

RED CAPITAL GROUP®

RECENT DEVELOPMENTS IN THE **STUDENT HOUSING FINANCE AND INVESTMENT MARKETS**

November 2011

To register for free access
to RED's full research reports,
please [click here](#).



RED CAPITAL GROUP • 800-830-5100 • www.redcapitalgroup.com

RED CAPITAL RESEARCH

– Daniel J. Hogan, Director and
Joseph Mandeville, Vice President

IN THIS REPORT:

| | |
|-----------------------------------------------------------|----|
| Current Conditions in Student Housing Markets | 2 |
| Quantifying the Drivers of Student Housing Demand | 3 |
| Student Housing Occupancy and Rent Trends | 5 |
| Student Housing Property Market Trends | 6 |
| Investment Strategies for a Maturing Market | 6 |
| Student Housing Financing Trends | 7 |
| Alternative Financing Methods | 10 |
| Conclusions | 10 |



DANIEL J. HOGAN
Director of Research,
(Columbus, Ohio)
RED CAPITAL GROUP
614.857.1416
djhogan@redcapitalgroup.com

Mr. Hogan graduated Cum Laude from the University of Massachusetts, Amherst with a BA in Economics and received an MBA from The George Washington University with concentrations in Finance and International Business. He previously held positions with Kidder Peabody, the Resolution Trust Corporation and the Fixed Income Group of Banc One Capital Markets, where he was Director of Asset-Backed Research.



The information contained in this report is intended as an overview. It is not intended for use in connection with specific leasing, buying or selling decisions. The information contained herein has been obtained from sources deemed reliable, however, RED CAPITAL GROUP, LLC makes no representation or warranty regarding the accuracy of the data, observations or conclusions.

RECENT DEVELOPMENTS IN THE STUDENT HOUSING FINANCE AND INVESTMENT MARKETS

In the four years since we last turned our attention to the investment opportunities in this space¹ a great deal has changed in the student housing market. What was a modest niche of the rental housing industry has evolved into a distinct core plus commercial real estate segment, attracting substantial institutional capital and a host of new competitors dedicated to student housing property development, investment and management.

While the growth of the industry is largely beneficial to all parties involved, bringing welcome liquidity and performance data to investors, market transparency to credit providers and vastly improved housing options to college students, the flow of capital to the sector also introduces new competitive risks. In this report, we examine the current condition of the market; valuation and property markets trends; and the latest wrinkles in student housing finance. We also revisit the prospects for college enrollment in the post-Generation Y world and consider investment strategies that may mitigate the related risks.

Current Conditions in Student Housing Markets

The demographic, social and economic factors driving student housing demand remain exceptionally favorable to the industry. The size of the primary users of student housing space – Americans aged 18 to 24 – is larger than ever and will continue to grow for another year or two. The highly competitive nature of the job market has elevated the bachelor's degree and increasingly professional and graduate degrees to career prerequisites, encouraging a growing percentage of young adults to enroll in a full-time course of study, a trend that appears to have longer to run. Moreover, with the recent recession and the weak job market that followed fewer available employment opportunities compete with college for the time and attention of contemporary young adults, making the four-year (and often longer) stint on campus the most viable option for the transition from adolescence to adulthood, even among the less academically inclined.

By the same token, the lure of ivy covered walls extends beyond the nation's borders. Matriculation of foreign students in American universities is at an all-time high and growing at a brisk clip. The American university education remains a rare domestically-manufactured luxury good that is highly prized by consumers across the globe.² As the emerging economic giants in East and South Asia and South America grow more prosperous, international demand for U.S. undergraduate and graduate program admissions is likely to grow.

At the same time, the resources available to private and state-supported institutions to finance new residential construction projects are scarcer than they have been in three generations, reflecting an extended period of weak endowment fund returns, increased tuition price sensitivity among consumers and intractable fiscal problems in many state capitals. With the fiscal condition of most states likely to become more challenging as federal stimulus dollars dwindle,

the role of the private sector in replacing obsolescent college residential space and providing for the needs of the growing full-time student body will only expand.

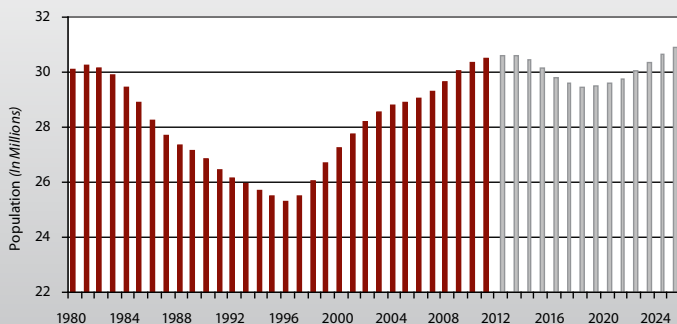
Quantifying the Drivers of Student Housing Demand

The broad case for investing in student housing remains compelling. Demographic, economic and labor market trends are largely constructive for enrollment growth in the short-term and, while looming adverse demographic changes and increasing competitive pressures cannot be ignored, appear promising over the longer-term horizon as well. The following is a brief summary of the key drivers of demand for private student residential space along with a few cautionary caveats regarding potential risks.

- **Population Demographics:** Generation Y, the progeny of the enormous Baby Boom cohort continues to swell the ranks of Americans aged 18 to 24 years, the sweet spot for full-time college enrollment. As illustrated in Exhibit 1, 2010 and 2011 were record years for the target age cohort population, eclipsing the 1981 crest of the Baby Boom wave.

Exhibit 1: Estimated and Projected U.S. Population Aged 18 - 24, 1980 - 2025

Source: Census Bureau, National Center for Education Statistics

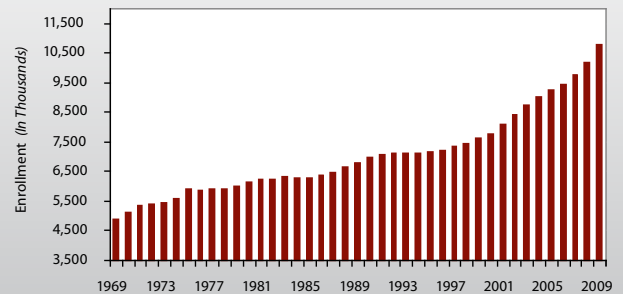


- The college-aged population is expected to increase marginally for another two years before it begins to undergo a five- to seven-year period of decline as the children of the small Generation X cohort begin to submit their applications to college. During the 2013 to 2018 period of decline, the Census Bureau projects peak-to-trough attrition of roughly 1.1 million persons or -3.5% in the population of 18- to 24-year olds. Cohort numbers will begin to recover by the onset of the next decade, building to a new record total by as early as 2024. Notably, the projected decrease in the college age demo will be much shallower and shorter in duration than the period that followed the eclipse of the Baby Boom explosion of the 1970s when the 18- to 24-year old cohort declined in 15 consecutive years, falling in that time frame by 4.9 million individuals, representing a peak-to-trough decline of -16.1%.
- **Increased Full-time College Participation Rates:** The percentage of young adults enrolled in full-time post-secondary degree programs has increased steadily since the 1960s, reflecting both the higher skill levels required in the contemporary labor market and the perception that post-secondary education generates an attractive investment return when increased lifetime earning potential is considered. Although other countervailing factors

may bear on this trend the college participation rate is likely to remain high and perhaps increase in the intermediate term so long as job opportunities for young adults without a college degree remain scarce. The four-year program full-time college enrollment statistics and 18 - 24 year old college participation rate trends are illustrated in Exhibits 2 and 3.

Exhibit 2: U.S. Four-year Degree Fall Enrollment

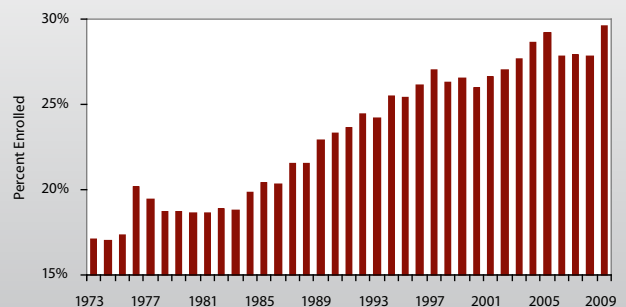
Source: National Center for Education Statistics



- *Notwithstanding the projected decline in the target population, the National Center for Education Statistics (NCES) expect college enrollment to continue to rise through 2019.* NCES forecast that the number of undergraduate and graduate students enrolled in full-time courses of study will increase by about 1.1 million or 13.2% by 2019. Moreover, the number of incoming freshman is projected to increase by about 380,000 (7.0%) to 3.4 million over the period, irrespective of the fact that the Census forecast no growth in the population of American 18-year olds over the intervening years (USCB Middle Immigration Series Projection).

Exhibit 3: Percentage of 18 - to 24-year old Americans Enrolled in a Four-year Degree Course of Study

Source: Census Bureau, National Center for Education Statistics



- *Full-time college participation rates tend to rise during periods of labor market weakness and decline when prosperity returns.* Still, investors have reason to be cautious. The upward secular trend in full-time college participation among 18- to 24-year olds accelerated on three occasions over the past twenty years. Each occasion coincided with a domestic economic recession or a period of slow job formation thereafter: the participation rate spiked nearly 3% between 1993 and 1997; and approximately 2% from 2000 and 2003 and again from 2008 and 2009. Upon the return of robust job creation in the first two cycles, however, the participation rate returned to the lower pre-recession level. It is likely that a variation on this pattern will evolve over the course of the next several years as the U.S. economy returns to full expansion mode.

¹ Investment Opportunities in the Student Housing Market: www.redcapitalgroup.com/research.

² According to the Institute of International Education, 95% of South Asians and 92% of North African and Middle Eastern students studying in the U.S. agree that the quality and reputation of American programs were factors in their decision to attend university here.