

Insights

STUDENT ACCOMMODATION: WHAT IS HAPPENING IN THE MARKET? SIX KEY THINGS YOU NEED TO KNOW

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SUMMARY

With a huge influx of students this year, both from the UK and abroad, there is high demand for purpose built student accommodation (PBSA). Yet, while there is a lot of willing capital looking to enter this market, as with everything at the moment, the sector faces challenges in the short to medium term, from rising debt and utility costs, build cost inflation and the ever developing building safety regulations. Providers are also under cost pressure looking to the future to ensure that their portfolios are geared up for net zero by 2030 and some of the decisions that they make now will play a big part in demonstrating their commitment to the green agenda.

In this article, Celia Berg and Jeremy Bark, leaders of our specialist student accommodation team and Harriet Raff, Knowledge Development Lawyer, reflect on their experience of recent trends in the sector.

1. RISING DEMAND FOR PBSA

There is no question that the pandemic hit the student accommodation market hard but, remembering the freedom of our years in further education, it is not surprising that students came back as soon as possible, proving that the sector is rightly a key real estate investment class. The new academic year has been a bumper year for university applications due to the large number of overseas students choosing to study in the UK.

This level of student demand for accommodation comes at a time when supply of HMOs (houses in multiple occupation) has been squeezed by many factors, including losses caused by the pandemic, tax changes and council tax hikes. As we know, general pressure on all forms of buy-to-let investors has caused a mass exodus and destabilised the whole of the residential letting market. Universities without sufficient stock of university-owned or nominated accommodation have found themselves in the press as, more so than ever before, those unable to offer sufficient housing in

their own cities were forced to impact the experience, and potentially wellbeing, of their students by housing them far and wide.

With rents for this year now fixed the question will be how far the pricing of rents for next year is going to rise. The cost of living crisis may force many UK students to revert to cheaper alternatives (such as HMO or choosing lower-cost locations for their studies) but demand for PBSA looks certain to be extremely high.

2. DEVELOPMENT

The squeeze on yields and unavailability of good quality stabilised assets had meant a greater number of investors looking to development of new PBSA this year. Forward funding has always been widespread in this market as investors can be confident that high quality well placed assets will be occupied by students once the development completes (unlike with more traditional assets where initial tenant buy-in can be critical).

This type of structuring had brought reliable profit margins for developers but it looked as though cost inflation and supply disruption would be the big hurdles this year and did make some developments unviable. Where deals have progressed, negotiations have been hard as developers struggle to accept increased delay risks in a market where delivering a property for the start of the academic year is critical.

These problems have recently paled in comparison to the underwriting pressures caused by swap rate shifts, lack of availability of development financing and utility costs rises. Although many of the big players will have hedged their energy costs for some time, those involved in development may not benefit from this and so the effect of global energy price rises will be outside of their control.

3. NET ZERO

The student population has been vocal about their concerns on climate change while providers are keen to demonstrate their green credentials to the market, shareholders and occupiers alike. The student accommodation market is seeing a huge drive towards net zero by 2030, with private providers implementing sustainability strategies to reduce energy consumption, carbon emissions and invest in renewable energy, both in the development (or refurbishment) and the operation of a building. We are seeing this driving investment decisions.

As buildings reach the end of their operational lives, universities might previously have looked to demolition and redevelopment, but with the embedded carbon associated with new builds, refurbishment may be favoured longer term. Even with refurbishment of accommodation as an option, a lot of universities that are sitting on old stock do not have or wish to tie up sufficient capital. On campus development and refurbishment needs are being considered in various new structures by universities creating interesting opportunities for those with the right track record.

As for the minimum energy efficiency standards (MEES), where student lets are assured shorthold tenancies, private landlords have not been able to let such property where it falls below the minimum rating of E since April 2020. But what about the future trajectory of MEES and the target B rating from 2030 (or any other rating that is entered as an interim milestone before that) – student accommodation comprises many properties that will never achieve this high an EPC rating. It may be that certain private providers will need to register on the private rented sector (PRS) exemptions register to confirm that they have made all the relevant energy efficiency improvements that can be made to the property (or that none can be made). Yet with a student population so engaged in climate change initiatives, reliance on the exclusions may be insufficient for this market. We are working with clients across various asset classes who want to push hard for the government to create a system which encourages everyone to do as much as they can and questioning the blanket barrier to improvement often caused by Grade II listings.

4. RENTERS' REFORM - EXCLUSION

Whilst the rest of the private rented sector will soon see the abolition of the no-fault eviction ground for an assured shorthold tenancy, the government has announced that PBSA will be excluded from this abolition. This announcement gives significant comfort to the PBSA providers whose financial modelling is based around the provision of short term accommodation for a period of academic study, and not beyond that. The government has clearly recognised that PBSA operators need to have the flexibility to issue tenancies based on the academic year without student tenants seeking to remain in occupation outside of this.

5. CLADDING AND BUILDING SAFETY ACT

The legacy of the Grenfell Tower disaster continues, with fire safety issues involving cladding, external facades and/or internal structures/arrangements of buildings still live, including for the PBSA sector. This year also saw the introduction of the new Building Safety Act 2022 ("the Act"). Whilst the Act is complex and introduces many new reforms seeking to ensure building safety going forward, it also contains significant new provisions seeking to address remediation of historic issues. These include potential new sources of remedy, within extended liability periods, against developers/contractors whilst also placing certain liabilities upon landlords. This may provide the PBSA sector with additional recourse for certain defects against developers and contractors (subject to the ongoing debate as to the extent to which student accommodation is caught within certain provisions of the Act).

6. TAXATION OF PBSA

VAT

The discussion around tax on PBSA and other residential sectors often focuses on VAT. However, the VAT position has been reasonably well understood for some time and experienced operators

know what to expect. In essence, it should be possible to build new student accommodation or convert existing non-residential buildings into student accommodation without incurring a significant amount of irrecoverable VAT. The classic example of irrecoverable VAT on development is “white goods” (strictly speaking it is VAT on items that are built in but are not construction materials) but this should be a known cost that operators can factor in. Any VAT incurred after the development phase is irrecoverable and is a net cost that should be taken into account in the business model when establishing rent levels.

Transfer Taxes

Transfer taxes in the UK vary across the different taxing authorities (SDLT in England and Northern Ireland, LBTT in Scotland and LTT in Wales). Whilst this should be a single cost on initial acquisition, one should also consider whether a subsequent transaction that may have transfer tax implications is required (e.g. the grant of a management lease in the propco/opco structure adopted by many operators) and ensure that relief is available.

Transfer taxes have become increasingly complex in respect of residential property over recent years. However, the PBSA sector has, where relevant conditions are met, been spared from a number of recent measures that have increased the transfer tax burden on residential property (e.g. the “non-resident surcharge” and “higher rates for additional dwellings rules”).

Certain reliefs may be available that can help to reduce the transfer tax cost on acquisition of PBSA, for example multiple dwellings relief (MDR) which could potentially reduce the rate at which transfer tax is payable to 1%. As with all reliefs, a number of conditions have to be met in order to be able to take advantage of MDR and in certain circumstances it is possible for the relief to be clawed back.

Different treatment is given to buildings that are classified as “halls of residence” for transfer tax purposes but the majority of PBSA tends to fall outside of that category.

Direct Tax

From a direct tax perspective, income and gains arising from all UK property is now subject to tax in the hands of both UK and non-UK investors, in accordance with their individual circumstances (e.g. subject to any reliefs that may be available). Each investor will need to ensure that it invests through a structure that optimises its returns taking into account its own tax profile and the profile of any co-investors.

The very brief overview above demonstrates the complexity of the taxation of PBSA in the UK. However, with careful planning, it is possible to make PBSA investments tax efficient.

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