VALUE-ADD INVESTMENTS GENERATING STRONG RETURNS

Repositioned and managed correctly, student-housing value-add deals can deliver big yields for owners and operators.

By Susan Fishman

Away from the headlines about sparkling amenity-rich new developments exists a different student housing landscape offering equally compelling returns and no more, and often less risk — value-add repositioning plays. Value-add players seek to find well-located properties at schools exhibiting enrollment growth but that carry below-market rents due to any number of factors. The reasons why these assets are set up for turnarounds? It could be operational flaws, mis-management, a bad reputation in the market or competitive challenges from other product. If not handled correctly, issues like competition from newer properties, overcoming reputation and asset repositioning can waylay any turnaround, but if they can be overcome and a student-life element can be introduced into the property, value-add investments can yield very strong returns.

Strong Asset

When it comes to student housing value-add, there are certain elements that make a strong investment. Like most players in the segment, Columbus Pacific Properties, which owns nearly 6,000 beds, looks for universities with enrollment growth.

"We also seek out properties where rents can be increased either through capital improvements, improved management, or as a result of the fact that they are below market," says President Brian Shirken.

Dorothy Jackman, managing director of the National Student Housing Group at Colliers International, says any asset close to campus that can either be repositioned into student housing or occupied by at least 50 percent students in a growing university market is a good investment.

"Many companies are incorporating a value-add component to their investment strategies as, in most cases, the yield can be greater than a traditional acquisition of a stabilized asset," says Jackman.

Investors are interested in both large and smaller scale value-add plays, she adds.

"It seems investors used to just focus on the major value-add play with significant improvements and repositioning, whereas now, investors are viewing a value-add play that could require a much smaller infusion of capital with a smaller amount of upside. We've seen value-add players also introduce their modifications in stages, as opposed to investing huge dollars right away."

Human Capital

Anyone can invest in a value-add play, says Andrew Stark, CEO of Campus Evolution Villages. What distinguishes the successful players from the unsuccessful is in how they operate their properties. The strategic advantage is in assets owned and managed by others who were not experts in the field.

"In student housing, it's a reputational issue that you usually have to overcome when buying a value-add," he notes. "It's the re-building of staff and of reputation in the market, together with putting dollars in and making some good improvements."

Campus Evolution typically takes under-managed properties and brings value through the human side of the sector, according to Stark. A year ago, the company took over a property that was zero percent pre-leased. After investing roughly $2 million, the property is now leading the market at more than 30 percent pre-leased this year.

The success, Stark points out, was not so much in the physical improvements as it was in the human touch. One resident tweeted that it was his 18th birthday and he just signed the first lease of his life with Campus Evolution. So the company went out, bought him a cake and delivered it to his dorm room. The student then posted the gesture on social media.

"I couldn't pay for the kind of advertising we got," says Stark. "We did something right, and they recognized it. At the same time, when we do something wrong and read about it, we knock on the door to find out how we can do better."

Shirken agrees that technology is the central communication mechanism when it comes to value-add. But the best way to communicate, he says, is by performance — upgrading the units, amenities, programming, transportation, service. Communication only supplements the execution.

"Students are skeptical; they don't often believe what you tell them, only what you show them," he notes. "So the best way to communicate it is to do it. Have students experience it and then communicate it to other students."

Columbus Pacific currently owns 2,414 student housing units in Ohio, Arizona and Texas. The company typically looks for larger properties, priced between $10 million and $100 million, with greater than 600 beds in primary, secondary or tertiary markets. It chooses properties located near nationally recognized universities with enrollment growth; and properties with opportunities to implement value-add programs including exterior and interior renovations and development of new amenities, incorporating professional property management and property re-branding.

In 2013, the company acquired River Park, a 700-bed property in Athens, Ohio. The asset had been managed by an owner whose primarily business was conventional multifamily. The previous owner had not committed a lot of resources to managing and servicing student-residents, or enhancing the student life experience, Shirken says.

For just under $1 million, Columbus Pacific added a pool, a new fitness center, a new rec room and a new computer center, and re-oriented the staffing toward providing service. The company also enhanced all of the common areas and moved the property away from short-term leases toward 12-month leases exclusively.

The improvements were completed by lease-up for 2013-2014, and the property is now at 98 percent occupancy with increased rents.

Another recent takeover was University Village at Ohio State University, an 1,800-bed property that had been owned by the same group for 30 years. The property had focused primarily on maintaining 100 percent occupancy and had been extremely well maintained, says Shirken.

"We observed that the rental structure was below market given that the focus had been occupancy over maximizing rent," he notes. "We saw a lot of historical rent discounts and leases that were less than 12 months."

Columbus Pacific focused on upgrading the student life experience, starting with transportation (the property is a mile and a half from campus, and most of the complaints had related to the inadequacy of transportation). The company added buses to the transportation system and upgraded the quality and frequency of the buses. It also significantly increased programming at the property to compete with all of the on-campus activities, with weekly events like tailgate parties, pool parties, and outings to local attractions.

The overall investment at Ohio State was also just under $1 million with an increase in annual revenue in excess of the capital investment.

Wow Factor

Vesper Holdings, a New York City-based real estate investment firm with a primary focus on student housing and conventional multifamily, has created a repositioning brand called Campus Life & Style (CLS) for value-add opportunities. The company transforms average properties into something “cool, hip and now,” with a design that’s ultra-modern, sleek and white with stark colors.

“We describe it as ‘Soho meets South Beach’,” says Elliot Tamir, co-founder and co-CEO of Vesper Holdings.

Vesper buys Class A, B and C properties that feel aged, outdated or stale, and invests anywhere from $400,000 to $5 million, depending on the amount of rehab needed. The repositioning includes a take on the boutique hotel, offering reception and concierge service, as well as resort-style amenities, including a pool area with luxury furniture, lounge cushions and covers with the property logo, and towel and lotion service.

“We will completely renovate the clubhouse, add amenities if necessary and create a design that is guaranteed to be different from what any other operator is doing in this niche business,” Tamir says. “A tremendous amount of detail goes into every space to really create a wow factor.”

In August of 2011, Vesper Holdings purchased Woodland Mews, a 233-unit, 506-bed apartment community located in Ann Arbor Mich., serving The University of Michigan. The property has 307,000 rentable square feet consisting of 117 large townhomes and 116 apartment-style units, a clubhouse, swimming pool, a private lake and walking trails. The property was 60 percent occupied and in disrepair at the time Vesper took possession.

Vesper Holdings acquired Woodland Mews near the University of Michigan in 2011. A redesigned club house and increased amenities are a few ways the company is adding value to the property.

Vesper hired Angelini Architects and renowned New York City interior designer Jon Call for the repositioning, which included modernizing the units with kitchens, flooring and appliances, completely remodeling the clubhouse and amenities, replacing the vinyl siding throughout the property, installing new signage, improving the landscaping, and repaving the driveway and parking areas.

Vesper connected the main level of the clubhouse to the lower level giving residents access to the fitness center, the spa and the pool area from within the clubhouse. A hotel concierge-style reception desk was installed, and the current kitchen in the clubhouse was transformed into a modern "lobby bar" that also acts as a functioning kitchen for resident events (with all appliances hidden from view). The bar contains an authentic Starbucks Coffee machine serving complimentary coffee to all residents each day. The main lounging area in the clubhouse was converted into a grand social lounge featuring a white grand piano, a new marble fireplace overlooking the resort-style pool and lake, and a 70-inch flat-screen TV above the fireplace. Finishes included Callacuta Gold Marble, white glass flooring, high-gloss lacquer cabinetry and ultra-modern, high-end furniture.

Vesper also created a modern, state-of-the-art business center with high-speed Internet, Wi-Fi, iMac and Sony Vaio Computers, as well as a color printer complimentary to residents, and built a new and enlarged, 24-hour, state-of-the-art fitness center and yoga studio. The resort-style pool area was enlarged with an all new pool deck and new modern pool furniture including wicker lounges with white cushions and cushion covers with the Woodland Mews logo, day beds and Vesper's signature red umbrellas. In addition, all residents receive complimentary towel and lotion service daily.

The $2 million renovation was completed in less than 12 months on time and within budget. The property leased up to 100 percent occupancy in 2012 and has remained at that level since. The renewal rate is 65 percent, and by January 2014 the property was almost fully pre-leased for the fall.

Another CLS property is Encore at Sam Houston State University in Huntsville, Texas. Vesper took over the 132-unit property, featuring all four-bedroom units, at occupancy below 90 percent, and completely redesigned the clubhouse, layout and amenities in similar "South Beach meets Soho style." The property now features a gaming center and lounge, a complimentary Starbucks lounge (offered in all CLS properties), a lobby bar with complete functioning kitchen, a study lounge and a gym with expensive, ultra high-sheen, rubber flooring. The overall investment was just under $1 million.

Key Considerations

While amenities like high-gloss lacquer cabinetry and top-of-the-line flooring can create an impressive space, they also require considerable upkeep (the rubber gym flooring needs to be buffed once a month), a challenge in the world of student housing.

"When you do the best, and create this modern, unbelievable look, it's very hard to keep it clean," Tamir notes. "But when it's clean, there's nothing nicer, so upkeep is key."

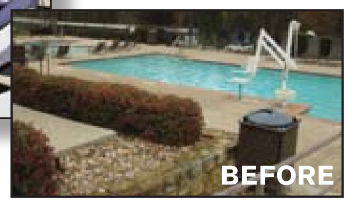
Other challenges include balancing the repositioning and leasing in the midst of construction, and delivering your product on time, says Tamir.

"You want to make sure to deliver your product on time because come September 1st, the leasing season is over. You have to have a good team, make sure your architectural plans are complete (you know what you want), and stay on top of everybody."

A sound rate structure is also key.

"If you overshoot your rates, that's a problem," says Tamir. "When you're repositioning the property and you set new rates, you could be off."

Encore, near Sam Houston State University in Huntsville, Texas, was repositioned by Vesper Holdings. The company added $1 million in upgrades to the property.



Stiff Competition

It's widely noted that, when it comes to value-add, the competition will always be new development. Students tend to flock to new development just because it's new, notes Shirken.

Location play is a big factor in remaining competitive. The best investments are well-located assets where there's an opportunity to add some amenities, reposition the management, and get in at a lower basis than the newer product that's being built, says Troy Manson, managing director of HFF, one of the largest intermediaries in the sector.

"In all likelihood, you're not going to achieve the rents that the newest properties in the market are commanding, but it's a comfortable spot to be in from a basis perspective."

In 2011, HFF completed student housing investment sales, debt placement and structured finance transactions at 25 universities across 16 states, totaling over $750 million. In the last year, the company did more than $1 billion in student housing deals, selling value-add to core product.

A recent deal for the company was Terrace View Apartments in Blacksburg, Va. The property was in good shape with limited deferred maintenance but had not been updated in many years. The previous owner, a joint venture between Iconic Development and Wheelock Street Capital, made significant upgrades, including a new clubhouse and fitness center, and added a disc golf course, a 28-person hot tub and a community garden. Other upgrades were added to units including faux hardwood floors, granite countertops, new appliances, refinished bathrooms and replaced fixtures. The overall investment was approximately $10,000 per unit, and ownership has raised rents approximately 20 percent on renovated units.

To remain competitive in the market, Jackman says buyers must purchase an asset at below replacement value and at a price point that allows for a return on their capital infusion.

Some companies even seek out value-add opportunities exclusively, adds Manson. It's an area where some private buyers with higher cost of capital can achieve their targeted returns and not have to compete with some of the larger institutional buyers on Class A properties.

"That's not to say these are the only types of properties that these groups are able to buy, it's just where they're able to leverage their strength in terms of what they feel is superior management or is a targeted value-add rehab program where they see untapped potential within an asset," says Manson. **SHB**