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KEYNOTE INTERVIEW

Finding the institutional horizon

Harrison Street Europe's Paul Bashir says there has never been a better time to invest in alternative property strategies

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Harrison Street has been a pioneer in driving alternative investment strategies, says Paul Bashir, Harrison Street's chief executive officer for Europe. While finding trends, particularly ones underpinned by ironclad demographics, is the firm's bread and butter, sometimes there is a time lag between an investment thesis looking good on paper and consumers adopting new behavior.

This was the case for purpose-built student housing in Europe before the market began maturing a decade ago, he says. He discusses the lessons learned from Harrison Street's success in the US and its subsequent experience investing in student accommodation and BTR strategies in Europe.

Q Why didn't student housing take off sooner in Europe?

A decade ago or more, consumer habits started to shift in European purpose-built student housing, but the supply of new stock was relatively low and has struggled with playing catch up to demand ever since.

You could see how the product in the US differed to the UK, and it was easy to see why it was appealing to a younger demographic whose consumption habits were changing. It was akin to a Nokia 9210 compared to an Apple iPhone; you could see the iPhone was so much better and did more, but all the market had here was the 9210.

There was a significant lag between demand shifting and supply of new assets coming online that were fit for purpose. In the real estate world, consumers want to see the product first before they shift their habits.

Once those habits have been changed, the industry needs the supply of fit-for-purpose product to keep pace – and the industry was slow to deliver the product. The current supply/demand dynamics are some of the most appealing market conditions we have seen in the past 10 years.

Last year, student accommodations transactions grew faster than any other property type in Europe, according to data compiled by the brokerage Knight Frank. A record £13.1 billion ($16.3 billion; €15 billion) was deployed across 270 transactions.

Harrison Street entered the European residential market in 2015. By 2018, our assets under management for purpose-built student accommodations and built-to-rent (BTR) apartments had grown to €680 million assets under management. Now that is more than €5 billion assets under management.

Our European strategy closely follows in the footsteps of everything we do in the US, and that experience across the Atlantic has been very beneficial in pioneering investing in alternative property types in the UK and continental Europe. It has also been critical in determining when a market is mature enough to take on institutional capital. We have strategically and incrementally added new alternative sectors over the years where we have seen the investable horizon in Europe becoming more institutional.

Q How has the competitive landscape for student accommodations and BTR in Europe evolved?

Competition in these sectors has really increased over the past few years, as the fundamentals become more well known to a wider pool of investors. We believe there are advantages to being committed to the region and these sectors, rather than having exposure on and off. Our team of Europe-focused executives has been together for years, allowing us to become domain experts and make timely investment decisions.

Q How did you determine student accommodation and BTR had reached institutional levels in Europe?

There are multiple factors that lead to an asset class becoming institutional. First, a market must be established.

For an asset type like student accommodation, students needed to experience the benefits of highly amenitized living to know it is something they want and need. Once those asset types come to market and start to influence consumer demand, that encourages more development of the asset type.

Another key factor is research. Institutional investors need data about supply and demand dynamics, demographics and comparables to enter a market. They need to understand a product and be able to benchmark it against traditional sectors. Student accommodation started to emerge as an institutional asset class in Europe around 2015-16 and now we have got nearly 10 years of data to look back on.

Then it is about getting investors comfortable with the ability to re-let these assets on a regular basis, familiarizing them with operators and their track record, and explaining how these assets are underwritten. All these factors need to come together. Each country in Europe is different, and we are dealing with highly fragmented markets.

Q What demographic trends underpin your investments in European student accommodations and BTR?

Europe's population is expected to shrink over the next century, but we are seeing increased urbanization across most key markets. Navigating these demographic shifts isn't easy. Our target markets are seeing double digit growth in populations providing a compelling investment backdrop.

In most countries, the fastest growth is happening in cities with populations between 1 million and 5 million, where people move for education and employment. Those tend to be younger people who will generate more wealth. In student accommodation, the demand is driven by both domestic and international students.

Spain is a great example of urban migration. We are focused on Barcelona and Madrid, but we also have assets in Valencia, Seville, Oviedo, Pamplona and Salamanca – all cities which are seeing incredible population growth and a lack of high-quality rental products.

Similarly, our BTR portfolio in the UK is focused on "the regions," cities like Glasgow, Edinburgh, Leeds, Liverpool and Birmingham, where we could see the high levels of population growth and the need for our product. Indeed, in the past 24 months, the regions have seen the highest rent growth in the UK because those areas have a significant supply/demand imbalance, partially driven by people who were working from home who opted to move out of London.

Q How has deglobalization or China and the West's decoupling impacted strategy?

One of the key trends in student accommodation has been the growth of students from places like China, India, Korea and South America. In the UK alone, international students last year grew by about 13 percent.

Regardless of geopolitical changes or deglobalization trends at a broader level, Europe's attractiveness to students coming from the middle class across many emerging economies is only growing. Europe is seen as a rite of passage for a lot of families, and it is proven that those families have been insensitive to pricing.

The devaluation of economies and currencies have increased the relative cost of education by 10-15 percent for some of these students, but we haven't seen these economic factors negatively impact demand at all. Sending your child to study abroad is a life decision, and for these countries with a rapidly expanding middle class, demand has proven to be on the rise. So, we have seen no political impact on students coming from countries like China to the UK or to Europe.

One example is Spain, which had a very small percentage of international students, just a fraction of what is seen in the UK. That was because they didn't offer many courses in English. For a Chinese student looking for an English-based education, Madrid and Barcelona were cool places to visit, but not the preferred places to study. Now, that has changed. Most international universities in Spain now offer English-speaking courses and that has opened those markets to a lot more students. We have seen a huge wave of those students come into Europe and we believe that is expected to continue.

Q How are you coping with rising costs? What are price increases doing to the outlook for development?

Construction costs have been steadily rising since covid, and even before. That has been an industry-wide, global phenomenon. We have dealt with it through structuring with our partners and through smarter price negotiations.

We have seen some of those factors that have caused those increases, including commodity prices and global shipping prices, start to come back to pre-pandemic levels. So, we are starting to see construction costs start to level off. The biggest factor that the development industry is facing is the cost of borrowing. It is different in different countries across Europe, but financing costs have gone up across the board and we don't anticipate that changing anytime soon.

So, we need to be focused on where we can generate alpha – looking at smarter asset management initiatives, specific locations and appropriate sectors that are able to capture top line rent growth. At the same time, we are also seeing some interesting entry points to buy assets from sellers whose balance sheets are starting to show signs of stress, and who need to find liquidity.

Ultimately, it has become a flight to quality, and there continue to be opportunities in alternative property sectors relative to other real estate sectors. The price pressures aren't going anywhere anytime soon, but they have done a lot to drive a lot of the non-professional developers and investors out of the market. Meanwhile, we remain committed to the long-term fundamental drivers of the sectors.

Q How have macroeconomic conditions impacted fundraising?

The institutional world is still dealing with, in some form, the denominator effect. We are hopefully getting to the tail end of that as the wider economic environment starts to settle and investors can have some short to medium term confidence.

However, one thing we have seen as a continued trend is investors looking at increasing their allocations to alternative real estate. The current environment has shifted those investors away from more traditional sectors that are more exposed to economic headwinds and towards the sectors in which we focus. We now have a 17-year track record of showing how these alternative sectors are negatively correlated to economic cycles.

"Resilience during economic downturns will continue to drive investors to alternative sectors"

We have seen a lot of interest from new investors who are looking to shift their real estate allocations. It might be a smaller allocation than it would have been 12 months ago, but it is still an allocation to maintain long-term exposure to real estate. Our strategies are demographic-driven, so they have now withstood multiple black swan events and continued to outperform traditional asset classes.

We believe this resilience during economic downturns will continue to drive investors to alternative sectors. And finally, as the student and BTR markets in Europe have matured, there is growing interest not only for opportunistic strategies, but for core alternative real asset strategies as well.

Q How do you characterize this moment in the broader arch European student accommodation and BTR?

This period has shined a light on the resilience of our sectors through numerous micro events and has verified our underlying fundamentals. During the past 36 months, through the pandemic and since the recent high interest rate, high inflation environment, we have shown that properties within these sectors are adaptable and able to capture rent growth even with a tough macroeconomic backdrop.

Student accommodation and BTR can still deliver projects that show a positive outlook and fundamentals to our investors, and assets can be operated competitively with respect to the wider macro environment. What we are all doing now is creating more of an industry track record for the alternative space in Europe.

In five years, we should be able to look back on this cycle, map our performance and continue to showcase how alternative property types are more resilient than other sectors through volatile economic conditions. ■