CAMPUS ADVANTAGE

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# How to Know When It's Time to Sell Your Student Housing Community

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The student housing sector has become a very popular asset class over the past several years. With comparatively recession-resistant characteristics[1], a historically steady rental stream buoyed by relatively high enrollment trends at four-year institutions[2], and tight on-campus housing supply, investing in off-campus student housing is now mainstream. *The New York Times* reported in February 2017 that capitalization rates — or the rates of return on investment — in the student housing sector typically run one-half to three-quarters of a percentage point higher than with traditional multifamily properties[3], making student housing an attractive segment for real estate investors.

As with all investments, knowing when to sell is key to maximizing returns on your student housing investment. In most cases, the investment strategy you set in your acquisition planning stage will dictate when you sell. For example, it would be unusual to sell an asset acquired to drive steady, long-term returns within a three- to four-year window. However, changes in business strategy, and most importantly, market conditions, can change the game plan[4]. In this paper, we explore the factors we've found to be the most important in knowing when to sell a student housing property, based on our decade-long experience. With investment return performance that has regularly exceeded both the NCREIF Property Index (NPI) and the PREA | IPD U.S. Property Fund Index over the past 10 years, we believe these strategies are a significant factor of our investment prowess at Campus Advantage.

So, how can you know with absolute certainty that a property is ready for sale? Unfortunately, there are no guarantees.

Determining when to dispose of a student housing asset is a time-intensive and complex process. However, at Campus Advantage, we believe three factors are critical to consistently identifying the right time to sell:

1. Staying true to your original investment thesis
2. Evaluating local market supply/demand fundamentals with a two- to three-year outlook
3. Completing annual reviews of financial performance

### 1. Staying True to Your Investment Thesis

A primary consideration in the sale of an asset should be the strategy or purpose for which the property was originally acquired as part of your portfolio. Was it purchased to turn the property around and increase its value for a near-term sale? Or for long-term cash flow? The answer to this


## SUMMARY

Know When to Hold 'Em, Know When to Fold 'Em

1. **Staying True to Your Investment Thesis**
2. **Evaluating Supply/Demand Fundamentals with a Two- to Three-Year Outlook**
3. **Completing Annual Reviews**

**Avoid Common Mistakes**

- **Holding on too long**
- **Getting greedy**
- **Not taking into account the optimal time to sell**


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question should drive initial hold vs. sell guidance.

If you purchased an undervalued property with a plan to renovate, for example, and have completed all of the planned capital infusion while achieving your projected rental increases related to the renovation, it may be an opportune time to sell. Alternatively, if you haven't completed all of your improvements, but you have achieved your revenue target and determined the incremental boost from completing the capital work does not provide an accretive return on investment, you may also want to sell and pitch an additional upside to the prospective buyer pool. In either case, if you've determined that you've maximized its value where only regular inflationary growth (rental rate growth of about 3%) is likely in the future, you can conclude that the best effort has been made to maximize the valuation of the property and it's likely an opportune time to sell.

Conversely, if your property's rents have increased by 10–15% and you still have opportunity to increase rental rate growth by some factor higher than inflation (say 4–5%) — along with no new upcoming supply pipeline and a stable university population — it is likely prudent to hold on to the asset for another year.

If you purchased an asset for steady, long-term returns, other than a wholesale change in capital markets or your investment partner deciding to reallocate capital to another asset type, the biggest factor affecting your annual hold/sell analysis should be whether your go-forward outlook for the asset is better than or worse than investment returns for similar or alternative investments. If the projected returns for the investment at your hold value are stable or increasing on a risk-adjusted basis to other similar investment opportunities, then you should hold. However, if your hold value is declining and there's more downside risk than upside potential on a go-forward basis, then it's likely time to sell. Projected returns are all about net operating income (NOI) growth and capital markets. You have some control over NOI growth and no control over capitalization rates and the cost of debt. Therefore, the clearest picture of the outlook deals with NOI growth, or whether your revenue will grow faster than your expenses. Putting considerations for effectively controlling expenses aside, your focus should be on how to effectively underwrite revenue growth as it relates to the short- to medium-term supply/demand fundamentals.

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## 2. Evaluating Supply/Demand Fundamentals with a Two- to Three-Year Outlook

While real estate investors know supply and demand is the name of the game in driving investment return, in the student housing industry, it's critical to maintain a two- to three-year outlook specific to each market in which you hold an asset. Understanding future supply is fundamental to any real estate investment opportunity. However, because of the unique nature of the fixed student housing leasing season, not getting in front of next year's supply additions can have a dramatic effect on revenue for a full 12 months, rather than the rolling effect typical for a conventional apartment or retail center investment.

Your supply-side evaluation should consider the pipeline of possible new student housing properties both on and off campus. On-campus housing plans can be derived from university planning documents, which are typically made available to the public. Your assessment should consider planned renovations in addition to net-new on-campus housing supply. Off-campus development plans can be tracked through conversations with local property managers and discussions with local planning officials, as well as through a subscription to services such as Axiometrics and CoStar.

It's important to project supply and demand two to three years out, doing your research not just on overall enrollment growth and new supply, but also changes in the student profile of the university. For example, consider shifts in student demographics, such as increasing rates of non-traditional students who are less likely to seek purpose-built student housing. Similarly, consider university-specific factors, like shifts to the university's student housing rules.

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While enrollment trends are on the rise nationally, many large state universities have capped enrollment or have paltry growth rates of less than 0.5%, such as the University of Texas (UT). At first glance, supply additions without any additional enrollment may seem like a recipe for disaster. However, it's possible that the university is focused on increased quality, not quantity, of students. For example, from 2012 to 2018, full-time enrollment at UT has been flat at approximately 48,000, while new supply of purpose-built beds increased by 4,023. During this time frame, the university focused on increasing student quality. The percentage of students from the top 10% of their graduating classes increased from 71.7% in 2012 to 74.4% in 2017. Perhaps even more importantly, the affluence of the student population increased, illustrated by a reduction of the percentage eligible for need-based aid (from 47.8% in fall 2012 to 39.9% in fall 2017). These higher-quality students have a tendency to demand, and the ability to afford, higher-quality housing, which explains the market's ability to absorb the additional 4,023 beds over the last five years with no enrollment growth.

That being said, there is a point where the market begins to soften because it cannot absorb additional supply. The total housing ratio tipping point seems to vary from market to market based on a variety of factors, such as affluence of students, depth of the non-purpose built or shadow market, ratio of local to non-local students, and more. Although we have not been able to pinpoint the exact total housing ratio tipping point, Campus Advantage questions the ability for a market to continue to absorb supply once the ratio of purpose-built beds, both on and off campus, exceeds 70% of the full-time enrollment.

### 3. Completing Annual Reviews

Campus Advantage completes an annual review of all assets following lease-up and move-in for the academic year coinciding with the annual revenue cycle. We look at occupancy, rental rates, and the progress of capital upgrades (if applicable), and conduct a high-level competitive analysis, as previously described in the supply-side evaluation. Because of the cyclical nature of student housing with a market's supply and demand fundamentals changing every fall, Campus Advantage believes conducting an annual review in the fall is the most appropriate.

### Avoid Common Mistakes

We see three common mistakes that lead to poor decisions in determining the right time to sell:

- **Holding on too long.** In holding student housing properties for three years or more, your investment should be suited for long-term capital growth. If a property is no longer experiencing significant rental rate growth, waiting longer than needed to sell the property will simply lose you money.
- **Getting greedy.** Often, there are unrealistic expectations around how much should be financially gained from selling a student housing property, or how much rental rates should increase over a given amount of time. Maintaining a realistic sense of property values and rental rates can help ensure you stay level-headed regarding the decision to sell.
- **Not taking into account the optimal time to sell.** When you are deciding whether or not to sell a property, the time of year should be a consideration. While it is not a good idea to hold onto a property too long, remembering tight student housing schedules will help you position your property at the ideal time. October/November is a risk-neutral time to sell[5]; because the lease-up season is complete, the concern of filling beds is removed. However, waiting too long after lease-up season means that buyers will have already moved on. While timing should never be the only factor when deciding whether or not to sell, it can aid investors that are on the fence in making the decision.

Ultimately, investing in student housing should result in wealth-building. Over time, your property should gain equity and provide you with income from cash flow and, hopefully, appreciation. Being mindful of your original investment strategy, tracking future supply/demand fundamentals, and completing annual reviews while avoiding common mistakes will help you properly evaluate and determine the best time to sell.

## THE CAMPUS ADVANTAGE TEAM

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Michael is charged with the execution of Investment Services for Campus Advantage. This entails the evaluation and analysis of potential investments — both real estate and corporate investments. Mr. Orsak supervises the processes of investment and acquisition, from consideration and evaluation, through underwriting, contract negotiations, and due diligence, to closing, including securing debt and equity.

# Case Study
## Acquiring and Selling The Marq

Campus Advantage has a well-established track record of creating value by turning around, stabilizing, and optimizing struggling assets. Our recent disposition of The Marq resulted in a significant increase in the property and community value, making the asset more profitable. Campus Advantage acquired The Marq in 2014 and successfully executed on its value-add investment strategy, infusing capital to cure deferred maintenance, as well as renovating common areas to provide students with amenities and services unequalled in the market. That, combined with an integrated marketing approach delivered by partner and industry specialist Catalyst, and the company's proven operations expertise, helped enhance the property's appeal in the market. After acquiring The Marq, Campus Advantage increased NOI by approximately 211%, or 23.8% compounded annually, within the first two years.

The decision to sell was made through a combination of forecasting a two- to three-year outlook and avoiding holding on for too long. We turned the property around very quickly, maximizing over 12 to 18 months. In the second year, we thought there was the possibility for about 5% rental rate growth, so we held it. However, in our third year, we saw that we were only at stable/inflationary rental rate growth. We also saw that the university was adding about 500 beds on campus, and that there was another 200-bed community that would open in 2018. With those factors, we thought it was likely we would only get about 2–3% rental rate growth in 2018, so we made the decision to sell a full academic year ahead in 2017, rather than wait to see the likely downward effects on value from the additional supply.

(1) Paula Poskon, founder, STOV Advisory Services, NAIOP's Development Magazine Spring 2017, "Why Investors Are Flocking to Student Housing"

(2) National Student Clearinghouse Research Center, "Current Term Enrollment Estimates – Spring 2017"

(3) Vivian Marino, *The New York Times*, "A Rush to Meet Rising Demand, and Expectations, for Student Housing"

(4) Joel Cone, Auction.com, "How Do You Know It's Time to Sell a Real Estate Investment Property?"

(5) Mallory Bulman, Multi-Housing News, "Buy, Sell or Hold? Student Housing Experts Share Their Strategies"