Dorm Deals

Expanding college rolls mean big demand for private apartment complexes to house students. Here's a study guide to cashing in. By Matthew Swibel

THE OBVIOUS WAYS to capitalize on the baby boom now revolve around things like pharmaceutical stocks and retirement communities. A less obvious play has to do with the children of the boomers now crowding college campuses: buy apartment buildings in college towns.

The college population from ages 18 to 24 is now 9.5 million, up 20% from a decade ago and possibly destined to peak only in 2010, according to the National Center for Public Policy & Higher Education. Dorms and fraternities take care of many. But 70% live off campus. Once disdained by investors loath to be landlords for latter-day Animal Houses, student apartments now are finding their way into the portfolios of wealthy investors, private equity firms and real estate investment trusts. Nowadays a dozen bidders are commonly vying to buy a student building, up from a handful in previous years, says Ryan Reid, who oversees student housing nationally for CB Richard Ellis, headquartered in Dallas.

What Animal House? A student apartment complex at the University of Florida, Gainesville.

GARY BOGDON FOR FORBES

While investors are wading in, acquisition prices haven't gotten out of hand—yet. The buildings often churn out decent yields, called "capitalization rates" in real estate lingo, of 6% to 7%. This is the net rental income (rent minus property taxes and other operating costs) divided by property value. Cap rates on prime Manhattan office space are around 5.5%.

Student rentals, which run $500 to $600 per unit at the midrange, aren't spartan boxes with cinder block walls. Most of Paradigm Properties' 34 student complexes in Florida, Oklahoma and North Carolina have swimming pools, fitness centers and wireless Internet. Another popular feature, says Paradigm's founder, Nathan S. Collier: a tanning bed.

Here are ways to get into this market.

REITS. Equity real estate investment trusts (the kind that hold buildings, not mortgages) are liquid and average a so-so 3.7% yield. Campus REITs do a bit better than that. Among campus pure plays are American

Campus Communities, with a 4.8% yield, Education Realty at 5.6% and GMH Communities at 6.8%. Caution: Accounting-related problems have bedeviled Education Realty and GMH. Education Realty cut its dividend in August because it had underestimated expenses. GMH announced that its internal controls were shaky, although a restatement of 2005 results didn't show much of a change. Because the company filed last year's financials late, it breached agreements with lenders, and conceivably it might have to cut the dividend to appease them.

REITS FOR RESIDENCE HALLS

The first three trusts listed below, focused on the college market, pay slightly better yields than the other apartment REITs. Note: GMH and Education Realty have gotten into accounting jams.

REIT	RECENT PRICE	DIVIDEND YIELD	2-YEAR ANNUALIZED GROWTH NAV[1]	FFO[2]
AMERICAN CAMPUS COMMUNITIES	$27.94	4.8%	22.6%	4.0%
EDUCATION REALTY	14.72	5.6	1.4	NA
GMH COMMUNITIES	13.32	6.8	7.8	39.9
HOME PROPERTIES	59.60	4.4	28.4	10.4
MID-AMERICA APARTMENT COMMUNITIES	60.45	3.9	41.6	5.6

Prices as of Nov. 13. NA: Not available. [1]Net asset value. [2]Funds from operations. *Sources: SNL Financial; Reuters Fundamentals via FactSet Research Systems.*

That makes the class act of this bunch American Campus. In September investors bought $133 million in newly offered shares, which the REIT used in part to pay off all variable-rate debt. It has 37 properties that are 98% leased. Christopher Lucas, an analyst with Robert W. Baird & Co., projects that this company's funds from operation (roughly speaking, net income plus depreciation minus maintenance-level capital expenditures) will climb 5.8% in 2007 and 12% in 2008.

COLLEGE TENANTS AREN'T AS WILD AND CRAZY AS THEIR REPUTATION WOULD SUGGEST.

When American Campus opened its 704-bed Callaway Villas in College Station, Tex. in August to serve Texas A&M students, the building was fully leased at $525 to $625 a month. That includes access to a swimming pool, fitness center, clubhouse and movie theater and to basketball and sand volleyball courts. Parking and electricity are extra.

TICS. You have some appreciated income-producing real estate you want to sell. You roll the proceeds into a share in a building or collection of buildings held through a "tenancy in common." Done right, the transaction postpones the capital gains tax due on the property you're selling. (To the extent you've claimed depreciation on this property over the years, your proceeds are taxed federally at 25%.) Done wrong, it costs you more in fees and sales commissions than you would have paid in taxes.

Of the 65 TIC sponsors nationwide, says Mark Kosanke, a registered securities broker and principal of Concorde Financial Group in Troy, Mich., four offer a lot of deals with college apartments as the acquired property: Woodlark Capital, Evergreen Realty Group, SCI Real Estate Investments and U.S. Advisors LLC. Of the three campus housing listings out this fall, Kosanke best liked a two-year-old property within walking distance of Middle Tennessee State promising an 8% payout of investors' capital and offered by Woodlark. Minimum investment: $208,000.

Still, control freaks beware. With tenancy in common you often can't legally transfer ownership to another person without other owners' and lenders' okay, which usually requires paperwork. If you need to unload your stake before the group decides to sell the property, no established secondary market exists.

BECOME A LANDLORD. Paradigm's Collier grew up near the Gainesville, Fla. campus of the University of Florida, where his father taught civil engineering. "We had some noisy student neighbors next door who kept waking us up at 3 a.m.," he recalls. "Finally, my dad bought the house to ensure he had quieter neighbors." The tenants were still students, but the elder Collier screened them.

Collier Jr. mowed the lawn and drew up the leases, and then started out on his own, financing, with interest-only mortgages, a duplex, followed by a 4-unit place and then a 16-unit student building. Today he employs 300 people overseeing nearly 8,000 units, half of them having at least three bedrooms. He builds or refurbishes 200-unit buildings at a cost of $15 million to $20 million.

"A lot of people are scared off by college students as tenants," Collier says. "I think most kids have an undeserved reputation. We get a lot of dirt, but very little damage." Student leases typically come with a parental guarantee, notes Baird analyst Lucas.

Before you buy an apartment building, sketch out a budget. Even if you keep it fully leased, you may be collecting rent only 10 months of the year, although a number of developers enforce 12-month leases. Property taxes, painting, cleaning and repairing can run to 40% of the rent roll. Hiring someone to screen applicants and collect checks (and hound late payers) will cost 10%. And even if you get a lot of hired help, plan on putting in a lot of your own hours. Collier visits each of his 34 properties every three months.

Schedule walk-ins. Inspecting utilities in an apartment on a regular basis will help you identify renters risking property damage—and keep them on high alert. If you're renting exclusively to students, state your policies clearly. Prohibiting parties that spill out into the hallway might go over easier if the complex offers a clubhouse that stays open late. F