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Big Real-Estate Firms Are Going to School

Developers Test the Market for Off-Campus College Housing; Amenities Include Tanning Beds and Resort-Style Pools

By Dawn Wotapka

Housing for college students, long dominated by small players willing to put up with beer pong and raucous parties, is attracting some of the biggest names in real-estate development.

Lennar Corp., one of the nation's largest home builders, this month broke ground on its first off-campus apartment community near the University of Texas at Austin. Toll Brothers Inc., best known for its sprawling suburban homes, is purchasing land near the University of Maryland in College Park and Penn State University in State College, Pa., on which it plans to build upscale student housing. The two Toll Brothers projects, totaling about 3,100 beds, could open by 2015.

Brandywine Realty Trust, a real-estate investment trust that specializes in suburban office space and other real estate, recently teamed up with Campus Crest Communities Inc., to build a 33-story tower in Philadelphia that will serve students from several schools, including the University of Pennsylvania and Drexel University.

The moves are designed to help the companies better weather the next economic recession by diversifying into areas considered less sensitive to downturns. During the real-estate crash, as prices of single-family homes declined and apartment landlords reduced rent, many student-housing landlords continued to raise rent, thanks to the generosity of parents and student-loan programs.

Meanwhile, established players in the market are on a buying spree in hopes of remaining competitive against the big-name newcomers. Last year, a record $3.7 billion of student-housing properties traded hands, up nearly 95% from the previous year, according to ARA Student Housing.

"A lot of people think our space is hot," said J. Wesley Rogers, president of Landmark Properties, a longtime owner and developer with about 5,000 beds and 2,700 under construction. "You see a lot of new players circling the space right now."

The frenzy comes amid increasing debate about the skyrocketing cost of college tuition and the ease of borrowing that is leading many students to graduate with heavy debt loads. Also, the companies are ramping up construction at time when college-student enrollment has slipped, falling 1.8% in 2012 from 2011, according to the nonprofit National Student Clearinghouse Research Center.

But the companies maintain that over the long term, enrollment will continue to rise, especially at large state schools where much of the construction is taking place. And they believe that demographics support an expanding industry. More than three million high-school students are expected to graduate each year until the 2021-2022 academic year, according to the Department of Education, and many of them are expected to pursue higher education. At the same time, enrollment from foreign students remains robust.

Yet, most colleges and universities don't have enough beds to go around. American colleges are short a total of between 1.5 million and 2.15 million beds, according to research from consultant Michael Gallis & Associates. Moreover, many colleges and universities lack the funds needed to upgrade current dormitories or build new ones and are relying on the private sector to fill the gap.

"They just can't accommodate all these people. Some of them have just handed over all the reins altogether," said Will Baker, a senior vice president with Walker & Dunlop Inc., which financed $157.1 million of off-campus housing deals in 2012.

Still, some industry analysts question whether some newcomers to student housing understand the hidden risks and high costs associated with the business, which requires more maintenance and management oversight than typical apartment housing. Students are notoriously hard on housing and they are known to hop from property to property, leaving older properties more at risk of occupancy declines.

Each bed typically turns over annually, and a bed that is empty when school starts often remains empty for the entire semester. Operators also have to balance the demands of students straddling childhood and adulthood, educators and overprotective parents.

Toll Brothers says it likely will allow property managers familiar with the student-housing business to help. "The management is very important because you have three months to get these buildings leased up," said Martin Connor, Toll's chief financial officer. "You have a two-week turnover period, generally, where all your tenants move out and all your tenants move in."

There is growing concern of overbuilding in some markets. Construction numbers for individual cities are limited, but some 40,000 off-campus beds are in the pipeline for 2013, according to ARA. The firm tracks 71 projects under way, up from about 40 last year.

To entice students to pay top dollar, developers are adding upscale amenities including tanning beds, resort-style pools and ice-skating rinks. Today's developments give students their own bedroom and bathroom, allowing developers to charge more rent. Depending on the market and how many students share a unit, monthly rents can

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approach $1,000 per bed.

"As today's parents know as they drop their kids off at college, these are not the most inexpensive places you can find, like some of us may have experienced in our college days," said Mr. Connor, 48 years old. "They are high quality, in great locations and generate significant rent."

There are concerns that some companies might be adding capacity too quickly. American Campus Communities Inc., the nation's largest publicly held owner of student housing, which spent $1.8 billion on new beds last year, surprised industry watchers earlier this month when it reported that its student housing portfolio was 43.3% preleased as of February for the 2013 academic year that begins next fall, down from 46.4% at this time last year.

"There's still plenty of time in the leasing season," American Campus Chief Executive Bill Bayless pointed out.

While it is still early, analysts are monitoring the issue. Alexander Goldfarb, a REIT analyst with Sandler O'Neill + Partners, said he is confident American Campus will fill the beds before the new academic year begins. But "if we get another quarter and the gap is still pretty big, people may question if it's a macro issue."

Developers' heavy construction activity has prompted Freddie Mac, which purchases student-housing loans from lenders, to turn somewhat cautious. "You can't help but notice there's a lot of interest now going into that space," said John Cannon, head of multifamily sales at Freddie Mac, which purchased $1.7 billion in student-housing loans last year, up 55% from 2011.

"You want to be careful that the market's not overheating and you're not getting ahead of yourself," he said.

A big reason why companies are diversifying into student housing is that they believe the sector is recession-resistant.

Kayne Anderson Real Estate Advisors, a private-equity investor with 15,000 beds, posted annual returns that exceeded 20% between 2007 and 2012, despite the economic downturn. The firm isn't worried about oversupply.

"I don't think we're in a situation where you're looking at overdevelopment," said Al Rabil, managing partner of Kayne Anderson. "In almost all cases, you're looking at a situation where development is just catching up in creating supply to keep up with demand."

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