

## Investment in Niche Property Types

This is a summary of the April 28, 2016 meeting of the ULI Chicago District Council, which gathered at Jenner & Block's Chicago office to hear an expert panel of professionals discuss investment trends in some of the hottest niche markets, including student housing, medical office and self-storage.

They explored topics that included what factors are prompting increased investment in these sectors, the leading sources of capital, some of the biggest obstacles for attracting capital, and how operators attract new capital flowing into the market.

The moderator for the session was Keith Largay, *Managing Director, Real Estate Investment Banking*, JLL. Panelists were Robert Bronstein, *President*, The Scion Group LLC; Lucy Fletcher, *Managing Director, International Capital Group & Americas Capital Markets*, JLL- Capital Markets; and Chris Merrill, *Co-Founder, President & CEO*, Harrison Street Real Estate Capital.

The Scion Group and Harrison Street Real Estate Capital are by far the two largest private owners of student housing, but for Scion, entry into the niche was “accidental,” said Robert Bronstein.

As a commercial real estate broker in Chicago some 18 years ago, Bronstein was involved in two student housing transactions with the School of the Art Institute, one at State and Madison and the other at State and Randolph.

“Seeing that student housing transform the School of the Art Institute from a very small, regional presence to a school that could draw nationally and internationally is what turned me on to (the student housing niche),” he recalled.

Without capital or a background in acquisitions or operations, Scion began as an advisory business. Now, acting as an investor and an operator, the company has done work for 170 schools in the United States and several other countries. With offices in Chicago, Southern California and Toronto, its 25 to 30 engagements annually range from feasibility analyses to running student housing for the University of Nevada, Las Vegas on an outsourced basis, Bronstein said.

When Merrill launched Harrison Street Real Estate Capital a little over a decade ago, the core strategy was creating a long-term business model that was not tied to timing economic cycles. Reflecting on demographic trends, his firm targeted education, healthcare and storage themes, and especially zeroed in on student housing as its largest investment.

To overcome the fragmented, smaller nature of the asset classes, Merrill's firm developed connections with 40 to 60 operators across the country to attain scale and diversification.

Then, about 2 ½ years after the company's formation, the economic downturn hit. Those general economic woes were "a challenging time," Merrill said, but they also served to validate the firm's blueprint.

"From one standpoint, it really helped our business. We didn't make money, but we really didn't lose money," he said. "We really preserved capital. It made people start to realize that there's something here to these assets... Now we have empirical data on how these assets perform in a down market."

Lucy Fletcher, who has worked in three regions for JLL, has observed the institutionalization of the sectors within these specialized asset classes. In particular, there has been strong interest coming out of Asia Pacific and Europe.

Those niches include student housing and medical office, as well as skilled nursing facilities, cold storage, and urban in-fill industrial spaces.

"We're increasingly seeing, despite the point in the cycle we're in, an increase in allocation to these sectors," Fletcher noted. "...I've seen that resilience is something investors are looking to (with) diversification outside the traditional four food groups" of multi-family, office, retail and industrial properties.

In reply to moderator Keith Largay's inquiry about how to find the right operators for senior housing or student housing, Merrill said the "operational intensity" is similar to traditional asset classes. However, "you need folks who understand certain nuances." In the student housing realm, that includes the ins and outs of roommate matching, vendor relationships, and how to handle the move-in and move-out timeframes on campus.

"For us, it's spending a lot of time with folks who have been doing this for a long time," Merrill added. "This isn't their first foray into senior housing or into student housing...it's in their DNA."

Investors are looking for companies that have a large enough portfolio to handle large investments of money—in the hundreds of millions of dollars, said Bronstein. Scion has separate wealth funds with the government of Singapore and the government of Canada. Both were looking to increase their investment in American student housing, "so it wasn't so much us seeking them out ...they were looking for the right platform to partner with."

When public REITs began investing in the category about five years ago, that helped others see it as a hedge in a down market, said Bronstein. Now, he added, it's a matter of "consolidating and institutionalizing," with investors looking to "partner with who is already there in terms of success and size."

One unique feature of American universities, Bronstein said, is that many are located "in the middle of nowhere," which causes concern among some foreign investors who are accustomed to universities in other parts of the world situated in the midst of larger population centers.

"Some people simply can't get past that," he noted. For those who do invest, they are banking on the "permanence and appeal" of those universities.

"The reality is if you want to invest in student housing, probably the most significant threshold you have to get across is that these universities have been there for a couple of centuries," Bronstein said. "They're going to be there for much longer than any of us are going to need to worry about. They're internationally known blue-chip brands."

Merrill and Fletcher echoed Bronstein's point about investors' need for large-scale deployment of capital.

"It's very hard for a lot of these folks to move without moving significant capital," Merrill said. "Doing one-off transactions is very challenging for a lot of investors out there, and for a lot of funds."

In meetings with institutional and private capital investors in the Asia Pacific region back in January, Fletcher recalled the categories of student housing, senior housing, medical office and cold storage coming up in almost every one.

Among the factors that make those sectors more appealing are immigration trends and shifts, she said. Skilled-nursing and senior housing facilities are attractive to Chinese corporations and developers who are looking to build expertise from U.S. and European operations, and then bring that operator model to China, Fletcher added.

Helping drive this trend, she said, is the aging of countries like China and Japan. "It is concerning," Fletcher said. "What happens to that generation as they Westernize and they become more mature in their own market? I think you will see more inbound investment from Western investors but also as they seek to upscale, they're going to be investing here to try to get that understanding and deep knowledge."

Later, Fletcher said some broader trends to look out for include in-fill industrial manufacturing, the conversion of obsolete industrial space into creative office space, and the [growth of pop-up stores](#).

Meanwhile, Harrison Street is exploring its business potential overseas in places like Asia and Europe, said Merrill. “But it’s going to take time,” he added, because it requires attention to differences, such as those in healthcare regulation, from one country to the next.

The firm will move first where there is “clear opportunity,” such as in Dublin, Ireland, which has 90,000 undergraduates and almost 200,000 students overall, but only 1,000 purpose-built student housing units, Merrill said.

In response to Largay’s question about the impact that student debt has on the ability to sustain rent levels, Bronstein offered a broader commentary on the overall value of college degrees. He said there is “eye-opening data” that point to “large flagship public universities” representing “phenomenal value.”

There are much higher levels of dissatisfaction and other problematic indices, such as student loan default, among those who have enrolled in private schools, he added.

As a result, Scion steers its investments toward those large flagship public universities whose strengths include math, science and engineering. He cited the University of Illinois, Purdue University and Virginia Tech as fitting this profile, and where Scion has a strong presence.

“Over time, we feel parents in particular are going to look ever more critically at \$150,000 or \$200,000 (for an) undergraduate education,” Bronstein added. “...for us, it’s all about the market and the permanence of the school, and there are no schools that are more permanent than public universities.”

Bolstering the point, Merrill said that during tough economic times, there are more cost-conscious students who would have otherwise gone to private schools who opt for public schools.

“You have to understand the asset class...there’s potentially more volatility” with more expensive universities, said Merrill.

In healthcare, the same principle applies. “If you invest in skilled nursing, which has public pay issues...there’s more volatility,” Merrill said. “If you stick to private-pay, need-based assets, you can remove some of that volatility.”

Continuing on the thread of managing risk, Merrill said that his company does only about 10 to 15 percent of its financing through government-sponsored enterprises Freddie Mac and Fannie Mae, with the vast majority of its business coming via commercial lenders.

“We feel they are partners with us,” he continued. “If there’s tough times, OK, we can sit down, roll up our sleeves, let’s figure these things out... Who do we want to be in that foxhole with if there are troubled times?”

Also raised during the discussion was the joint venture of Scion, the Canada Pension Plan Investment Board and GIC, Singapore’s sovereign wealth fund, [to buy InvenTrust Properties’ student housing business for \\$1.4 billion.](#)

Bronstein said the complex transaction, set to close by June, is the most significant in the history of student housing, and included “favorable pricing” because of the joint venture’s willingness to take on debt as well as four construction projects already under way.

In addition, Merrill discussed Harrison Street’s [recent acquisition of Campus Crest Communities for \\$1.9 billion.](#) The company was familiar with many of the 75 properties in the deal, since Harrison Street was part of a joint venture with Campus Crest over the years—getting involved with Campus Crest when it had only five or six properties

“The complexity of these deals is off the charts...we had evolved as a company that had the ability to do that, but it was one heck of a learning experience,” Merrill said.

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