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Today's college student housing makes the grade

Less than 10 years ago multifamily properties leased largely to college students were considered by most permanent lenders to be less desirable than conventionally leased apartment projects. These concerns were not unfounded as many student oriented projects tended to be older and less well maintained than others in the marketplace. In addition, lease terms were often for the academic year which left projects with 100% turnover in June and no income stream for three months. As a result, when financing was available it often came from higher-risk lenders.

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Several trends developed over the past 10 years that made projects leased by undergraduates much more attractive to Fannie Mae and other mainstream long-term lenders:

1.) The number of undergraduates in American colleges and universities is growing;

2.) Many state universities have functionally obsolete dormitories and on-campus apartments dating from the 1950s, 1960s and 1970s;

3.) Fiscal constraints prohibit many state universities from developing new housing and new academic facilities simultaneously. Many universities prefer to build a new science center or renovate a business school than construct new dormitories;

4.) Some universities want to exit the non-core business of housing management and focus on the core business of academic excellence;

5.) Rising student expectations regarding privacy, security, amenities and convenience can put universities without modern housing options at a competitive disadvantage;

6.) The entry of first-tier developers into student housing brought excellence of design and architecture, extensive amenity packages, 12-month by-the-bed lease structures, professional management and a level of standardization to a highly fragmented market.

Prior to the kick-off of the Dedicated Student Housing Program in the late 1990s, Fannie Mae viewed properties with student occupancy in excess of 20% as having a higher risk profile than conventional multifamily projects. Combined with more conservative underwriting, Fannie Mae would not recognize the premium income generated by renting to students. For example, if a two-bedroom apartment had a monthly market rent of $500 but two students were charged monthly rent of $300 each ($600 in total), the premium of $100 per month was not recognized or underwritten. For a 200-unit project, this $100 per month per unit totals $240,000 per year in unrecognized income – income that fell directly to the bottom line. In addition, as many lease terms were for the academic year, escrows were required to ensure that cash was available to pay debt service during summer months.

Fannie Mae's Dedicated Student Housing Program focuses on permanent financing for properties occupied 80% or more by college students – both conventional multifamily units and projects developed specifically for students (sometimes referred to as purpose-built). These projects can be off-campus or on land leased from a university. The most important underwriting change is Fannie Mae's acceptance of contractual by-the-bed rent, which can generate unit income that is significantly higher than could be garnered in the general marketplace – especially for three and four bedroom configurations.

Developers responded to higher student expectations for privacy by supplying fully furnished three and four bedroom units with two to four bathrooms. Privacy is ensured further by separately keyed bedroom door locks. Response to the demand for on-site amenities and convenience resulted in swimming pools, sand volleyball courts, game rooms, individual high-speed internet and cable television access, coffee bars, computer labs, conference and study rooms, a plethora of parking spaces, and shuttle services to the university. While not every new property contains each amenity noted above, most will contain some combination of targeted amenities.

Developers ensured a year-round income stream by requiring 12-month leases. These leases are typically guaranteed by parents or guardians unless the student is employed and has sufficient independent income to qualify without a guarantor. The 12-month lease terms eliminated the lender requirement to escrow monies to cover debt service during summer months.

Management acumen is a key to the success of a project dedicated to students. Owners should want a project with a reputation for quality, quiet environment, convenience and security – issues important to most tenants; and paramount to female students who make up almost 60% of all undergraduates in the United States. Leases should grant on-site personnel frequent access to units to inspect for damage, the costs of which are also guaranteed by parents or guardians pursuant to leases. These inspections can take place as an adjunct to a quarterly replacement of filters in HVAC units.

As there is 100% turnover in a single month at most student properties, management's ability to pre-lease for the following academic year is crucial to project success. Owners must strive to maintain excellent relationships with students – who are a primary referral source for the following school year – and with the university, which likely provides a list of off-campus housing options for upper-classmen on a web site and at the housing office. And, some managers go further to solidify relationships with students by providing part-time employment in the on-site leasing office.

When underwriting a debt request, lenders will focus on the depth of a borrower's experience with student housing, the size of a university's resident student population, enrollment trends, the university's plans for on-campus housing, barriers to entry, existing and planned competition (conventional and purpose-built) and access to public transportation if the project is not within walking distance to campus. At the same time, as modern student housing has become somewhat standardized and has generated a successful track record in the multifamily industry, permanent lenders are eager to provide long-term debt capital on parameters that more closely mirror those for conventional apartments. Look for this trend to continue.

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