

RHB

RENTAL HOUSING BUSINESS

2014

STUDENT HOUSING

REPORT



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DEVELOPMENT

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2014 RHB STUDENT HOUSING REPORT

According to Statistics Canada, there were more than 1.2 million people pursuing an undergraduate degree in 2013, which included 898,400 full-time students. About half of these students need student housing. These numbers have increased year over year, and studies have shown that they will continue to rise. Many universities will provide a place of residence to first-year students who need accommodations during the school year. However, this is not always possible. According to a Canada Mortgage and Housing Corporation (CMHC) survey, only two-thirds of colleges and universities in Canada own student housing either on- or off-campus. Also, once students complete their first year of post-secondary education, they must find their own place to stay.

Student housing in Canada is a growing market, but it is at least 10 years behind the US with respect to its relative size and available offerings. In fact, the US has 10 times the number of student housing units on a per capita basis. According to CMHC research, most post-secondary institutions have very low vacancy rates, and some housing options are filled to capacity. Even though enrolment is increasing year to year, many post-secondary institutions have no immediate plans to increase the number of student housing units. This means that there is a lot of room for growth and opportunities for private developers and property managers.

The *2014 RHB Student Housing Report* serves to inform the Canadian rental housing industry on the most current and pertinent information fuelling this profitable and rewarding segment of the multi-unit

rental housing industry. This article will showcase the student housing industry and how it is undeveloped and underserved in Canada.

The *2014 RHB Student Housing Report* is divided into three sections:

- Section one covers development financing and property development of student housing. It discusses the different financing models for student housing properties, construction challenges tied to these types of buildings and issues to consider when upgrading or rehabilitating student housing.
- Section two covers the topics of student ownership and property management. It discusses the options associated with student housing from a student's perspective, and the issues and challenges involved in owning and managing student housing properties.
- Section three is a case study of The MARQ, the student housing management platform of Centurion Asset Management Inc. It examines The MARQ's approach to managing student housing and how Centurion works with developers to fund and build new student housing projects.

To evaluate and deliver the most pertinent and up-to-date market information for this report, *RHB Magazine* collaborated with Greg Romundt, Wayne Tuck and Steve Stewart from Centurion Asset Management Inc., the asset manager for Centurion Apartment REIT; Mark Humphreys from Humphreys & Partners Architects; Dario Battista from isure & Belpac Capri Insurance Brokers Ltd.; and Greg Spangler from Halsall Associates.



1 DEVELOPMENT FINANCING AND PROPERTY DEVELOPMENTS

Before putting shovel to ground to build student housing, you should answer a number of important questions:

- How much will it cost, and how long will it take to recoup your investment?
- How will you finance the development?
- Where will you build it?
- When will it be completed?
- What amenities are available in the area, and what do you need to provide?
- What factors should be considered when converting properties to student housing?

Development financing

Almost all property developers require some amount of financing to fund their construction projects, as there are significant expenses with building multi-unit properties. However, traditional lenders are not always comfortable with providing financing for certain asset classes in which they have little or no experience. Student housing typically falls into this category. As a result, developers must find other sources of financing to help with developing new properties or stabilizing existing assets.

One type of funding is mezzanine financing, where the developer will get additional financing to bridge the gap between what they have borrowed from a traditional lender and what they still need to complete the project. A traditional lender will typically provide maximum financing that equals 65% of the project's finished value or 75% of the total cost of the project. Mezzanine financing provides a portion of the remainder of the funding required to

Steve Stewart - Director Mortgage Investments, Centurion

complete the project, typically 85–90% of the project cost. Some deals include the right of first offer to purchase the project when completed, which gives the developer a ready buyer when the time comes to sell.

Developers can also choose to raise a higher level of financing through equity participation or equity co-investment, where the lender takes an equity position in the development, as well as a share of the profits, in exchange for construction financing. In this scenario, the financing firm typically provides a “promote” to the developer by taking a smaller equity interest than the percentage of equity provided. For example, in a project requiring \$1 million of equity, the financing company might provide 75% of the equity but only earn 50% profit participation, so the developer will still earn half the profits while only contributing 25% of the equity. However, the financing firm might require the full return of its capital before the developer’s equity contribution is paid out, which makes it a safer position for the financing partner. The contract can also include the right of first offer to purchase, which will typically lead to an arrangement to acquire the new building when development is complete.

“Developers might find that it is difficult to arrange financing for student housing projects, as there are a limited number of active conventional lenders,” said Steve Stewart, Director of Mortgage Investments, Centurion. “There are also a limited number of mezzanine and joint venture partners. Student housing is not broadly understood among traditional finance partners, as it is a relatively niche market. It’s important to form partnerships with firms that understand the space and its challenges.”

Property development

When it comes to real estate, everyone knows that location is one of the most important factors in determining property value; this is especially true with student housing. A building designed for student housing can have amenities and design features that would appeal to every student, but they won’t rent there if it’s too far from campus. There are a limited number of available and desirable sites near every campus, and there are many issues that can prevent a developer from purchasing or building on those properties.

Municipalities, residential communities and educational institutions can provide a number of roadblocks to building on the best sites. In some cases, there may be older housing stock around the university, and there could



Wayne Tuck - VP Operations, COO, Centurion

be pressure to preserve these buildings. Some people who live near the university also have a NIMBY attitude, and don’t want large student housing projects in or near their neighbourhoods. Municipal governments might prevent rezoning of properties, even when there is a demand for higher density around the university.

“The appetite for student housing varies across municipalities, and achieving the required rezoning can be difficult,” said Steve. “For example, we are aware of projects in the Guelph and Kingston markets where the municipality was strongly opposed to significant rezoning applications near the universities. In Waterloo, the municipality took the progressive approach of rezoning a large multi-block area near campus to allow extensive redevelopment of student housing.”

Every construction project is subject to deadline pressures. With a typical multi-residential apartment building, if the project is completed a month later, all you lose is a month of rent. However, timing is crucial when planning the construction of a student housing project. If your student housing project is not ready for the start of school year, you’ll lose a whole year of rental income. At the same time, you don’t want to complete a project too early, as it will sit around for several months not earning rent.

While student housing is a growing market, it should be noted that some neighbourhoods near colleges and universities are more built up than others. In some cases, there is too much supply to meet the demand, and some markets are nearing (or have reached) their saturation points. With more companies entering the sector and more student housing being built, it will become more



Renovated kitchen at The MARQ London – 75 Ann Street

difficult to fill a building at the desired rent levels. This can have a deleterious affect on the investment and ongoing rental income.

“There is a lot of buzz for the sector, and a lot of companies trying to get into this space,” said Greg Romundt, President, Centurion Asset Management Inc. “Some have a ‘build it and they will come’ mentality, but you cannot fix a bad location with a good building. Some sites will be developed that shouldn’t be, and that will result in bad investments.”

Upgrading and repurposing student housing

Repurposing multi-unit rental properties for student housing has its challenges. In addition to location, you must carefully consider the market and whether changes to existing floor plans will go far enough to meet the needs of today’s student renter. Despite the allure of higher revenues and margins, you have to calculate the current gap between multi-unit rental and student housing cap rates when assessing the economic viability of such a conversion.

Student housing owners must ensure that their rental properties meet current building codes when they engage in major renovations or there is a major change of occupancy. A major renovation would typically involve removal and reconstruction of building components, such as interior walls, floors or roofs. Any extensions or additions to the building would also need to comply with the current code. If a building is being converted from a multi-unit rental property to student housing, then there would be no change in major occupancy as long as the number of suites remains the same and the interior renovations are limited.

“However, any dividing of existing residential suites would constitute a change in occupancy,” said Greg Spangler, Project Principal, Halsall Associates. “A conversion from office to residential building would be an obvious change in occupancy. In some cases, the change of occupancy would trigger the need to install a sprinkler system.”

When contemplating major renovations, owners should consider five key areas:

- **Personal safety:** Light levels must be adequate in the parking garage, stairwells and corridors, and windows should have opening restrictors. Balcony guards should exceed minimum code requirements.
- **Fire safety:** Fire safety components, such as the fire alarm, signaling devices, sprinklers and fire extinguishers, need to be maintained and regularly inspected.
- **Durability:** Finishes must be durable to withstand the high occupancy and annual turnaround at these buildings.
- **Structure:** To minimize concrete deterioration (and potential safety risks from loose concrete), regularly inspect and maintain exposed structural components such as concrete balconies and parking garage slabs. Any loose concrete that could fall should be immediately removed.
- **Building envelope:** Water penetration into the building can lead to deterioration of concealed components and the development of mold. The building envelope must be designed to keep water away from the interior components. It must also be kept in a state of good repair.

Depending on the property’s age, owners might need to undertake cladding and roof repairs to address existing leaks or as preventative maintenance to avoid future leaks. Effectively coordinating completion of this work with the typical school cycle will allow the owner to schedule the work during times of lower occupancy, such as the summer, rather than being forced to complete emergency repairs during less ideal times.

“With all residential properties, timing of work is important, but with student housing, it’s critical,” said Greg Spangler. “It’s important to minimize the amount of construction and obstructions during peak move-in and move-out seasons. And noisy work should be scheduled outside of peak study periods.”



2 STUDENT OWNERSHIP AND PROPERTY MANAGEMENT

If you're going to get into the business of managing student housing, then you need to answer the following questions:

- What are students looking for in a rental property?
- What do you need to do to adequately service their needs?
- What amenities should you provide in your student housing property?
- How is managing student housing different than other rental properties?
- What type of insurance is required for student housing?

What's available for students?

In the past, students might have had to rent a room or basement apartment on their own, or get together with friends to rent an apartment or house. If they were lucky, they might have been able to get into a house or apartment that was converted into student housing, or an older building run by a sole proprietor. Even though first-year students often have the option of staying in school-provided dormitories or other accommodations, they might not want to pursue that option for the fear of living with strangers.

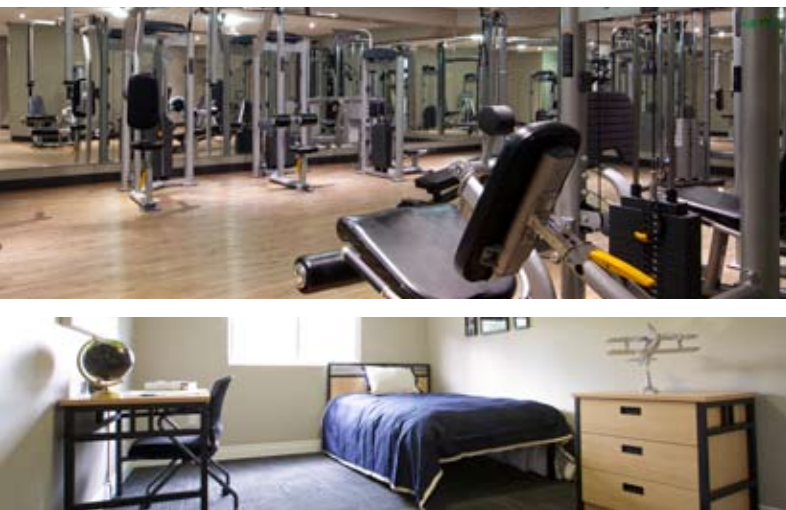
Today's college and university students have many housing options available to them, including renting a unit in purpose-built student housing. These properties are very similar to apartment buildings, but they are aimed at housing students. The buildings are typically located on or near college and university campuses, and are often part of a larger community of student residences. Student housing is designed with the students' interests in mind, and includes amenities geared to them, such as access to public transportation, study rooms, exercise and entertainment areas, Wi-Fi, staffing and security.

"Student housing provides college and university students with a better campus living experience because it is as much about the social experience as it is about

the accommodations,” said Greg Romundt. “Parents also know that their children will be living in a safer environment, as student housing offers professional property management, security features and more.”

Layouts, amenities and trends

Buildings designed specifically for student housing have different layouts and amenities than most apartment buildings. One key difference is the bed-bath ratio. A typical two- or three-bedroom rental unit might have one or two bathrooms. However, a newer student housing unit would likely be built with one bathroom for every bedroom to achieve bed-bath parity, and some units could include five bedrooms. Kitchens are typically smaller and designed to be used by more people than would occur in an apartment unit.



“Student housing units tend to have smaller bedrooms, so the cost per unit is lower compared to a typical apartment unit based on bedroom sizes,” said Greg Romundt. “However, student housing buildings will also have more amenity-focused spaces, such as movie theatres, soundproof music rooms, gyms, games rooms and lounges, study and meeting rooms. They also have less available parking per unit, so there is less space allocated for vehicles in student housing.”

There is a growing trend to provide more upscale student housing options with more available amenities. Units are becoming more lavish, with higher end finishes in kitchens and bathrooms, granite countertops, hardwood floors and other features. Bed-bath parity is becoming practically mandatory, as well as bike storage, fully wired or wireless buildings, attractive landscaping and more. Some property

managers will also provide students with free bus passes or free shuttle buses to make it easier for them to get around.

“Student housing is obviously different than typical rental housing because you are leasing to 18- to 25-year-olds, and this is their first apartment,” said Mark Humphreys, Chief Executive Officer, Humphreys & Partners Architects. “They want high-speed Internet, to be close to campus and a good price. Room sizing is also very important and how bathrooms are arranged, but one of the most important things is that they want a cool, hip place with loads of amenities.”

Property management

Different types of rental properties create a range of issues for property owners and managers. Multi-unit residential apartment buildings typically offer one-year leases and experience relatively low turnover rates on a year-over-year



basis. Hotels are at the other end of the spectrum, as the rooms turn over nearly completely on a day-to-day basis. Student housing has a turnover rate of about 50% per year, and the average student will rent their unit for one to three years.

A key challenge in managing student housing involves dealing with move-ins and move-outs. Most properties have two very busy time periods: the mass move-ins and outs in April and September. These periods will challenge the logistics and efficiency of any property management firm, as managers have to coordinate large groups of tenants moving in and out at the same time. Consequently, marketing and leasing both operate on seasonal cycles, and are tied to the schools’ academic calendars.

“Managing the leasing cycle is another significant challenge,” said Greg Romundt. “When managing a



On call at The MARQ London

typical apartment building, after someone moves out, you can follow standard marketing procedures to attract new tenants and avoid missing out on too much rent. When you don't fill a unit in student housing, it can equate to a full or partial year of lost rent. It takes effort and coordination to ensure that units are ready to be filled by tenants."

Property management firms in the student housing space must juggle a number of priorities to ensure that their properties are filled. They must work with colleges and universities so that they can make students aware of their housing options, such as during tabling events at universities and colleges where they can promote their particular product. While student housing firms must deal with students, they also have to appeal to the parents, who are responsible for validating their children's housing option choice.

"In a typical rental property with 250 units, you'll have 250 clients," said Mark. "When you have 250 student units, you might have 750 beds or 750 clients, each with two parents, so you have to deal with 2,250 clients."

Property management also involves people management. This means that property managers must learn how to address a wide range of issues, from handling tenants' repair requests to dealing with problem tenants. Most tenants are experienced renters, and they know what to expect from rental living. They also tend to view their rental units like their homes, and other tenants as their neighbours.

Student housing is a very different challenge for property managers. Many students are living away from home for the first time, and they might not have much experience with living in a rental property. They must learn to co-exist with virtual strangers in a relatively small living space. People and personalities can conflict, and that

can lead to difficult situations, which can have an impact on the property. Also, students are often living in their first real home away from home, so it becomes a learning experience for everyone involved.

"Generally, the students are respectful, but as a property manager, you have to work with them to ensure that they recognize they are living in a communal environment, cohabitating with many others who are looking to balance their studies and an active social life," said Wayne Tuck, Vice President of Operations and COO, Centurion. "You also need to keep a close eye on the building and units, so typically you will conduct unit and common area inspections more frequently than in apartment buildings."

What about insurance?

It should be noted that typical renters tend to treat their rental properties as their primary residence; they often personalize and form an attachment to their space. However, student tenants know that their rental accommodations are temporary, and will sometimes treat it as such. This can increase the property owner's liability exposure. Insurance geared toward rental properties can provide sufficient coverage for student housing. The challenge for owners is that some insurance companies and brokers are not as familiar with the student housing industry. As a result, they might charge higher insurance rates than normal or offer reduced coverage, and some will even refuse to insure this sector.

Student housing owners should first find a broker who understands the sector and its needs. They should also understand the types of insurance required for these types of rental properties. When purchasing insurance, owners should determine whether the coverage is broad form or includes named perils. The policy should cover issues typical for rental properties, including boiler and machinery breakdowns, sewer backup and rental income, as well as adequate building and liability limits. It is also helpful to deal with an insurance company that provides risk management services.

"Student rental housing market is very much misunderstood by many brokers and insurers," said Dario Batista, President, Isure & Belpac Insurance Brokers Ltd. "Insurance products can be customized to meet the needs of student housing. High quality coverage can be found through a brokerage that understands student housing and that has relationships with insurers prepared to offer proper coverage."



The birth of The MARQ

Centurion owns and manages about 2,000 student housing units, and has been operating in this space for a number of years. Centurion determined that the student housing industry was relatively undeveloped and underserved in Canada, and there were significant opportunities for growth. It believed that it could leverage its multi-residential rental housing experience to provide institutional-grade asset and property management services to a marketplace filled with smaller players. At the same time, students would benefit from Centurion's combination of multi-residential management experience, systems and services.

Centurion engaged a brand development consultant in 2013 to help it develop its student housing platform. The goal was to first identify its customers' needs, which involved talking to college and university administrators and personnel, as well as students and their parents. Centurion also wanted to engage a variety of stakeholders in the student housing industry to determine where people thought that it was going. The company launched The MARQ brand in early 2014, and rebranded several of its properties and units to spread its message. It currently manages six properties in London and Waterloo, and will continue to expand across the growing student housing portfolio.

"The MARQ's key message is to make its student living options the centre of its residents' overall university experience," said Wayne. "It aims to do so by providing a safe, clean and secure living environment with modern décor and amenities in a convenient location, where it's all about an authentic university experience."

When Centurion first entered the student housing market, it worked with third-party property managers to learn best practices for managing these types of properties. Centurion had a lot of experience with managing multi-residential rental properties, but it wanted to learn how to apply this knowledge to student housing. Management believed that it could bring its background as an institutional-grade property manager to the student housing space and raise the overall level of professionalism and service offering. For example, The MARQ employs a higher staffing complement than typical rental properties, which includes a dedicated on-site housing manager to provide operations oversight and a touch point for residents and parents, dedicated administrators to handle typical rental transactions, and a maintenance team to respond to resident requests and generally take care of the property.

The MARQ takes a sophisticated approach to marketing, developing specific tactics and campaigns within a broader strategy to engage the students, their parents and the university at every level possible. Comprehensive market data analysis, social media touch points, athletic and academic sponsorships, and special events play a big part in helping to get the message across.

"We leveraged our extensive experience in typical property operations, and incorporated what we had learned about student housing," said Wayne. "We are committed to this space and are comfortable that The MARQ can provide property management services to other student housing developments. Our aim is to be recognized as industry leaders in the provision of these

very specialized management services, and to improve overall standards in the student housing industry.”

Growing the portfolio

Centurion has been involved in many different student housing projects, ranging in size from 25 units (75 beds) to 100 units (489 beds). It has focused on markets outside the Greater Toronto Area, such as Montreal, Waterloo and London. Centurion is currently involved in financing several building projects in Waterloo and London, with about 1,500 units in development, and is also looking into opportunities in Toronto, Guelph, Hamilton, Barrie and Kingston, as well as in other provinces.

said Steve. “The bank loaned the developer 75 per cent of cost, we financed 10 per cent of cost and the developer covered the remainder primarily through unencumbered land value.”

As for The MARQ, apart from additional management opportunities in its growing portfolio and its developers, Centurion is actively pursuing third-party management contracts for student housing developments where it sees there is a strategic fit, and the goals of owners are aligned with its own philosophy and approach under The MARQ brand.



Wayne Tuck, VP Operations, COO, Centurion / The MARQ and Romina Talarico, Housing Manager of The MARQ Waterloo in a renovated unit at 173 King St. N

“The brand is off to a good start,” said Greg Romundt. “The properties operating as The MARQ in London and Waterloo are not only full for the Fall 2014 cycle, they are also capturing more than their fair share of the market.”

The key path to growth involves providing construction financing to student housing developers. It plans to achieve this in different ways. In most cases, the company provides either mezzanine financing or equity co-investment, and it will include the first right of offer to purchase the completed project if and when the developer wants to sell the property. Centurion also provides bridge financing in cases where there is a short-term repayment gap between the level of interim construction financing in place as construction finishes and the level of available takeout financing available after initial lease stabilization.

“In one instance, we provided a developer with mezzanine financing for a high-rise student residence,”

“We hope to grow the brand, in support of our overall marketing efforts at the property level,” said Wayne. “We want people to identify with The MARQ, and recognize that it is all about that authentic university experience, where students can find that safe, comfortable environment where everyone can learn, socialize and grow. At the same time, we create a situation where owners can realize a real value-add.”

Conclusion

Student housing is a relatively small but growing niche in Canada, and it is at least a decade behind the US in terms of offerings and options for students. While there are many challenges for new property managers entering the market, there are also numerous opportunities for growth. Finding the right location is the first major step, but it is also important to provide students with the appropriate amenities and to tailor your property management approach to this particular demographic. ■