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College-Town Real Estate: The Next Big Niche?

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Peter Wynn Thompson for The New York Times

Barbara J. Gaffen and Michael H. Zaransky of Prime Property Investors, above, with carpet deliveries for their rentals near Purdue University.

FROM now through Labor Day, thousands of college students will be settling into off-campus apartments across the country as they haul in their PC's and stereos, their boxes of DVD's, clothing and sports paraphernalia, for the fall semester.

For some unhappy neighbors, this may conjure up images of ceaseless parties and beer cans galore. But some investors see something more propitious: a steady stream of revenue, for starters, and growth potential for years to come.

"The student housing market is a good niche opportunity today," said Kenneth T. Rosen, chairman of the Rosen Consulting Group, a real estate and economics research company in Berkeley, Calif. "The demographics are excellent, and the demand is great."

College enrollments have been on the rise as the baby boomers' children — sometimes known as the "echo boom" generation — come of age. This group, born from 1982 to 1995, is about 80 million strong. Yet the supply of on-campus housing is becoming increasingly limited.

At some state universities, like the University of New Mexico in Albuquerque and the University of Nevada in Las Vegas, fewer than 10 percent of the students live on campus, according to Michael H. Zaransky, author of the new book "Profit by Investing in Student Housing" (Kaplan Publishing). At Boise State University in Idaho, the ratio of beds to enrolled students was just 4.6 percent, according to data he collected two years ago.

"Most resident dorms are aged, but universities, particularly the public universities, are under severe financial pressure and simply do not have the money to meet the demand by building more dorms," Mr. Zaransky said.

Seeing an opportunity to meet widening demand, Mr. Zaransky's own real estate firm, Prime Property Investors in Northbrook, Ill., has been shifting its focus to off-campus student housing in the last couple of years, with the purchase or development of apartments and town houses near the University of Illinois, Purdue University, Loyola University of Chicago and Florida State University. The firm rents out 700 beds in all, he says.

"We try to buy as close as possible to the schools — within walking distance," he said. "Those are the apartments that tend to get rented first and get higher rental increases."

Right now, with the school year about to commence, all of its units are spoken for. "I'm not aware of any other sector in the residential housing business where you can count on 100 percent occupancy," he said.

Of course, there are few other segments where the turnover can approach 100 percent. While roughly a third of the student tenants typically renew their leases before they expire by early to mid-August, property owners must work hard earlier in the year to rent the remaining units.

They also have only a narrow window of time to replace furnishings and to do all the repair work, cleaning and painting that is often required after everyone moves out.

"It is much more management intensive" than traditional housing, said Ralph L. Block, a real estate portfolio manager at the Phocas Financial Corporation, who is looking into investing in student housing for his company. He called the sector "risky in one sense and not as risky in another."

"The risk comes with the fact that the turnover period is very short; if you make some bad estimates and you don't get your apartments filled at the right time, you'll have a vacancy rate lasting the entire year, because it's hard to convert them to alternative uses," Mr. Block explained. "But the steadiness of demand and still fairly limited supply argues for less risk."

(Unlike traditional apartments, which are leased by the unit, student housing projects are often leased by the bed, and, increasingly, the leases are guaranteed by a parent.)

Student housing has already proved profitable for many investors. The capitalization rates — meaning the initial yields — can often exceed those on conventional multifamily homes, industry experts say.

"We averaged, on the projects sold in the last year, around 6.4 percent, compared with a 5.1 percent cap rate for traditional multifamily," said Ryan S. Reid, first vice president and national director of student housing at CB Richard Ellis, a commercial real estate brokerage firm.

But as student housing becomes more widely accepted by investors — and more expensive to buy — the gap is expected to narrow. Markets where land is in short supply — like New York, Boston, Chicago and parts of Florida and California — are already considered hot markets, according to Mr. Reid. Austin, Tex., is another favored spot.

The bulk of the estimated $160 billion student housing market remains controlled by independent companies and investment groups that operate mostly regionally. Institutional and individual investors can participate in some deals, usually for a minimum investment of $50,000 to $150,000.

Some tenants-in-common programs, or T.I.C.'s, nascent products that offer fractional ownership of properties, also invest in student housing.

Wall Street has been slower to catch on. "The capital markets weren't quite sure how to look at this product type," Mr. Reid said. "They still had what we could call more of the 'Animal House' view of what student housing was."

But in the last couple of years, three real estate investment trusts specializing in student housing have emerged — **GMH Communities Trust**, **American Campus Communities** and **Education Realty Trust** — making the sector more accessible to passive investors with less money to invest. (**Equity Residential** also has some student housing properties in its portfolio.)

Although the three student-housing REIT's are still finding their bearings, at least two of them, American Campus Communities and Education Realty Trust, have managed healthy returns. This year through July, American Campus Communities had a total return (price appreciation and dividend) of 10.07 percent while Education Realty returned 28.76 percent, according to the National Association of Real Estate Investment Trusts. By comparison, the total return for all equity REIT's during that period was 16.12 percent, the association said.

Tight supplies of student housing may offer an opportunity for investors.

But GMH Communities, which also builds and operates military housing, had a negative yield of 16.04 percent for the first seven months of this year, according to the association. The company recently disclosed that it has had to borrow heavily in order to pay dividends.

Mr. Block of Phocas Financial said he likes Education Realty, in which he invests himself. The company has focused mostly on smaller schools in less-urban areas but plans to expand into bigger cities. Its portfolio includes 36,637 beds at 59 college communities in 21 states.

The company was developing private off-campus housing long before it was public.

"Our first project was in 1964 in Chapel Hill, N.C.," the home of the University of North Carolina, "and we are still there," said Paul O. Bower, the chief executive. "We've served the children of the original tenants, and soon the grandchildren."

Some of Education Realty's units include luxury amenities like swimming pools, while others are more like dormitories, Mr. Bower said.

At this time of year, the occupancy level for all of them starts at 100 percent. "We lose a percentage point or two throughout the year," he said, adding that the most labor-intensive part of the operation is managing the units. "Eighty percent of the overhead expenses is for management," he said.

Mr. Zaransky of Prime Property Investors suggests that intrepid investors who want to go it alone — by buying condominiums or town houses and renting them out — hire professional managers to oversee the properties. Management fees are typically 5 to 8 percent of the rent collected, he said.

Monthly rents vary by region. In the Southeast, for instance, they can range from $450 to nearly $800 a bed, according to Tom E. Lewis Jr., a managing partner at **Flagstone Holdings** in Miami, which specializes in acquiring and developing student housing in that region.

And with demand for private student housing expected to remain strong for the next several years, industry experts say, investors can almost bank on steady rent increases regardless of economic conditions or the interest rate climate. The same can't be said about conventional apartments.

"The success of these investments is tied to college enrollment, not to external economic factors like job creation," Mr. Zaransky said. "In fact, one can argue that in bad economic times, people will want to pursue better credentials and go back to school."