Student investment properties

2. 0 Introduction

Property assets such as land and buildings are key resources for all types of organizations. Since there are a lots of demand in the property market, it caused investors started investing in property assets. Residential property is one of the target sectors to invest from investor's speculation.

However, investing in student property market (student investment properties) has become a new type of investing trend in residential property. There is an increase in the demand of student properties vicinity to any campus. Student properties are popular because of its location and accessibility. Hence, there is high demand towards the properties nearby to the area. It caused many investors involved in investing in this sector nowadays.

Furniture and facilities that provided in student properties is one of the factors that will took into consideration when students renting the unit. Thus, it can be one of the factors that investors will have to think of when investing in student property market. Furthermore, this chapter will discuss about the definition of investment, characteristic of real estate, parties involved in property investment, definition of rate of return / return on investment, capitalization rate, factors and reasons that should be considered when investing in student property market (student investment properties).

2. 1 Definition of Investment

Investing is defined in several ways, such as placing money for profitable purposes, or extending capital in return of perceived profits. Another definition for investing, favored by many economists, which is known as "

Investing is defined as giving up present consumption in exchange for future benefit”.

Business Dictionary defined that investment is money committed or property acquired for future income. In addition, it is also known as trading between risk and reward while aiming for incremental gain and preservation of the invested amount (principal). Two main classes of investment are:

1. Fixed income investment such as bonds, fixed deposits, preference shares
2. Variable income investment such as business ownership (equities) and

property ownership.

Investment means the purchase of any incoming yielding asset, such as securities (stocks and bonds), or real estate. The assets themselves are also referred to as investments due to financial theory. In economic theory, investment means expenditures for additions to capital. Capital is usually defined as man-made goods used in production, such as machines and other productive equipments (Anatol Murad, 1962).

2. 2 Characteristics of Real Estate

There are two types of characteristics which are known as physical and economic. (Real Estate Decision, 2002)

2. 2. 1 Physical Characteristic

Physical characteristic of land are its immobility, indestructibility, and nonhomogenity. Once the size and shape of a parcel of land are established, the legal nature of the land is also established with respect to mineral and air rights. Knowledge of the legal concept of land is important for making an analysis of its physical characteristics. Land in its legal sense is immobile because it cannot be moved from one place to another. Moreover, The location of the mineral rights and the air rights cannot be moved even if the surface is moved.

Land is indestructible in the sense that movement of the surface does not destroy the full package of rights. Even though there are many types of human act that may destroy the land but they are not capable to destroy land in its legal sense. Land cannot be destroyed because its location cannot be destroyed.

Land is non-homogeneous because each parcel of land can be distinguished from all other parcels of land on the basis of several physical characteristics. The size and shape, geological features of elevation, slope, drainage capacity, mineral composition, soil fertility, and bedrock characteristics can be different from each of parcel of land. However, even if all of these characteristics are perfectly identical, each parcel of land is unique because of its location. No two parcels of land occupy the same space on the earth's surface.

2. 2. 2 Economic Characteristic

The first economic characteristic of real estate is high price. Real estate is the only commodity that the typical consumer buys that is measured in multiples of that individual's or household's income. Second characteristic of real estate is shared with many other commodities that the consumer buys. It is because purchasing a real estate is generally undertaken with borrowed funds. The third economic characteristic of real estate arises from its physical characteristics of immobility, nonhomogenity, and location. The search costs, or information gathering costs, associated with comparison shopping are greater for real estate than for any other product. Purchaser must expend money and time to examine the many different units that are being considered for possible purchase or rental.

The fourth economic characteristic of real estate is scarcity. Because of total amount of land available is limited, real estate in both its components of land and improvements is not available in sufficient quantities to meet the desires that all individuals have for it. The fifth economic characteristic is the concept of situs, the economic location of a parcel of real estate. Each parcel is affected by changes in economic and demographic factors in the surrounding area because each parcel is immobile. Sixth economic characteristic is the influence that the quantity and the quality of surrounding structures and other off-site improvements to the land have on the property in question. For an example, the value of subject property increase when the quantity of desirable improvements increased, or when their physical quality improves. Finally, concept of fixity is the final economic characteristic. Real estate has a long physical and economic life because it cannot be moved or easily altered once the investment is fixed.

2. 3 Investing in Real Estate

According to Micheal C. Thomsett, (2009), there are several reasons of investing in real estate which are:

It is one of the few finite investments. Land is limited resources in the world. Hence, prices will rise when it is used up. Type of development such as development of housing, office, commercial, industrial, recreational, government, and lodging purposes is also limited due to limited amount of space can be used. There is some land which is used for reserve purposes, some cannot developed due to zoning restriction and topographical problem. It shows that land which is suitable for developing has become less followed by time passing and it shall be one of the sectors to invest.

Real estate is a safe investment compared with stock market. The historical record for real estate, like all markets, has had ups and down. But over time, real estate has kept pace with inflation and has usually exceed the Consumer Price Index (CPI) growth rate. The real estate cycle is highly predictable, following patterns based on normal supply and demand and varying regionally but in the same manner for each cycle. With a growing population caused by both natural increases and immigration, demand pressure on housing stock has continued. In addition, real estate is considered one of the basic needs to human. People need shelter and housing provides them with that. Hence, there are always demand in real estate.

Real estate investors can have opportunities for tax shelter which given by the local government. Real estate investors in United States enjoy exceptional federal income tax benefits. The benefits are unlike those available for any other investment. The 1997 Taxpayer Relief Act dramatically improved the tax benefits of owning your own home by eliminating the tax on profits for the first $500, 000 when primary residences are sold. Investors are allowed to deduct all of the necessary expenses connected with owning rental property, such as for repairs, cleaning, accounting, interest, property taxes and others. In addition, cost of improvements on the buildings over a period of years can be claim by real estate investors. Besides that, capital allowance, exemption of foreign investment tax and reduction of real property gain tax is an exceptional tax from Malaysia government to real estate investors.

Fourth, real estate is a visible investment. There is something satisfying and reassuring about owning an intrinsic property. Property is an tangible object and it is a fixed. It is visible and touchable. In comparison, investing in stocks market directly or through mutual funds is an intangible investment because investors own the company's real assets indirectly. (Micheal C. Thomsett, 2009)

2. 4 Investors involve in Real Estate

According to Jack Harvey , (1996), investing in real estate is usually involve private persons, private trusts and the institutions such as insurance companies, pension funds, charities, property companies, property bond funds and property unit trusts. Each of the parties involved in have different objectives and their preferences.

2. 4. 1 Private persons

Private person can be anybody who purchases a property rather than renting it. The return received from rented the property should at least equal to what could be obtained from the return invested in elsewhere. For example, a person may rent rather than buy a shop either through lack of capital or because it is considered that the money can be more profitably employed in carrying stock, and so on.

Owner-occupiers, for example, shop owners, farmers and households, are holding wealth in the form of real property. They enjoy a full equity interest income or satisfaction from the use of their property, and normally a hedge against inflation.

Other private persons investing in this property sector usually have only limited funds. Thus their direct investment tends to be restricted to dwellings and secondary shops. Indirectly, however, they can invest in prime shops and offices by buying property bonds or shares in property companies.

2. 4. 2 Insurance companies

Insurance companies try to match assets to future liabilities, and this largely determines the spread of their portfolios as between short term and long term fixed-interest investments and equity holdings. Due to short term and long term fixed interest investments, insurance companies find the advantageous to own properties directly rather than through shares in property companies because:

Direct investment in property gives the company more control than an investment in property company shares

A substantial holding of the shares of a property company (necessary to exercise some control) may be more difficult to dispose of than a first-class building.

The prices of buildings have tended to be less volatile than the prices of property company shares.

The high gearing of a property company is of little advantage to an insurance company, which always holds part of its assets in fixed money terms.

Holding shares in a property company represents an inefficient way invest in property, since corporation tax is deducted from profits attributable to dividend, whereas the insurance company pays a lower tax rate on life income.

Insurance companies still hold a part of their assets in mortgages as an alternative to fixed interest bearing stock.

2. 4. 3 Pension funds

Pension funds compete strongly with insurance companies and property companies in investing in real estate. it helps to retain the real value of the accumulated pension funds.

The smaller pension funds invest in property indirectly through pension fund property unit trusts, whose trust deeds limit membership to pension funds and charities enjoying tax exemption. Such trusts afford the advantages of property investment without management problems. They prefer to purchase and manage their own properties.

2. 4. 4 Charities and trusts

Charities and trusts are concerned not only with income (from which periodic distributions are made) but also with retaining the real value of thrust funds. Consequently, although they pay no income tax, they cannot invest entirely in high yielding securities. Charities receive some investment each year. They are therefore constantly reviewing their existing portfolios. The function is to observe that possible adjustments could best serve their beneficiaries in present and future condition.

2. 4. 5 Property companies

Property investment and development companies have grown considerably since 1945, largely reflecting the boom in urban redevelopment. Most tend to be highly geared, their capital consisting of a high proportion of loans to ordinary shares. Properties owned provide the security against borrowing, while interest charges are covered by regular rents. High gearing is beneficial to the few ordinary shareholders when profits are good, and it makes it easier to retain control.

The larger companies tend to specialize in office blocks or prime shop properties, and a few (such as Slough Estates) in industrial property. Residential property investment is confined mainly to smaller companies, many of which engage in ‘ break-up’ operations, selling houses and flats to fitting tenants or, when vacant possession is obtained, to owner-occupiers.

2. 4. 6 Foreign investors

Overseas investment in UK property has increased considerably since the fall in property prices through the recession and the 1992 devaluation of sterling. Foreign banks have also been active in funding such purchasers.

2. 4. 7 Property bond funds

The person wishing to invest in property is faced with the snag of having insufficient funds to buy prime property, the kind which has shown the greatest capital growth. The property bond fund, a comparatively recent innovation, partly succeeds in overcoming this difficulty. Subscribers buy a number of units in a fund which invests the money in first class property. These funds take an active interest in the management of their properties, revaluing them at fixed intervals.

2. 4. 8 Property unit trusts

A similar principle operates with those unit trusts which specialize in property, nut in order to avoid management commitments, such unit trusts use their funds to buy shares in property companies such as hotels which are concerned with property.

2. 5 Rate of Return / Return On Investment (ROI)

From Wikipedia, Rate of Return (ROR), also known as Return on Investment (ROI), rate of profit or sometimes just return, is the ratio of money gained or lost (whether realized or unrealized) on an investment relative to the amount of money invested. The amount of money gained or lost may be referred to as interest, profit/loss, gain/loss, or net income/loss. The money invested may be referred to as the asset, capital, principal, or the cost basis of the investment. ROI is usually expressed as a percentage rather than a fraction.

Return on Investment is the actual earnings from the investment. This is apart from any returns that represent repayment of the principal invested (called amortization). In real estate, it is sometimes difficult to determine how much of income is Return on Investment and how much is a Return of Investment. It depends on what types of properties are invested. For example, renting a property that depreciates in value, some of the rental income must go toward significant repairs or even, eventually, replacing the building when it become useless from age or obsolescence.

It is vital because it makes a difference in evaluating the performance of the investment. The Return on Investment determines how well the money is invested. Return of Investment affects risk of capital. The sooner the investment is recovered, the less risk there is of losing it. Measures of Return on Investment include the equity dividend rate, based on a one year analysis, and the internal rate of return, based on a multi-year projection by using discounted cash flow techniques. There are few elements need to be included when considering rate of return. The elements are:

A safe rate: the rate that could get if putting the money into a perfectly safe and liquid investment.

A liquidity premium: compensates for the difficulty of and time required in selling the property. Stocks and bonds may be sold at market value within a moment's notice, whereas selling real estate may take months or years.

A management premium: for the burden of monitoring and making decision about the investment.

A risk premium: accounts for the chance that may not get back the money invested or the return will be lower than expected.

Formula for ROI = NOI

Capital of the Investment

2. 6 Capitalization rate

Formula for Cap Rate = NOI Estimated Market Value = NOI

Market Value Cap Rate

From Real Estate Investment Analysis Software, it defines that Capitalization Rate (“ Cap Rate”) is a ratio used to compare properties with different valuations, and to also place a value on a property based on the income it generates. The Cap Rate is computed by taking the rental net operating income (NOI) and dividing it by the property’s fair market value (FMV). The higher the Capitalization Rate is the better.

Capitalization Rate or Cap Rate is also known as a ratio used to estimate the value of income producing properties. Put simply, the cap rate is the net operating income divided by the sales price or value of a property expressed as a percentage. Investors, lenders and appraisers use the cap rate to estimate the purchase price for different types of income producing properties. A market cap rate is determined by evaluating the financial data of similar properties which have recently sold in a specific market. It provides a more reliable estimate of value than a market Gross Rent Multiplier since the cap rate calculation utilizes more of a property’s financial detail. The GRM calculation only considers a property’s selling price and gross rents. The Cap Rate calculation incorporates a property’s selling price, gross rents, non rental income, vacancy amount and operating expenses thus providing a more reliable estimate of value.

The Cap rate may vary in different areas of a city for many reasons such as desirability of location, level of crime and general condition of an area. In a real estate market where net operating incomes are increasing and cap rates are declining over time for a given type of investment property such as office buildings, values will be generally increasing. If net operating incomes are decreasing and capitalization rates are increasing over time in a given market place, property values will be declining.

From Investopedia, capitalization rate is a method used to convert an estimate of a single year's income expectancy into an indication of value in one direct step, by dividing the income estimate by an appropriate rate.

2. 7 Reason that student property market is attractive to investors, Real Estate Research in United Kingdom, 2007

The student property market is attractive to investors for a number of reasons. Firstly, demographic trends support increasing demand, in terms of both the magnitude of population growth and matriculation rates. University-owned supply has failed to keep pace with demand growth, leaving a large and growing supply gap, as the private sector has been slow to fill the void. Moreover, much of the existing student housing stock is old and obsolete, and does not meet evolving industry standards or satisfy student preferences in terms of unit design and project amenities. Thus, the effective gap between the units preferred and those actually supplied is magnified.

Per-unit rents for student housing generally exceed those for normal apartments, as units have more tenants paying rent. Recent rent growth also has been greater. Rents and occupancy tend to be less sensitive to economic cycles than normal apartments. It does not affect much by economic factor especially during economic recession period. Besides that, credit-loss at student complexes typically is below that of conventional apartments because they got parents as their guarantee. Parents are the person who responsible to the rental paying of the students. Thus, it makes the investors in this sector more secure.

2. 8 Risk factor when investing in student property, Real Estate Research in United Kingdom, 2007

Student property presents a number of challenges and risks unique to this sector, which if not managed property, can affect the performance of the investment. They are:

Short leasing cycle: Most student property is leased during a narrow window of time during the spring semester, and few students move during the academic year, so prospects for filling vacancies once this window has passed are limited. If management has misjudged rents or amenities, it could have long-term implications for the project.

High reliance on a single source of demand: Demand for student property primarily comes from one nearby university (though student housing projects in urban markets sometimes can draw from more than school). Developers and investors must know the local student population and admission trends and gear their product toward their student base.

High turnover: Unit turnover during the academic year is small, but only about one-third of students typically renew, creating high annual turnover that all occurs in a concentrated time.

Reputation: Word of mouth is the key to marketing efforts for off-campus property. If a property is not well managed or maintain, students will quickly spread the word, which could affect future demand.

Wear and tear: Maintenance costs can be higher for student property due to more intensive use by the students, and the short time to turn-around units (

though the perceived extent of student abuse is sometimes exaggerated relative to the reality).

Economic cycles: The demand for student housing overall is less cyclical than that for other real estate categories. Student enrollments do not vacillate as dramatically as do, say, employment and consumer spending. Even so, students will seek for less expensive units during recessions. Weak market conditions for regular apartments can attract students seeking bargain rents.

2. 9 Summary of Chapter

This chapter on literature review has discussed the definition of investment, rate of return, capitalization rate, characteristic of real estate, investors investing in real estate, reason investing in real estate, reason investing in student property market (student investment property) and risk investing in student property market (student investment property).

Rate of Return / Return on Investment is considered same as Capitalization Rate in this study. Capital of the investment is similar with market value of the property that would be investing in. In addition, research methodology used in gathering the information will be discussed in the following chapter. The process of data collection, analysis and determination on study area also will be explained in the following chapter.