

INSIGHT



STUDENT PROPERTY

2014

2014 STUDENT PROPERTY

OVERVIEW

"The sector has undergone a funding revolution... but the best is yet to come."



James Pullan, Head of Student Property

The resolution to the Opal collapse has proven that investors recognise value in the sector.

Occupational demand is now on a firm upward trajectory and all core UK markets are structurally undersupplied with student accommodation. The new equity is excited by the opportunity sophisticated branding and targeted marketing could bring to the sector.

We forecast 2014 will see increased rental growth, sharpening yields and improved investment performance for existing funds. The sector has undergone a funding revolution but in many respects the best is yet to come.

STRUCTURALLY UNDERSUPPLIED MARKET

The underlying appetite for higher education has demonstrated its resilience through both the recession and the introduction of tuition fees. Investors are attracted to a sector where there is a demonstrable undersupply.

"We believe it is realistic for numbers of international students in higher education to grow by 15%-20% over the next five years... there is no cap on the number of students who can come to study in the UK and no intention to introduce one."

*International Education: Global Growth and Prosperity July 2013
Department for Business, Innovation and Skills*

FORECAST

Knight Frank project that domestic, European Union and international student acceptances will rise over the next five years. We anticipate that the rise in September 2014 will be in excess of 3%.

In figure 1, we have identified the demand supply imbalance within core markets in the UK. For each city identified we have informed the size of the overall pie chart with the total number of full-time students at each higher education institution located in that city. The area shaded blue represents the number of students able to access "university halls of residence" as provided by the higher education institutions. The UK is typified by universities who provide accommodation for less than a quarter of the total student intake.

The area shaded yellow represents Purpose Built Student Accommodation (PBSA) provided by the private sector operators. Despite significant investment into the PBSA sector over the past decade, it is noticeable that the majority of the markets have less accommodation provided by the private sector than by the university sector.

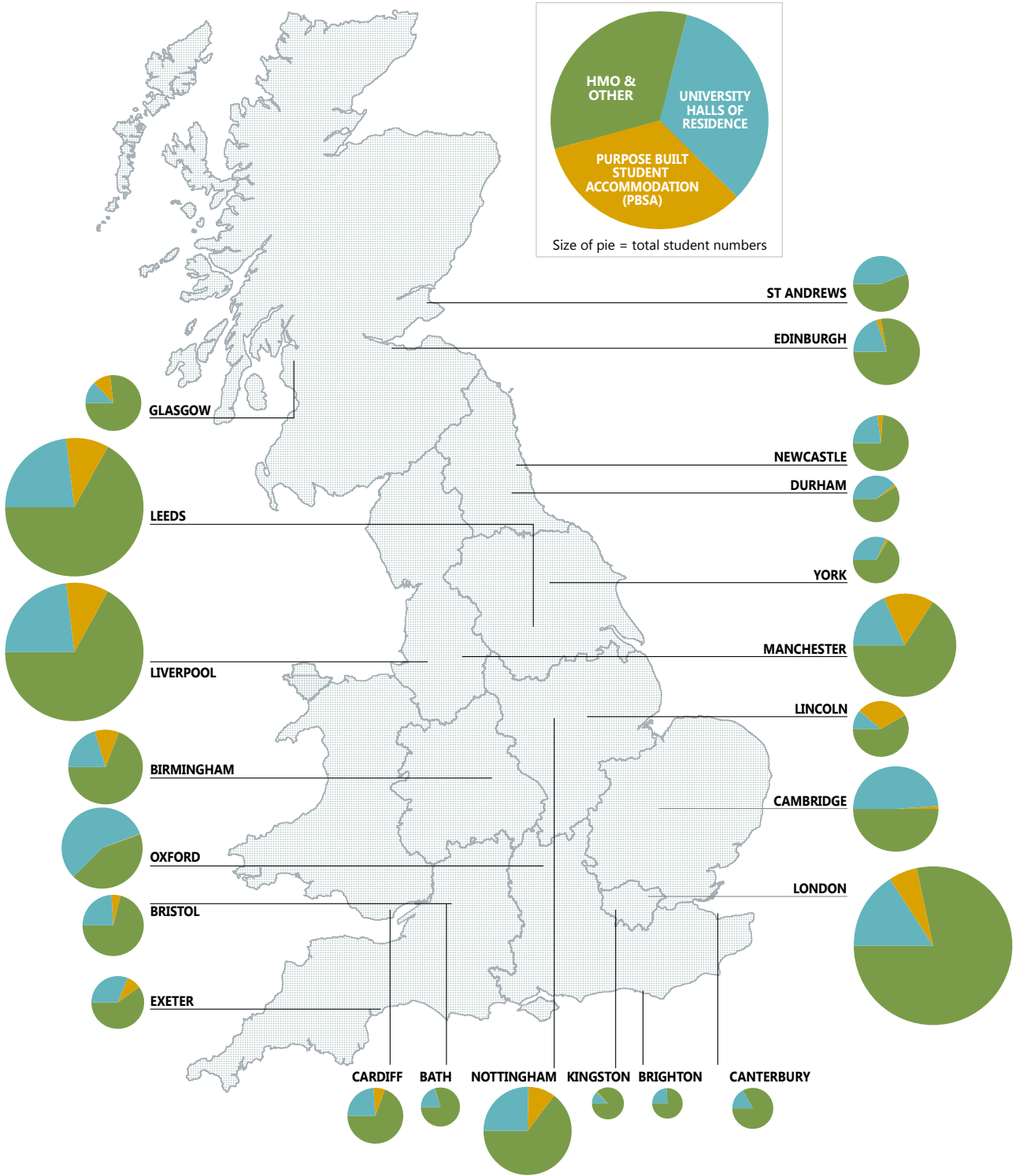
The area shaded green within each pie represents the number of students that are unable to access either university

halls of residence or PBSA. The structural undersupply of student accommodation is obvious at a glance. Students unable to access PBSA generally take second hand housing stock or houses in multiple occupation (HMO has been used in this document to reference both). Whilst structural undersupply is a feature of all core UK markets it remains most pronounced in locations such as London, Edinburgh, Newcastle and Bristol.

A major driver for the development of PBSA is a demand from overseas students.

David Willetts, MP and Minister for Universities and Science, has made clear that government policy is set to encourage the predicted rise in international students. The imperative for UK universities to maintain their global competitiveness will drive the further development of high quality accommodation as part of the overall student experience package.

Figure 1
Structurally undersupplied market



FORECAST

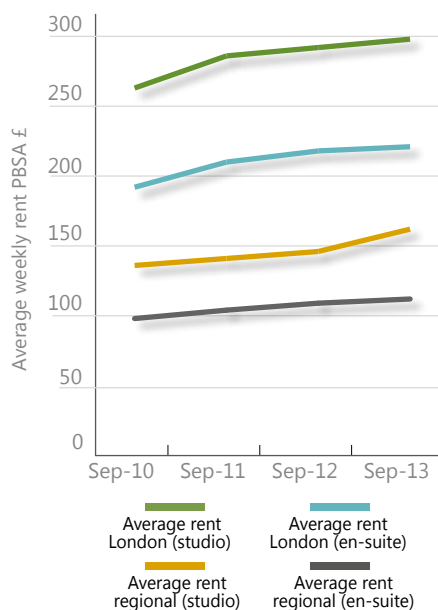
All core markets currently remain structurally undersupplied. With student numbers rising the imbalance will not be corrected within the short term.

Source: Knight Frank / QS

RENTAL PERFORMANCE

The student accommodation sector has produced positive rental growth throughout every year of the economic downturn.

Figure 2
Rental growth



Source: Knight Frank

The Knight Frank Student Property Index reveals rental growth in London is up 1.73% from the previous academic year, while regionally, rental growth averages at 1.55%. Across the UK blended rental growth is 1.59% to September 2013. Rental growth of this order demonstrates a strong performance for the sector in the context of the introduction of tuition fees. It is this extraordinary resilience that particularly attracts investors to the sector.

The headline rental growth figure is aggregated from data that demonstrates greater turbulence under the surface. Cities such as Bristol, Edinburgh, Cardiff, Liverpool and Newcastle have all experienced strong rental growth of between 3% and 4% as a result of high-performing universities and acute undersupply of accommodation. Cities such as Preston, Leeds and Birmingham have seen one-off rental reductions as operators have taken a more risk averse approach to ensure they achieve full occupancy. We would comment that instances of rental reductions are relatively unusual in the sector and that the striking feature of the commencement of September 2013 academic year was that all core markets were fully let. It is arguably

a strength of the sector that rents can react so quickly to market conditions with annual adjustments occurring at the start of each new academic year.

The Knight Frank Student Property Index also reveals that "studio" rents have grown marginally more quickly than rents in "en-suite" cluster flat bedrooms. Although modest, this difference reflects a growing confidence in the sector in the attractiveness of the studio product to international students.

Students in London currently pay an average of £299 per week for studio accommodation. Availability of such accommodation remains very limited relative to the total student population. On the supply side, the existing limited pipeline of new student accommodation in London is forecast to fall in the face of an increasingly hostile planning environment. On the demand side the number of international students will continue to rise year-on-year. We forecast that prime central London demand/supply imbalance will actually worsen in the next five years and that rental escalation for London student accommodation will be above the UK trend over this period.

EXPERT OPINION

We have invited Keith White, Managing Director of CRM (the largest independent student accommodation provider in the UK) to provide his independent view of the market.

"The outstanding opportunities await those ready to move away from traditional solutions."

*Keith White,
Managing Director of CRM*

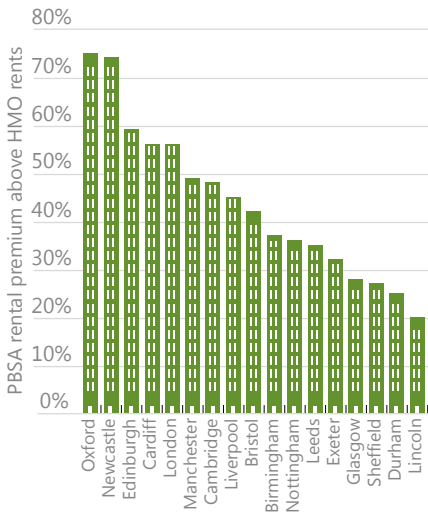
"Increasingly, students are choosing their accommodation for reasons beyond just price. They are demanding clever design that allows social groups to form and bond; such as placing kitchens and lounges at the heart of the design and not despatched to the ends of corridors. Likewise, they are demanding services that create wider social interaction; such as events and private activities, all of which adds to their experience.

Intelligent institutional investors and developers who are open to embracing

this change will succeed. We are noting significant US equity investment, yet it remains to be seen if the US operating model will transfer across the Atlantic.

As a result of strong demand and new entrants, we would anticipate that over the coming months the sector continues to perform strongly. The outstanding opportunities await those ready to move away from traditional solutions."

Figure 3
Students elect to pay more for PBSA



Source: AccommodationforStudents.com/
Knight Frank

HMO VS PBSA

The sector has demonstrated that, given the choice, students will elect to pay significantly more for PBSA accommodation than HMO stock.

Students acting as consumers recognise the added value professionally managed high specification PBSA delivers and will pay a premium over HMO stock for this.

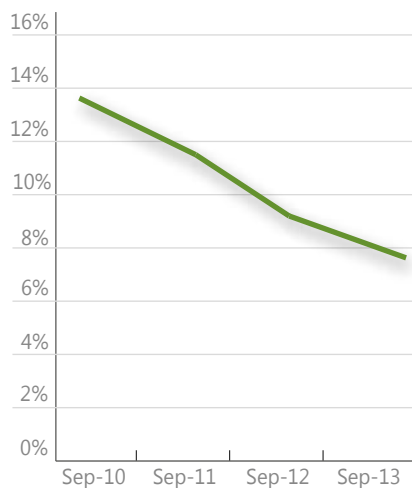
The growth in the PBSA market over the past decade has given students who cannot access university halls of residence choice. The PBSA options offer higher quality accommodation, rents inclusive of bills, varying options on tenancy lengths, a branded product, enhanced internet connectivity, professional management, a secure environment and in general a premium living experience.

Figure 3 shows the price differential between PBSA rents and HMO rents. This chart demonstrates that in every student

accommodation market across the country, students will elect to pay considerably more for quality. Rents for PBSA are up to 75% higher than HMOs in cities such as Oxford and Newcastle, reducing to an average premium of 56% in London. Even in cities such as Lincoln, PBSA rents tend to be 20% higher than average alternative housing in the city.

We observe that there appears to be some correlation between cities with high PBSA/HMO differentials and cities that contain the smallest volumes of PBSA (such as Oxford and Newcastle). Cities with a small gap between PBSA/HMO rents (such as Glasgow, Lincoln and Sheffield) tend to have a more mature PBSA provision.

Figure 4
Totting up total returns



Source: Knight Frank

TOTAL INVESTMENT RETURNS

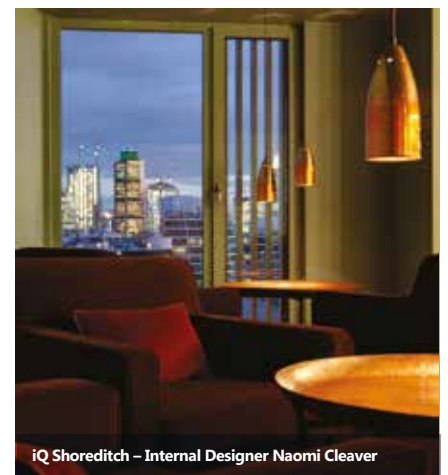
Investor returns set to stabilise

Total investor returns in student accommodation for September 2013 were 7.8%. These returns have fallen over the past four years in line with other property asset classes. Knight Frank projects that investment returns in student property will stabilise in 2014 as a result of above trend rental growth offsetting any future sharpening in yields.

Sentiment in the sector is very strong with more equity than product. We project that prime yields will tighten in 2014 with transactions demonstrating a focus on core university markets and current-generation specification.

Rental growth in September 2013 was positive but arguably relatively muted. We anticipate rental growth in 2014 will move to 2.75% in the regions and 3.0% in London.

We project that total investment returns will see a stabilising net effect as rental growth offsets yield compression.



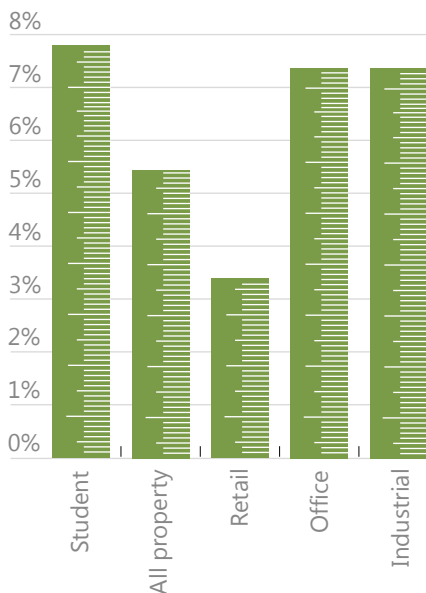
iQ Shoreditch – Internal Designer Naomi Cleaver

FORECAST

Total annual returns are projected to remain stable as the anticipated pick up in rental growth is likely to offset any yield compression that occurs over the next year.

2014 STUDENT PROPERTY

Figure 5
How assets compare
Total returns year to September 2013



Source: Knight Frank / IPD

13%

UK's market share of international students, up from 12.8% in 2006.

Source: OECD



INVESTMENT OVERVIEW

Total returns in the student accommodation sector have outperformed all other traditional asset classes.

The Knight Frank Student Property Index shows that total returns from student accommodation outperformed other property asset classes in the year to September. This has been the case since 2011.

The attraction of the student accommodation sector has been driven by the story of structural undersupply and positive rental growth every year throughout the economic downturn. We forecast this contra cyclical dynamic will remain the driving force behind investment into the medium term. The structural undersupply remains in all key university markets and this will ensure positive rental growth remains a defining characteristic.

The stability and performance combined with the improvement in profile of the sector have established student accommodation as an asset class in its own right.

Notwithstanding the positive sentiment in the sector, the first three quarters of 2013 were characterised by uncertainty following the collapse of the Opal Group. We believe 2014 will be characterised by growing investor confidence as the influx of equity from diverse sources drives a successful resolution.

Interest in the student property sector has been driven by an understanding of the structural imbalance combined with recognition that there are opportunities for adding value in the sector. Areas where new entrants are specifically looking to add value include "re-branding". There is an observation that the UK student accommodation sector falls behind the more sophisticated approach taken in both other sectors (such as hotels) and other regions (specifically the US).

In the hotel sector, brands such as Travelodge or Hilton target defined segments of the customer base. Hotel consumers have a very high level of brand recognition and understand which hotel operators cater for each price point. In the student accommodation sector, the brand segmentation is unsophisticated and the student accommodation brands have a very low level of recognition by students. The natural evolution for the

student accommodation sector is for an increasing trend to focus on 'brand' and 'market segmentation'.

New entrants to the sector are looking to import 'best-in-class' branding ideas and target specific market segments/user groups. The customer experience focus aligns closely with the target of achieving best total investment returns for the sector.

Consolidation of platforms will be a feature of the market over the next five years. The added value a strong brand delivers translates to occupancy and rents. The best national operator platforms will find stronger muscle in attracting students. This will feed through into economies of scale and total returns. This economic imperative will drive consolidation of the local/regional portfolios into the national portfolios operating under a single banner within a single stable.

Added value opportunities are also observed in upgrading specification. First and second generation schemes are marked out by their "institutional" grade decoration, lighting and arrangement. It is generally possible to transform the presentation of older stock by refurbishing and renewing. This work will often have a direct and disproportionately attractive benefit on rents.

There is a perception that the sector currently looks good value in absolute terms. Knight Frank is of the view that student accommodation direct-let yields look good value in the context of both historic UK levels and by reference to US yields. Many of the opportunities to secure stock are at price points below the current development viability point. The expectation of beneficial yield shifts yet to happen was a feature of purchaser sentiment in the final quarter of 2013.

FORECAST

Student property returns will continue to outstrip traditional asset classes with yield compression into 2014.

WINDOW OF OPPORTUNITY

A characteristic of 2013 was the rise of the university lease.

Universities willing to provide long term contractual guarantees on student accommodation have been able to derive three key benefits. Firstly, they can procure student accommodation to their own design and specification without having to directly fund construction. Secondly they can attract students with rents fixed at very low levels. Finally, universities are able to exercise an option at a peppercorn upon expiry of the lease to acquire the freehold interest of the accommodation.

Universities have been able to drive such deals because the institutions will pay handsomely for such leases. Institutions are attracted to such an arrangement largely because of the security of income flow underpinned by the covenant of the university. L&G became the market leaders in acquiring and securing such "income strip" deals in 2013.

We forecast that in 2014 an increasing volume of universities will take advantage of the benefits offered by income strip deals. Universities are gearing up to meet the

challenges of becoming globally competitive and the income strip deal currently provides exceptional benefits. However the **window of opportunity may not be open forever**. Such deals are driven by the coincidence of historically low bond rates combined with voracious institutional appetite for covenanted long-term income flows. When bond rates drift upwards (as they almost inevitably will) the attractive dynamic of the deal may shift away from universities closing the window of opportunity for them.

"HIGHER" EDUCATION

There has been an increasing trend for PBSA to be provided in landmark trophy buildings. The rising investor confidence in student accommodation (and Higher Education) has also been demonstrated in the height of student accommodation developments. This is true of both London and the regions. In figure 6 we have identified the tallest

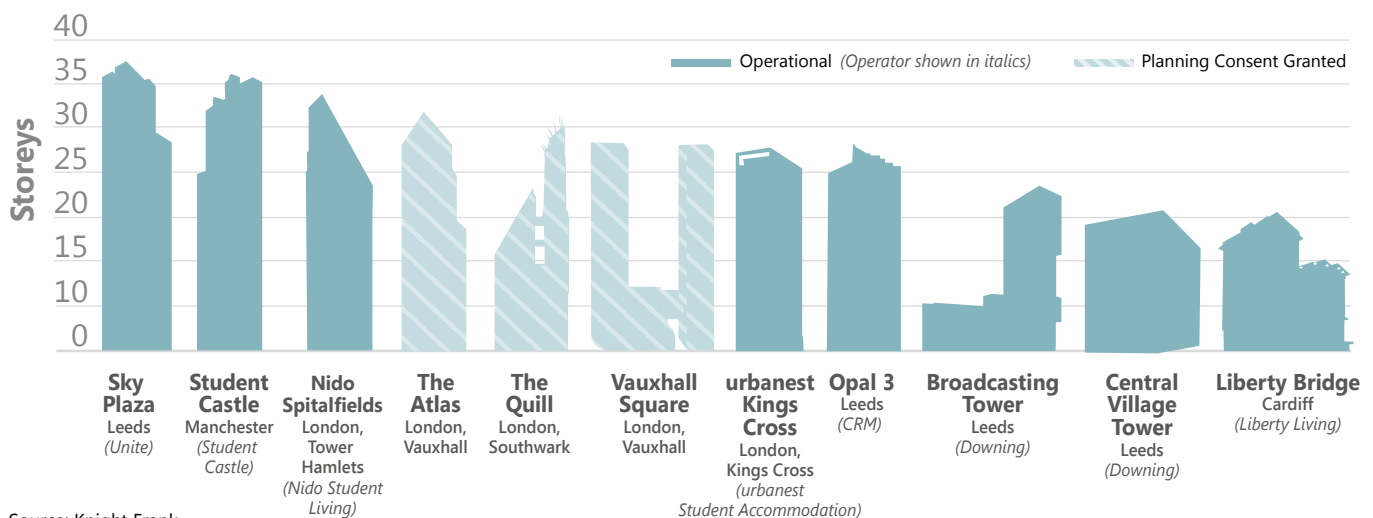
student accommodation buildings in the UK which demonstrate this increasing confidence.

London has three planning consents that are yet to be developed out in excess of 25 storeys. It is probable with the Community Infrastructure Levy (CIL) coming in that these will be the last tall tower developments of

student accommodation in London for the foreseeable future.

The tallest student accommodation schemes in the UK are the physical manifestation of investor support for the sector. Their elegant construction and iconic design demonstrate how mature this sector's investment market has become.

Figure 6
"Higher" Education – student accommodation rising by degrees Tall student towers in the UK – 20+ storeys



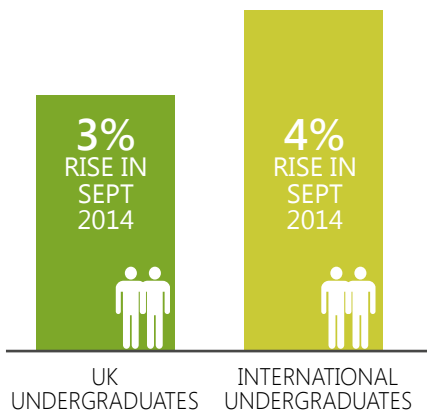
Source: Knight Frank

FORECAST

Rising investor confidence is demonstrated by the increasingly iconic nature of construction. Although occupiers and investors alike will pay a premium for such iconic buildings, we forecast that the Community Infrastructure Levy (CIL) will restrict further supply of such buildings in London.

FORECASTS

STUDENT NUMBERS



RENTAL GROWTH

2014/15 ACADEMIC YEAR



DIRECT LET YIELDS



Source: Knight Frank

KNIGHT FRANK STUDENT PROPERTY



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