Recent years have seen the UK student accommodation market mature, developing into an asset class in its own right consistently outperforming the market. Despite undergoing a massive period of change, most UK universities continue to enjoy excellent financial covenant strength, and have played no small part in the recent success of the student accommodation sector. Despite this, long term funding for projects is scarce, with short term debt only available on increasingly prohibitive terms, there being an undercurrent of the banks not wishing to be overexposed to the vagaries of any particular sector, including that of student accommodation. Of late, there have been a sequence of "income strip deals" by institutional investors and it is this structure that this article looks to shed light on.

What are 'income strip deals'?

Essentially they are traditional forward funding deals whereby typically an investor, such as a pension fund, in conjunction with a developer, delivers new residences. Upfront a university commits to the development by agreeing to take, on practical completion being achieved, a long lease for usually between 35 and 45 years on a non-assignable basis. Rents are fixed and subject to annual increases linked to RPI, often with a cap and collar arrangement. Importantly, at the expiry of the lease term, the university has an option to acquire the freehold (and thus the asset) for £1. Liability for repair and the running of the accommodation rests with the university, hence the fund landlord just strips the income out of the asset.

Who is doing these deals?

L&G (Legal & General) concluded their first deal with Imperial College to provide a post graduate hall of residence at Clapham Junction, followed by a second deal with Greenwich University. That scheme was developed by McLaren Property to provide 368 beds on a 35 year term at a rent of just over £2 million per annum, reviewed annually in line with RPI uplifts. It is located adjacent to Greenwich DLR Station with completion scheduled for September 2014 and includes 6,000 square feet of commercial space sitting alongside the student housing.

Both deals see the accommodation reverting outright to the university at the end of the lease term, that being a key part of the attraction for universities.

Variations on the theme

Alternative delivery structures for student accommodation whether as a pure property development basis, such as City University’s student accommodation, academic and sports provision with Generation Estates off the Goswell Road, or using a project finance structure such as recent deals concluded by Nottingham Trent University, Reading University and the University of Essex, are well established but those for pure academic projects less so. With often no obvious alternative use and missing the rental stream otherwise enjoyed from the let of the beds to students, the market has found it difficult to step in. We have some thoughts of our own as to how this could be achieved and, whilst outside the scope of this article, we would be delighted to share those with you. It is not easy to see how the ‘income strip’ structure would assist given that the usual issues around irrecoverable VAT are still going to apply. (That said, we are seeing increasingly mixed projects – student accommodation combined with academic, sports and other leisure facilities.)

It is possible, however, to see how the university (often holding surplus estate) can provide the site. A land interest of just a few days longer than that granted to the university on practical completion could be delivered upfront to the (intermediate) fund landlord, making the reversion of the asset to the university at the end of the term, neater. Indeed, we are acting for one University on this basis at the moment.
Why do it?

If the need for the accommodation exists with capacity on the university’s balance sheet being presented to make strategic investments in other parts of the university’s operations, this does offer a neater and simpler solution from a structuring point of view, and another way of accessing long term funding doing away with the uncertainty of a refinancing only a few years down the track.

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