INVESTOR ORIENTATION: PROPERTY OPPORTUNITIES ON CAMPUS

Global Property

March 2020

With the potential for long term growth prospects and a track record of resilience through economic downturns, this increasingly institutionalised property sector can be a defensive play for investors.

Educational institutions have traditionally provided students with access to accommodation on or near campus, but in recent years, student housing has increasingly been outsourced to third-party asset owners and operators.

As a result, we have seen student accommodation evolve into an in-demand sector by institutional investors and have witnessed rapid growth in sophisticated student housing assets that offer safe and affordable rooms with amenities tailored to the unique needs of students.

Global investment into student housing totalled more than US$17 billion in 2018, which is more than 4.2x the capital the sector attracted 10 years prior, according to Savills Research.

The vast majority of the capital invested into the sector is through direct, unlisted property, however, equity investors can still get exposure to student accommodation assets through a number of publicly traded REITs (Real Estate Investment Trusts). Major listed names in the sector include American Campus Communities (US), Unite Group (UK), GCP Student Living (UK), Xior Student Housing (EU) and Empiric Student Property (UK).*

Background: Coronavirus and its potential impacts on the listed student accommodation sector

The global outbreak of the Novel Coronavirus (COVID-19) is a public health and safety concern first and foremost, however, the virus also has significant implications for the outlook of the global economy. COVID-19 has already disrupted global supply chains, while causing a considerable protraction in international travel, tourism and retail foot traffic, and it has also resulted in the quarantining of workers and students. Clearly, none of these factors augur particularly well for economic growth.

In the US and the UK, where most listed student housing vehicles are concentrated, the long-term impact of COVID-19 on the student accommodation sector is expected to be relatively benign. In both markets, the current academic year is already well underway, having started before the widespread outbreak of the virus and the occupancy levels last reported by major student housing landlords were very strong.

Furthermore, as the next academic year doesn't commence until August/ September in these markets, there is no immediate cause for concern regarding the operating metrics of landlords in the sector. To date, major landlords have not reported any material impacts on reservations from international students for the upcoming academic year.

That said, given the level of uncertainty around the outbreak, there is a risk that international travel bans could persist long enough to materially impact international enrolments in the next academic year and beyond. There is also the threat of prolonged campus quarantines and shut-downs. The coalescence of both these factors does not bode particularly well for on-campus student populations, a key driver of student housing demand.

The University of Washington was the first major university in the US to temporarily shift classes entirely online for its 50,000 students until the end of the winter quarter and many others are now following suit in the US and globally.

Long-standing quarantines would clearly be a net negative for the occupancy rates experienced by student accommodation landlords for as long as they persist. However, notwithstanding the near term risks, over the medium to long term the virus is not expected to materially impact the favourable long term prospects of the sector.

In reality, there are few real estate sectors, if any, more well placed to withstand the potential knock-on effects of COVID-19 than student accommodation. In the event that our worst fears pan out, and the virus causes unemployment to rise substantially and wage growth consumer spending to decline materially, student accommodation is very well placed as a highly defensive sub-sector of a defensive asset class.

In this paper, we explore the factors that have made student accommodation a highly appealing sector for institutional capital, including a detailed examination of the sectors inherent resilience in periods of labour market deterioration and economic decline.

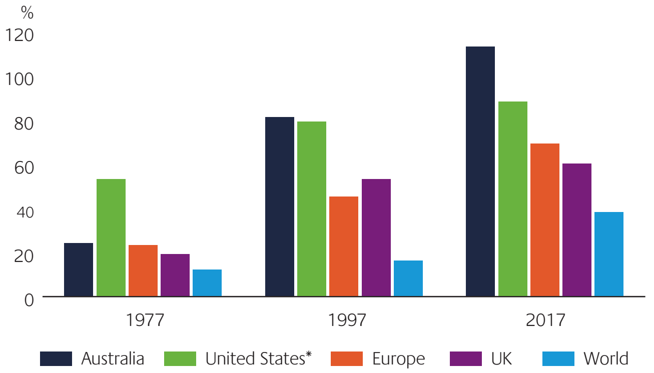
* For illustrative purposes only. Reference to the names of each company mentioned in this communication is merely for explaining the investment strategy, and should not be construed as investment advice or investment recommendation of those companies. Companies mentioned herein may or may not form part of the holdings of First State Investments.

The 'knowledge economy'

Participation rates in tertiary education have risen strongly in the last half-century as the world has shifted towards a 'knowledge economy', with higher education becoming increasingly necessary to achieve a high standard of living. This naturally benefits university enrolment numbers and therefore the amount of demand for student accommodation beds.

The following chart illustrates how the tertiary gross enrolment ratio (TGER) has changed over time globally and in key markets. The TGER is the ratio of total enrolment in tertiary education, regardless of age, expressed as a percentage of the total population of the five-year age group that officially corresponds to the tertiary level of education, that is, the five-year age group immediately succeeding the completion of secondary school.

Tertiary gross enrolment ratio by region



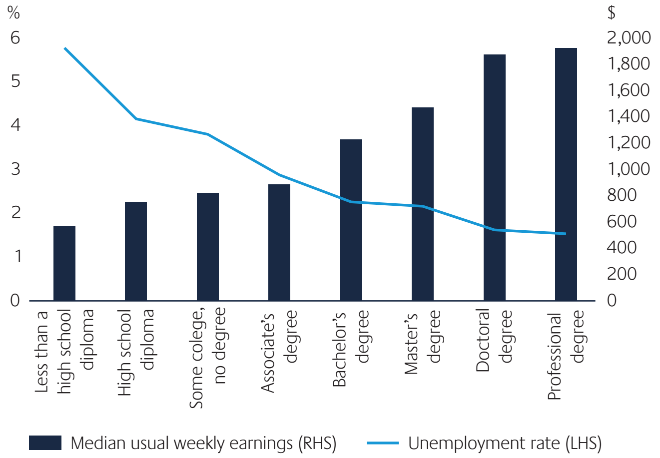
Source: World Bank, 2019. *The United States 1997 data point actually refers to 1996 as there is no data available for 1997 via World Bank.

Given these structural changes, it is unsurprising that university enrolment is strong in highly sought after markets. In Autumn of 2017, the United States had 19.8 million students enrolled in college (National Center for Education Statistics, 2019); the UK had 2.3 million tertiary students in 2017-18 (Higher Education Statistics Agency, 2019); and Australia had 1.6 million university enrolled students for the full year 2018 (Department of Education, 2019).

While overall enrolment has moderated in some regions from the peak levels achieved around the time of the Global Financial Crisis (GFC), there has still been consistent growth in the key sub-markets relevant to student housing landlords. In the US for example, the 4-year public universities segment has seen solid enrolment growth, recording a compound annual growth rate of +1.6% between 2010 and Autumn 2017 (National Center for Education Statistics 2018).

Furthermore, the value of a tertiary education remains intact, which is expected to support robust student numbers going forward. The following chart depicts how university graduates continue to enjoy vastly superior economic outcomes, earning higher median incomes while experiencing lower rates of unemployment on average.

Employment statistics by qualification level, United States of America

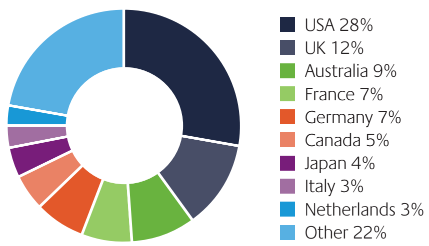


Source: Current Population Survey, U.S. Department of Labor, U.S. Bureau of Labor Statistics, 2019. Data is for persons aged 25 and over; earnings are for full-time wage and salary workers

According to the QS 2020 World University Rankings, 75% of the top 20 most highly rated universities are located in the US and the UK. Unsurprisingly, demand for places is strongest at these highly rated institutions. In fact, the top 10 British universities have grown their student numbers by 50,000 since 2012, accounting for 42% of all enrolment growth. Accordingly, property fundamentals are generally the strongest in the top tier university markets.

Rapidly rising international student mobility has also supported university enrolments in major markets, such as the US, UK and Australia, with international students representing a growing income stream for universities and a key market for student accommodation providers.

Place of study for international students

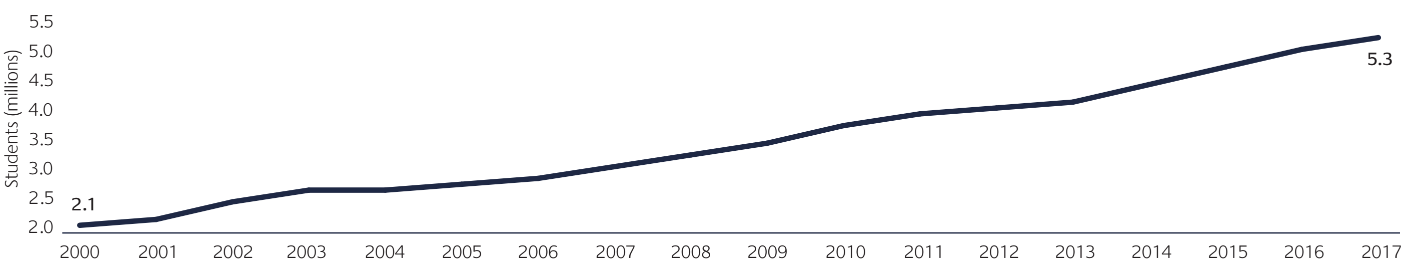


Source: Education at a Glance 2018, OECD (via Unite Group 2019 interim results presentation)

Governments are increasingly cognisant of how international study can benefit their domestic economies and have played a significant role, along with universities, in actively promoting themselves as destinations for international students, while working to reduce some of the barriers to international study.

This has seen the number of internationally mobile students grow to more than 5.3 million in 2017, reflecting an uplift of more than 150% since 2000 (UNESCO 2019).

Total outbound internationally mobile tertiary students studying abroad globally

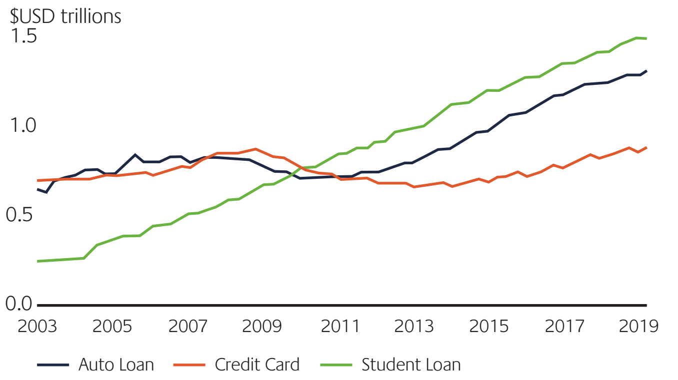


Source: UNSECO Institute for Statistics 2020

Growth in student credit

There has been rapid growth in student loan debt in recent years, which has in effect helped finance the growth of student accommodation as an asset class. Student debt has been the largest of three common categories of consumer debt in the USA since 2010 and has grown consistently for many years. Similar trends have been evident in other key markets.

US Consumer Debt Composition



Source: New York Fed Consumer Credit Panel, Equifax, 2019

The rising quantum of debt and rising rates of delinquency generates a lot of negative attention in the media and politics in the US and the UK particularly, with many questioning the affordability of higher education and the sustainability of enrolments.

There are certainly imperfections in both the American and British systems, with discourse often revolving around questions of whether students are charged a fair rate of interest; if loans are structured with fair and reasonable covenants; and whether certain groups of students are disproportionately burdened by student debt.

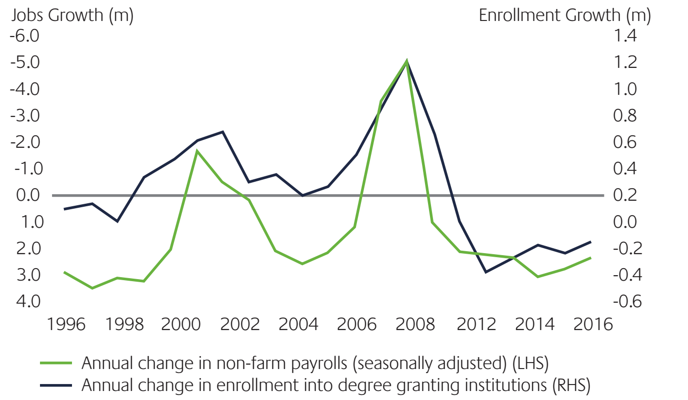
Nevertheless, the 'explosion' of student loans has also led to positive outcomes. Students that participate in tertiary education can monetise their knowledge when selling their 'services' to the benefit of the community at large, and as explored, university graduates enjoy far better economic outcomes on average.

It seems that student loan debt is a topic that fuels public angst, possibly based on the concept that young people are being saddled with hard to pay debt at a sensitive time of their life. The emotive nature of this observation is readily apparent.

A 'recession-proof' sector?

Some pundits have dubbed student accommodation a 'recession-proof' sector due to its resilience through the GFC. While it is both imprudent and arguably foolish to believe that any risky asset is without some level of downside risk, the sector has certainly demonstrated defensive characteristics over time. These characteristics reflect the strong inverse relationship between university enrolment growth and employment growth, as the following chart depicts.

US non-farm payrolls growth (inverted) vs US university enrolment growth



Source: US Bureau of Labor Statistics, National Center for Education Statistics, 2019.

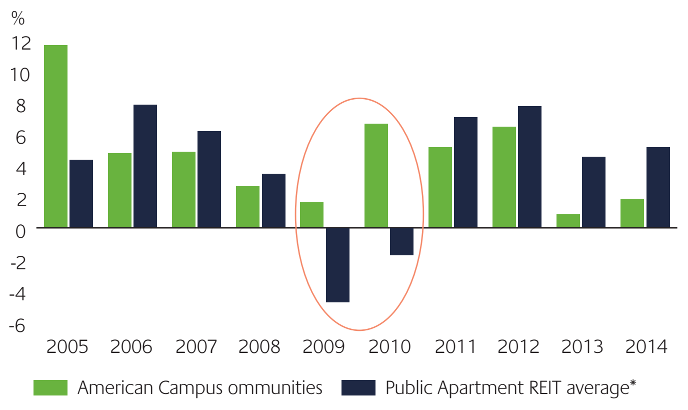
History shows us that in recessionary conditions, when the number of people in the workforce falls, university enrolment tends to rise, as people look to improve their prospects of finding work in a challenging labour market.

Therefore, in economic downturns, the demand for student accommodation should increase correspondingly with higher enrolments, thus, benefiting occupancy levels and same-store rental income, all other things equal. This is why the sector is typically seen as a desirable investment in times of economic uncertainty.

This through-the-cycle resilience has been on full display by the world's largest student housing REIT, American Campus Communities, which has generated same-store rental revenue growth and net operating income (NOI) growth in every year since its IPO in 2004, including during the GFC.

The following chart illustrates the resilience of American Campus Communities during and following the GFC, in comparison to public apartment REITs, which on average recorded negative earnings growth during 2009 and 2010.

Annual Same Store NOI Growth
American Campus Communities vs Public Apartment REITs



Source: American Campus Communities NAREIT Investor Presentation, November 2015

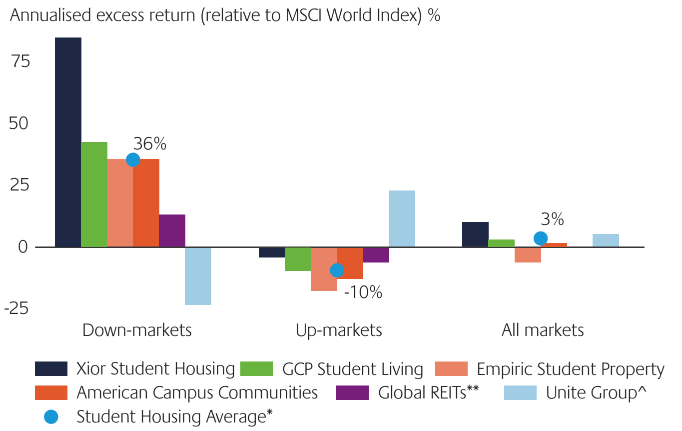
* Includes: UDR, ESS, MAA, AIV, EQR, AVB, CPT, and PPS.

Student accommodation as a defensive portfolio exposure

Since the rental income generated by student accommodation assets is reasonably resilient during economic downturns, when most companies typically struggle to grow their earnings, the performance of the sector has a relatively weak correlation with the wider equity market. As such, investments into student accommodation can provide portfolios with diversification benefits, helping to reduce overall downside risk.

The following chart illustrates how major listed student accommodation owners have performed in different market conditions in the last 15 years, relative to the broader equity market.

The relative performance of student accommodation REITs in different market conditions



Source: Factset, First Sentier Investors.

Past performance is no indication of future performance. Performance reflects total returns (including dividends) and is stated in local currency terms. All figures are annualised excess returns relative to the MSCI World Index. Up-markets refer to months when the MSCI World Index achieves a positive total return. Down-markets reflect the opposite. All markets reflects the overall annualised excess returns.

American Campus Communities and Unite Group calculations reflect data between December 2004 and December 2019; GCP Student Living calculations reflect data between June 2013 and December 2019; Empiric Student Property calculations reflect data between October 2014 and December 2019; and Xior Student Housing calculations reflect data between January 2016 and December 2019.

*Refers to the median outcome of the five REITs

**Refers to the FTSE EPRA NAREIT Developed Index

^ Unite Group only officially earned 'REIT' status on 1 January 2017.

It is evident that, on average, listed student accommodation owners have had a tendency to outperform equities significantly during down-markets, even more so than the broader listed property market, highlighting the appeal of student housing as a defensive exposure that can help to smooth portfolio expected returns irrespective of the forthcoming market conditions.

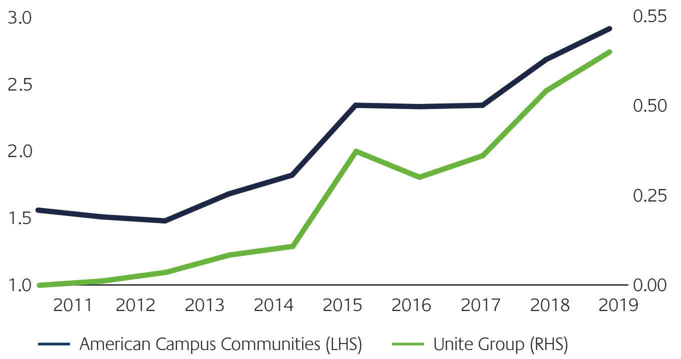
More than just a portfolio hedge

Despite its defensive characteristics, the student accommodation sector should not be pigeon-holed as a mere portfolio hedge. REITs in the sector are also able to generate attractive external growth through accretive acquisitions and development activity. This can provide investors with attractive FFO (funds from operations) / cash flow growth on an absolute and per share basis.

These improving cash flows tend to be largely redistributed back to shareholders through growing dividend payments, while remaining cash flows (i.e. retained earnings) are reinvested to cover operating costs and to fund growth opportunities.

In both instances, the total return (i.e. capital appreciation plus distribution payments) delivered to shareholders is typically bolstered by FFO/share growth.

Dividends per share



Source: FactSet.

All distribution per share metrics are expressed in Australian Dollar terms and reflect historical actuals.

The student accommodation sector has generally delivered strong returns to shareholders over time. As of 31 December 2019, Unite Group has delivered shareholders an annual average return of more than 15% p.a. since its inception in June 1999, including 61% in the 2019 calendar year, 25% p.a. in the last 5 years and 18% p.a. in the last decade. American Campus Communities has generated a total return of more than 11% p.a. since its inception in August 2004, including 18% during the 2019 calendar year, 7% p.a. in the last 5 years and 9% p.a. in the last decade.

The modernisation of student housing

As the sector matures, student accommodation developers are actively modernising obsolete housing stock such as residence halls on-campus and low-density residences off-campus, into modern, purpose built products with consumer driven amenities.

In the US, the shift towards purpose built student accommodation is being driven by the need for universities to upgrade their existing housing stock to remain competitive. At universities where American Campus Communities are positioned, the median age of on-campus housing stock is 52 years old.

New purpose built developments are increasingly being built as 'pedestrian to campus' properties, while offering an enhanced living and learning environment, as well as heightened privacy and security. In spite of this, new purpose built products are typically being offered to students at relatively attractive price points.

Purpose built student accommodation operators are also becoming increasingly sophisticated in their use of technology. Landlords are able to enhance the customer experience and offer 24/7 support via smart phone apps that enable students to connect with their flat mates before moving in, log maintenance requests, receive building updates and alerts, report noise issues, get help when locked out, access laundry services and more.

The modernisation of obsolete stock and ongoing product differentiation gives landlords substantial growth potential in the rapidly growing and highly fragmented student housing market.

Summary

The listed student accommodation sector has delivered shareholders excellent, through-the-cycle returns over the last 15 years.

We believe the flood of institutional capital into student housing is testament to the sector's resilient cash flow profile, the tendency of student housing landlords to outperform in bear markets, the attractive potential for external growth on offer to prudent asset owners, and the allure of tapping into the thematically appealing university sector.

The attractiveness of the university sector remains intact as graduates continue to enjoy superior outcomes on average, which is continuing to support robust student populations at highly regarded institutions.

This, combined with the increasing quality of product offerings through portfolio modernisation, enhanced location, improved building amenity and the increased adoption of technology, is leading to strong tenant demand for student accommodation assets, which we expect to continue into the future.