixed rate of less than 7% amortized over 30 years.

So what makes a student housing developer an attractive borrower? “At the core, we’re looking for the right supply and demand for the beds and the right proximity to the campus,” says Matthew McManus, chairman of Philadelphia-based NAI Bluestone. “Probably the last consideration is the competency level of the developer and its ability to execute the business plan.”

Developers new to the product type can still wield an advantage over competitors if they have strong connections with the university and local government. These relationships indicate a developer has a leg up when it comes to selling and marketing the product as well as understanding the needs and wants of a specific campus, McManus says.

“The challenge for anybody today, whether they’re buying or going to develop, is cobbling together the debt capital necessary to put [a deal] together,” McManus says. “More than ever it

requires great relationships with your senior financing sources.” Or, he adds, a developer can hire an investment bank and leverage that lender’s relationships to put together special financing.

### Back to campus

In the absence of a sweetheart lender for private, off-campus projects, some developers are turning to on-campus properties that will be owned by the university and financed through tax-exempt revenue bonds. Valdosta, Ga.-based Ambling University Development Group, for instance, recently closed on four major development transactions, despite challenging financial markets. The projects include:

▶ North Georgia College and State University in Dahlonega, Ga.: At slightly more than \$80 million, this project includes a 1,081-space parking deck, 38,000 sq. ft. dining facility and two residential facilities consisting of a total of 956 beds.

▶ South Georgia College in Douglas, Ga.: This \$14.5 million building will feature a 292-bed student residence hall.

▶ Southern Polytechnic State University in Marietta, Ga.: This \$40 million project includes a 334-seat dining facility, a 600-bed residence hall and 10 special-interest houses totaling 120 beds, all designed to qualify for LEED Silver certification under the U.S. Green Building Council’s Leadership in Energy & Environmental Design program.

▶ The University of South Dakota in Vermillion, S.D.: This \$31 million project features a 550-bed student residential village, also designed to achieve LEED Silver certification.

All three deals in Georgia were awarded in the first quarter of this year. The residential construction portion of each

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of Ambling’s projects is slated for completion next fall.

“These projects have all become fast-tracked,” says Greg Blais, president of Ambling University Development Group. “The trend is for universities to solicit development teams in the summer or fall and expect housing for the next fall.” And that timeline puts a lot of stress on the development teams, he adds.

The first two projects — North Georgia College and South Georgia College — were funded through the conventional tax-exempt bond model, historically employed through the University System of Georgia and its board of regents. The bonds support host institutions and use their backing of the projects to further improve the credit of the bonds, explains Blais.

The Southern Polytechnic and University of South Dakota projects were pooled with other developments to be funded by a state higher-education authority authorized by their respective legislatures.

In Georgia, that body is called the Georgia Higher Education Facilities Authority (GHEFA), which issues bonds for various board of regents projects. GHEFA was signed into law in 2006, and in November 2008 issued its first bonds, totaling more than \$99.8 million.

### Perfect timing, or else

Experts also say that the success of any student housing project depends on the ability of the developer to complete construction on time. Projects that do not meet their target date — typically mid-

summer — will sit vacant for the entire school year. These properties can become candidates for distress, which presents opportunities for savvy investors.

Indeed, it takes a smart investor to ferret out distressed student housing assets because the sector remains fundamentally sound, according to experts. “When we look to most of our national competitors, occupancy is as high as it’s always been, rental rate growth is still there,” confirms Swan of Campus Habitat, which owns and manages 3,000 beds at 12 properties in seven states. In the 10 years that the company has been in operation, it has never sold an asset.

Because student housing is so resilient, it takes poor management, a lack of expertise or downright neglect to bring a property to its knees. Swan maintains that most student housing in the U.S. is owned by families that often have other property types in their portfolios, such as retail or hotel, that are operating in the red.

In the current economic downturn, he says, many of these owners have been diverting cash from healthy student housing properties to prop up the underperforming assets they own.

“A distressed owner can cause a distressed asset,” says Swan. When cash is diverted, deferred maintenance starts to add up and property staffing levels decline. By the time the owner realizes it has serious issues, it’s May and the property is not leased for that August move-in. It is



**SMART ASSUMPTION:** Campus Habitat acquired this 120-unit, 481-bed Class-A student housing project adjacent to the University of Wyoming in Laramie out of receivership for 50 cents on the dollar.

not long then before an asset bought at the top of the market with a non-recourse loan structured as a commercial mortgage-backed security falls into special servicing.

What makes a potential buyer attractive to the special servicer, says Swan, is creditworthiness and management expertise. And it is here that Campus Habitat is gaining a foothold, with its ability to quickly acquire and reposition distressed assets.

To date, Campus Habitat has used CMBS loan assumptions to acquire two

distressed assets and one non-distressed asset. One of the distressed properties, acquired out of receivership, was a 120-unit, 481-bed Class-A student housing project adjacent to the University of Wyoming in Laramie. Campus Habitat paid 50 cents on the dollar in the deal.

CMBS loan assumptions are appealing for several reasons in the current environment. For one, the loan-to-value ratio is typically 80% to 85% compared with about 65% to 70% on new loans. The interest rates on an assumed loan remain the same as when the loan was

originated, usually below 5%, which also beats the market. The price is negotiable and discounts — as the price of the Laramie, Wyo. property indicates — can be steep, in the half-off realm.

“Student housing remains strong and resilient, so we’re not seeing the sheer number of [distressed] deals that you’re probably seeing in the hotel sector or in the office sector,” says Swan. “But we’re starting to see quite a bit, and really at the end of the day what the servicers are looking for is certainty of execution.” ■

**Sibley Fleming is managing editor.**

## What turns a healthy property into a dog?

Last year Collegiate Management Group, based in Irvine, Calif., launched Collegiate Property Recovery Division to turn around student housing properties that were going into default. The properties that are managed by the new division don’t necessarily get into that kind of trouble because of bad location or because they were erected in overbuilt markets.

Oftentimes, these otherwise healthy properties simply suffer from a lack of strong management, according to Christina Aclin, director of business development with Irvine, Calif.-based Collegiate. And this is not a situation that lenders today, already inundated with other property types, are willing to repeat.

“Management has become a make or break with all of the banks,” explains Aclin. “You have to have a strong manager on your team in order to get anything to go through.”

So what causes failure when it comes to the lease-up and day-to-day operations of a student housing project? Collegiate, which currently has 5,000 beds in its portfolio, may have a simple answer to what appears to be a complex question. In broad-brush strokes, Aclin maintains that managers need to become a part of the university community that their project serves.



**AROUND CAMPUS:** Collegiate Management Group took the 243-bed Riverfront Residence Hall in Flint, Mich., from 0% occupancy to 86% in eight weeks for fall 2009.

For instance, eight weeks ago Collegiate took over management of the 243-bed Riverfront Residence Hall in downtown Flint, Mich., which serves students at Mott Community College, the University of Michigan-Flint, Kettering University and Baker College. Over a two-month period, Collegiate took the property, a hotel conversion, from 0% occupancy to 86%.

While the property was not in receivership, it did require a quick lease-up. Collegiate began by working on one master lease and by holding bi-weekly meetings with the schools to discuss residents’

life, marketing and any incidents that happened at the property. The manager also ran through all of the design aspects and security plans with all of the universities so that they would feel comfortable referring students to Riverfront.

But blending into the community doesn’t stop there. “We help advertise their on-campus meal plans, their counseling programs, any music events that they’re having,” says Aclin. “It’s a partnership rather than us being the off-campus competitor.”

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