UK Education – April 2019

SPOTLIGHT
Savills Research

UK higher education spotlight

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Five global real estate themes that have relevance to university estates strategies

"Higher education should be at the centre of the modern mixed-use environment"

For our first Higher Education Spotlight we look across our global real estate advisory business for themes and changes that are taking place that might be interest to or even worth adopting in University's real estate strategies.

What was most notable from this global sweep is how many of the trends that are taking place in the office, retail, residential and hospitality sectors are very relevant to those who manage university estates. It was also particularly interesting to see how some of the themes that the more mainstream real estate sectors are struggling with are those that Britain's universities developed and mastered some time ago.

The over-riding themes of this exercise have found that there is a global appetite for secure-income investments, as well as a desire to invest in existing assets in a more sustainable and impactful fashion. Both of these themes, we believe, mean that methods of investing/financing and potential partnering, are going to rise to the forefront of future strategic decisions for University's estates over the next decade.

We will be returning to some of these themes in more detail in future Higher Education Spotlights, but we hope that you find our five key global real-estate themes thought provoking.

1 Mixing uses and blurring spaces

Commercial property developers and urban regeneration specialists have fully embraced the idea of mixing uses, blurring space and placemaking over the last decade, for a variety of reasons. More recently major housing providers such as Urban & Civic have also acknowledged the relatively simple idea that a mono-cultural environment is unattractive to its users.

Of course, just making an attractive place does not necessarily pay off. Indeed for a long time spending on soft non-income generating uses was seen as hard to justify and only the domain of the public sector. However, the statistics show that an ever increasing number of developments are ticking the mixed-use box, with Savills research in 2017 showing that the majority of larger developments planned across the UK were mixed-use.

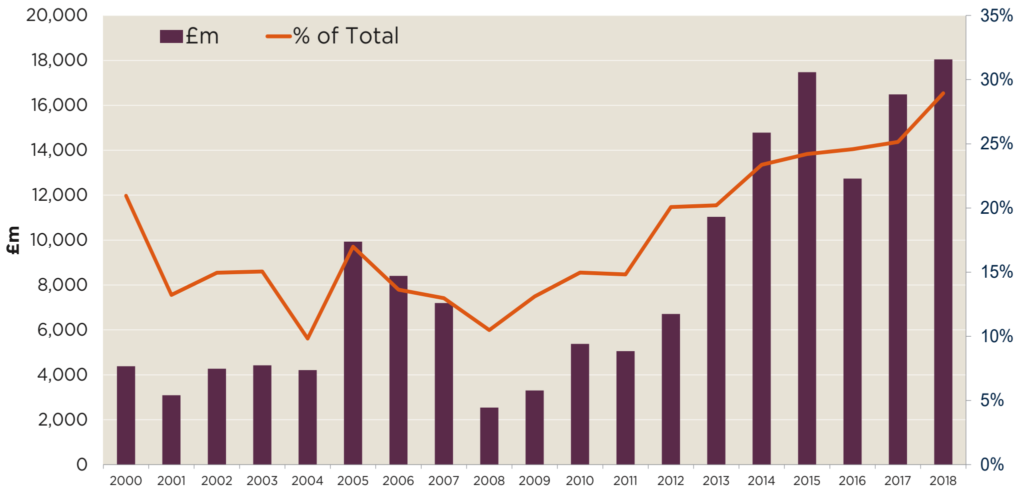
We have identified three themes driving this rise:

Projects are getting bigger: As developers and investors get larger, so do the projects that they need to deliver to add value to their investors or shareholders' interests. However, few locations can support large single-use developments, so mixing uses reduces letting and sales risks. Also, a mixed-use development plan often allows a developer to flex or phase the delivery to fit the market cycle.

People prefer mixed-use environments: While this might seem blindingly obvious, it has taken the real estate industry a long time to accept the fact that mixed-use areas are more interesting than single-use. Whether we compare the historic British market town with the sterile US shopping mall, or the 1980's campus style business park with the Kings Cross development in London, we can see that occupiers, visitors and local residents all prefer a mixed-use environment. This not only makes delivering the project easier, but also enhances the investment performance by bolstering user experience and hence spend. More recently the debate has also swung towards whether mixed-use environments are better for well-being, particularly where either the size of the project or the mix of uses allows the inclusion of health and/or education facilities.

Investors have become increasingly comfortable with mixed-use projects: 20 years ago developers and owners were more biased towards single-use projects and assets as they were perceived as simpler and more saleable. However, as the chart below shows, investment in mixed-use assets or portfolios in the UK has quadrupled over the last ten years.

Mixed-use and 'alternatives' investment in the UK has more than quadrupled over the last decade, and now accounts for 30% of total property investment



Source Savills, Property Data

Implications for higher education

So, where does education fit into the mixed-use question? The simple answer is right at the centre. Many cities around the country and indeed the world grew up around their educational institutions, with the mix of uses starting as planned and then growing organically. However, the global real estate community has only recently rediscovered the joys of an educational anchor, whether it be a primary or secondary school as part of a major residential-led scheme, or the University of the Arts at the heart of King's Cross.

Not only do schools or higher education institutions provide an immediate draw to the development, but they also increase footfall and dwell time across the day. This makes the project feel more alive and exciting than a single use residential or office scheme.

Another advantage of delivering a mixed-use environment is that it delivers the ability to co-use facilities and services that might not have been viable in a single-use location. Whether this be a health centre, a playing field, a library or just intellectual capital, there are few businesses or residents - or indeed universities - who would not value more of it.

This then swings us towards the wider topics of the sharing economy, shared space and porous campuses. Perhaps one of the biggest ironies of this debate is that many developers around the world have copied the openness and mixed-use nature of university towns, while the universities themselves have become more inward facing and siloed.

Spending an extra 50% on placemaking can increase land values by 25%

Savills Spotlight on The Value of Placemaking, 2017

2 The sharing economy, co-working and workspace as a service

The phrase 'sharing economy' is a relatively new one, and also a highly inaccurate one. Lots of excitable articles will tell you that AirBnB is the world's biggest hotel operator yet owns no property, or that Uber is the biggest taxi company yet owns no cars – however what neither company is doing is sharing. They are merely enabling people to pay a rent for a product or service, which is hardly a new concept!

The competition to come up with the next big idea for the sharing economy has led people to think about traditional real estate challenges with a more open mind. For example, virtually every office utilisation study that has been done in the last 30 years has concluded that around 40% of the desks in any office are unused for much of the working day. This is a huge waste of resource and recognition of that has led to the rise of themes such as hot-desking and agile working. More recently however we have seen the rise of Workspace as a Service (WaaS) and co-working.

The biggest name in this space at the moment is WeWork, who have acquired 3.5m sq ft of office space just in London since 2013. Indeed, the sector as a whole now occupies 20m sq ft of office space across central London, which is nearly 8% of the total stock.

What WeWork and their peers offer is the ability to occupy space for a short period, anything from a month upwards, and to adjust the amount of space you need on a more regular basis than a more traditional commercial property lease. This means that not only do businesses not end up having excess space, but also that they can expand much more quickly and easily than they might have been able to in the past.

As the concept of WaaS has developed, and competition amongst providers has intensified, we have seen the type of offer and services that are on offer broaden. WeWork is experimenting not only with co-living, but also the provision of educational facilities on site. Convene's offer is based much more around education and knowledge-sharing, with conference and seminar facilities at the heart of their offer. We have also seen other WaaS operators edge towards delivering more technical space, whether they be for 3d printing or for laboratories.

The advantage for the occupiers or customers of these facilities are not just about the flexibility of lease, but also about community and shared services. Whether the services are included as part of the membership fee, or paid for on a draw-down basis they mean that smaller businesses now have access to the facilities that historically you might only have had if you worked for a major bank or technology company. These services can include IT support, food & beverage, conference facilities, healthcare & insurance, access to expensive hardware, and education.

While the phrase 'sharing economy' is a little disingenuous, the trend that it describes is gathering pace globally and we expect that the majority of commercial property spaces will be occupied this way in the future. Not only does the concept of leasing your workspace only when you need it fit the way that people and companies increasingly want to work, it also will create new income streams for owners of underutilised real-estate.

4.5m sq ft of office space was leased to flexible office providers in the UK in 2017/18

“The opportunity offered to universities by the rise of the sharing economy is considerable”

Implications for higher education

The first and most obvious implication of these trends for universities is that short term real-estate requirements need now not involve a long term lease. If you need some office, storage or seminar space for a limited period then maybe there will be a provider in your city who will rent it to you for that period fully-serviced.

However, we believe that the biggest opportunity for universities around the rise of WaaS is monetising under-utilised space. This sector has evolved to satisfy the corporate real estate manager who looks out across their unused desks for which they are paying rent and shakes their head. The same opportunity must be true for the Director of Estates who looks at their student accomodation, lecture and seminar rooms, and laboratories both in term and vacation time.

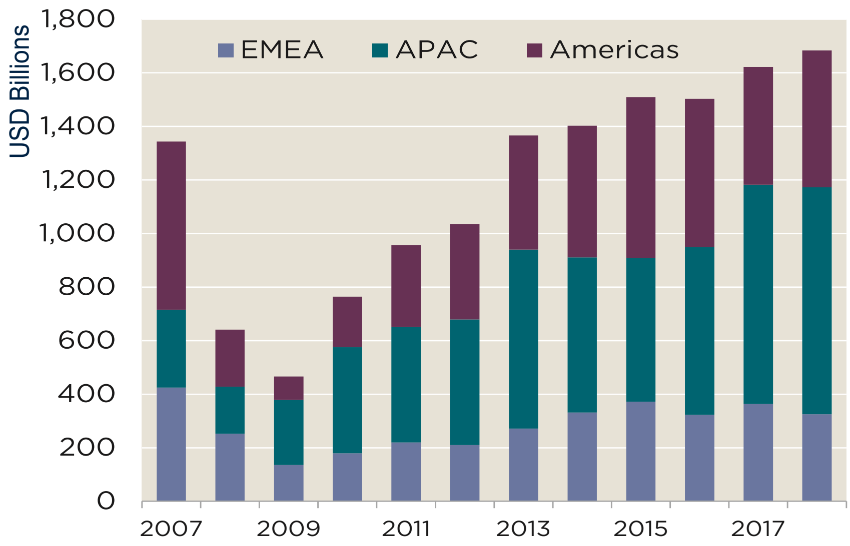
So, what’s new you ask? Universities have always rented out bedrooms and lecture halls to the conference and convention market in vacations for example. The main change of the last few years however has been the rise of the intermediary application such as AirBnB, Uber or Workthere. It is now much easier to match providers and customers, though no platform has yet emerged to do the same thing for education-related space.

The other major change ties into both this and our first trend on mixing of uses and amenities. Users of space are increasingly demanding more from their “landlord” and the environment in which they work. Whether it is wellness-enhancing spaces such as playing fields and sports halls, medical support, or learning opportunities, we believe that universities which already have many of these facilities are becoming a more attractive workplace than those that don’t.

Indeed, there are aspects of many university’s real estate portfolios that are virtually unique and unlikely ever to be competed for.

While student and staff safety and security is, and always should be, the first concern of any university considering sharing or renting its facilities, we believe that the potential opportunity offered by the rise of the sharing economy is considerable. The benefits to the institution need not only be financial, and may be as simple as improving community engagement or strengthening links with business. The first and most obvious question for any Finance Director or Director of Estates might be “do I have any space that I can rent out on a short term basis”, but the bigger and more interesting question for the future is probably around how important a role the institution could play in satisfying a rising consumer need for experiences, health and well-being.

Global investment into real-estate reached $1.7 trillion in 2018



Source Savills, RCA

3 Own versus lease - the corporate real estate conundrum

The debate about whether an organisation should spend its capital on owning its property, or on whatever its core business is, has ebbed and flowed for the last 50 years. For a long time manufacturers such as Ford, or retailers such as Marks & Spencer saw owning their own property as not only insulating them from the vagaries of the real estate cycle, but also as safeguarding the family silver. The 1990s and 2000s saw a swing away from owning to leasing, as many management teams and their advisers argued that a retailer would be better spending its capital on its core business rather than buying property. More recently there has been much debate in global real estate circles as to whether the new accounting regulations for leases might cause a swing back to owning rather than leasing.

On 1st January 2019 new accounting changes came into force that will result in some fundamental changes to business finances, decision making and financial reports of profitability. For international companies (excluding the US, which operates under a different system), the IFRS (International Reporting Standard) 16, will be the official regulation that replaces the current IAS (International Accounting Standard) 17.

Essentially, under the new IFRS 16, anything that looks or behaves like a lease or that contains an ‘embedded’ lease will be included in the new regulations. The term ‘lease’ in this instance can refer to property, personal property, machinery, vehicles and equipment. For most real estate, the impact will be substantial, with almost all leases being brought onto the balance sheet as an asset and a liability. Leases will be capitalised based on who controls the right to use the asset. In future, some leases may, therefore, become service agreements to avoid them being capitalised, but another entity must have control over the right of use. Serviced offices and collaborative workspace may receive a major boost from the changes, and this is another factor that has been behind the boom in WaaS that we discussed earlier.

“Most universities have operational facilities that could be sold and leased back”

While the simple take-away might be that it now makes more sense to own your property than lease it, the argument remains fairly nuanced. Certainly leases will now appear as an asset and a liability on balance sheets, and very long leases will be heavily disincentivised for a while (also making owning look more attractive). However, we believe that the fundamental question for any real estate user will remain the simple one of whether they can do something more useful with the capital than just investing it in buying their own property,

What is most interesting about this debate is how few businesses appear to have decided to buy their own premises. Indeed, over the last 12 months we have seen a rise in the number of sale-and-leasebacks of headquarters space, such as Goldman Sachs’ £1.2bn sale-and-leasback of its yet to be occupied HQ to Korea’s National Pension Service.

The clue as to why companies are still choosing to lease rather than own is in the details of the Goldman Sachs deal. What Goldmans were offering was a 25 year lease to a globally strong covenant with an option to break at the 20th year. The fact the final bidders for this very large asset included two pension funds and two private family offices points to another global trend – the hunt for income.

Since the Global Financial Crisis (GFC) the sustained period of low interest rates has meant that traditional ‘safe’ asset classes like cash and sovereign bonds have delivered much lower yields or returns than normal. We estimate that the volume of capital invested into real estate (excluding domestic housing) has risen from $600bn in 2008 to $1.7trn in 2018. This means that 2018 was the most active year ever in the global real estate market, almost 30% higher than the last peak in 2007.

Low interest rates are not the only reason for the boom in interest in real estate as an asset class. Other drivers include financial liberalisation in some parts of Asia-Pacific, as well as the very rapid growth of some economies in that region. Volatile price movements in resource-producing regions have also played their part, as investors from those countries seek to hedge volatility against stability. However, the key driver of the rise in attractiveness of property as an asset class has been its comparatively strong return compared to other asset classes.

All these factors have combined to make real estate, and most importantly income-producing real estate, an increasingly popular asset class for both institutional and private investors. Indeed, we estimate that 57% of the $1.7trn that was invested into property last year was focused on longer-income assets.

Looking ahead, while we do expect interest rates in the UK and elsewhere to “normalise” over the next decade, the correlation between real estate yields and base rates has become less strong. Investors who look across a multitude of asset classes, and particularly those who are looking for longer-term secure income streams, will reach a point where the yield on sovereign bonds becomes attractive enough again to suggest a re-allocation of some money away from real estate and back into bonds. This will mean that as and when interest rates do start to normalise then the volume of money targeted at global real estate will reduce, and this in turn will reduce downward pressure on the yields on the most ‘dry’ and ‘core’ assets.

However, we do not expect real estate yields to move in lock-step with local rises in base rates as the global appetite for income-producing assets will remain strong.

Implications for higher education

Some universities have already benefited from the swing towards low yielding but secure income that has been prevalent since the GFC. Chiefly this has been through the student housing market where annual global investment activity has risen from $4-6bn pa in 2007-2010 to $14-$18bn pa in 2016-2018. Indeed, the UK is by far the largest student housing investment market in Europe, with transactional volumes in line with those of the USA (a market with almost ten times the number of students).

However, given the strong global appetite for secure income streams now might be the time for some universities to think about what other assets they own or plan to build that could be sold and leased back.

We would be the last to suggest that any institution consider selling off the ‘family silver’. However, most universities own a plethora of operational facilities ranging from office space, science parks and innovation centres, to restaurants, shops and warehoused. All these types of property are eminently investible, particularly when the income stream is attached to a long lease on a covenant of the quality of a typical UK university.

The benefits of this approach to the university would include unlocking capital that might be better used on other core aspects of the institutions’s activities, as well as assisting in future proofing the estate.

$19.5bn

of sale and leasebacks took place in 2018

57%

of all real-estate investment globally last year was income-producing

"The built environment accounts for 41% of all global energy usage, 40% of natural resource usage and 38% of all CO_2 emissions"

4 Doing good - social returns and impact investing

Social returns and impact investing are two relatively new themes that have emerged in the global investment community, though much of the debate to date has been taking place outside the real estate asset class. Despite this, we expect that an increasing desire to 'do good' will motivate many private and institutional investor strategies in the future, and actually property as an asset class arguably offers a lot of opportunities to invest for good.

While the two terms come at the topic from slightly different angles, they have both evolved from the well-established desire to invest either for or taking account of Environmental, Social and Governance (ESG) factors. Other commonly used terms that broadly cover the space include sustainable investing, socially-responsible investing, or mission-related investing.

Despite starting in the 1960's, ESG investing has boomed in recent years due to the rise in sustainability (environmental and otherwise) challenges facing the world. This has heightened investors' awareness of how their client's motivations might change away from just demanding a pure total return towards a blend of total and social return. A 2016 research paper from Bank of America suggested that over the next two to three decades the millennial generation could put $15-$20 trillion into US-domiciled ESG investments, which would roughly double the size of the US equity market. Indeed, since its founding in 2006, the United Nations Principles for Responsible Investing (PIRI) has attracted support from nearly 2,000 signatories representing over $68 trillion of assets under management.

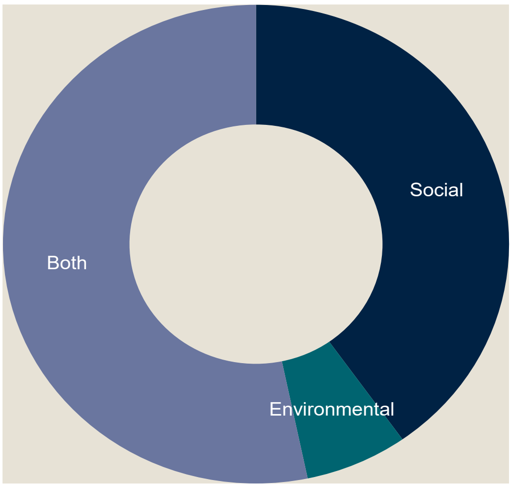
Unsurprisingly ESG investors have been asking a lot of questions of the built environment, since buildings account for 41% of all energy usage, 40% of natural resource usage and 38% of all CO_2 emissions.

However, in the early days much of the swing towards energy labelling of buildings and the wider environmental sustainability debate was hampered by asking the wrong questions. For example, the key question should not be 'will someone pay more for this sustainable building?' but 'is it cheaper to operate because it is sustainable?'.

The concept of Impact Investing naturally followed on from the rise of ESG investing and in essence it asks whether an investment makes a positive impact beyond the economic return. This might be in terms of a net environmental benefit or a social one. While the spotlight of Impact Investing has primarily been focused on bond issues to date, we see no reason why real-estate should not play a very real part in this debate. Indeed, real-estate may even be one the best ways of Impact Investing.

The size of the prize is huge, with the most recent Global Impact Investing Network Annual Survey estimating that the market doubled from $114bn in 2017 to $228bn in 2018.

The primary objective of impact investing is to make both a positive social and environmental impact through investment behaviour and decisions



Source GIIN

There are already impact funds focusing on both residential and commercial property, and their focus varies from having a positive environmental affect to having a positive social effect. Much of the real estate focused activity to date has been in the residential space, as improving or delivering new social housing delivers an immediate social good. However, more recently there is an increasing recognition that commercial property can deliver a social good through enhancing health & wellbeing, or education & skills. Many large UK commercial property investors and owners are members of the Better Building Partnership which started to improve the sustainability of the existing commercial stock, but is increasingly looking beyond just environmental issues. For example, an enhanced social return can be delivered by such simple things as job creation and apprentice schemes during the construction phase of a project, or by the sharing of the eventual facilities with community groups.

Implications for higher education

We believe that education providers and owners of educational property are already delivering a significant social return. However, there may be an opportunity to marry up this behaviour with investors who are looking for solutions to their desire to be more impactful.

Universities were impact investors long before the term was even coined. This is because improving people's education is arguably the greatest social good. However, there are to date relatively few examples where a higher education provider has teamed up with an investor with the specific aim of delivering social returns.

Given the ever increasing pot of money targeted at Impact

> **Seniors housing on or close to educational campuses offers a wide variety of benefits to both the university and the local community**

Investing, the challenge will be finding destinations for that money. An asset where a university is curating a porous educational offer that enhances the local community should tick many of the boxes that increasingly socially aware investors are looking for.

Furthermore, Impact Investing will require that the real-estate industry thinks more about the long-term impacts of investments. This is generally something that real-estate owners have been fairly bad at, but an area in which universities and their endowment funds have excelled. Thus, not only might universities be able to deliver the assets that deliver impactful investments but also the long view that escapes some institutional investors in real-estate.

5 Seniors housing - investing in demographic change

One of the other major themes in global real estate investment in recent years has been investing in demographic or structural change. At one end of the spectrum this has driven a surge in investor interest in student accommodation and the Private Rented Sector, and at the other end of the demographic curve in seniors housing.

Real Capital Analytics estimate that the global volume of money invested in seniors housing reached $13bn in 2018, with the UK and Europe remaining comparatively undeveloped given the forecast growth in the proportion of the population that will be over 65 years of age in the next decade.

Savills latest Healthcare Investment Market Update shows that investment in that sector was up 3.6% in 2018, reaching its highest ever level. The majority of this investment was targeted at the elderly/long-term care sector, with the investment volume exceeding £1bn last year.

Investor demand for these types of assets far exceeds supply, with particularly strong demand from non-domestic investors. This imbalance between supply and demand has resulted in steady yield hardening over the last six years, with prime yields for care homes hardening by 225bps over that period.

Not only is the investor demand being driven by a desire to invest in demographic change, but these assets are also delivering rental growth. While many care home rents are linked to RPI, we estimate that like-for-like rents on standing investments are 7.6% higher in real terms that they were in 2014.

While many of the seniors-focused assets that have been traded in recent years have involved some form of care provision, there is also a rapidly growing sub-sector which is private-rented space aimed at seniors. This is a much more evolved asset class in the USA and we expect it to grow significantly in the UK as investors graduate from the multi-family/private rented sector/student housing into the next most logical demographic play. Given the lack of stock that is currently available to invest in the UK the first opportunities that will be available to investors will be development-orientated.

Implications for higher education

An increasing number of North American universities have been developing seniors living, retirement communities, or continuing care retirement communities in recent years. We believe that this as yet unexplored asset class could be a major opportunity for British universities.

There is a wide variety of offers on American campuses, ranging from privately rented independent living, through assisted living and finally into nursing homes. The type of accommodation also varies and includes apartments, cottages and single-family homes.

Generally the model is for a developer to partner with the college or university where the academic institution either puts in the land or offers servicing. The eventual income stream is then shared between the joint venture partners. Some facilities are on or adjacent to campuses with strong service and educational ties with the university or college, while others have a looser relationship and less frequent contact with the sponsoring institution.

While the number of such projects is not yet huge in the USA, the names of the colleges and universities who have tried it are high quality, and includes Duke, Notre Dame, Penn State and the University of Florida.

The attractions of these communities to senior citizens include access to university social, educational and healthcare amenities, as well as socialisation and stimulation. There is also evidence of some brand loyalty emerging, with studies estimating that 10-20% of residents are alumni of that institution.

For the educational institution some of the benefits are very tangible e.g. the income stream from the rents, or the capital receipt from a sale & leaseback, or the impact investing effect of improving people's lives. Other benefits to the university could include a ready pool of volunteers for on-campus activities; the creation of an intergenerational community to the benefit of students; and the usage of facilities and possibly even classes in quieter periods as part of a generational swing towards lifelong learning.

Investment in UK healthcare property reached its highest ever level in 2018

Savills Education

At Savills we take great pride in our Higher Education work. With more than 25 years of experience in the sector, it is a priority for our business.

We have dedicated sector specialists working on and adding value to some of the UK's most complex and high profile Higher Education projects. We have worked with a significant number of the UK's universities on:

- Operational estates;
- Student accommodation portfolios;
- Commercial opportunities, including Science/Innovation parks;
- Land/property investments;
- Surplus assets.

We can provide a comprehensive property service across the entire development cycle - from formulating estate strategies, implementing projects, commencing operations, and optimising the efficiencies of an institution's operational estate, right through to renewal and redevelopment, including maximising value on surplus assets.

For further information, please contact us or visit www.savills.co.uk/sectors/education

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