

GCP Student Living

FY19 results

Continuing to benefit from strong fundamentals

GCP Student Living (DIGS) is continuing to benefit from strong supply-demand fundamentals in the markets in which it operates, primarily in and around London. It is maintaining full occupancy, rents continue to grow ahead of inflation and profitability is showing the benefits of scale. Dividends are growing and cover building as new assets come on stream, and DIGS is well on track for full cover on a fully developed and let basis. Investor sentiment towards the sector is positive and the new London Plan appears to be adding to the scarcity value of DIGS's London assets.

Year end	Rental income (£m)	Adjusted earnings* (£m)	Adjusted EPS* (p)	EPRA NAV/share (p)	DPS (p)
06/16	22.5	9.7	5.30	136.9	5.66
06/17	28.8	13.6	4.69	139.1	5.75
06/18	35.8	15.4	4.01	149.1	5.95
06/19	44.4	21.2	5.23	165.5	6.15

Note: *Adjusted for revaluation movements, gains/losses on disposal, licence fees on forward-funded developments and other exceptional items.

Strong student and investor demand in London

Positively for DIGS, with 87% of its assets in and around London, international student applications continue to grow (+8.9% for 2019/20) and despite Brexit, EU applications also show slight growth. Government plans to boost international student numbers and income are also positive. The operational assets are again fully occupied for 2019/20, with like-for-like rental growth of 4.4% (2018/19: 3.5%). In the investment market, recent transactions indicate continuing strong investor interest in London assets in particular and the new London Plan seems likely to further reduce the supply of new London assets and increase the scarcity value of existing assets.

15.4% NAV total return in FY19

As DIGS had previously reported, EPRA NAV per share increased by 11% to 165.5p in FY19 and, including reinvestment of dividends paid, the NAV total return was 15.4%. Based on the share price, shareholder total return was 14.8% and the annualised return since IPO is now 12.9%. Rental income growth of 24% included a nine-month contribution from Scape Bloomsbury, above inflation rental growth, and continued full occupancy. The operating margin increased to c 59% from c 57% and adjusted EPS grew c 30% to 5.23p. DPS declared increased 3.4% to 6.15p and was 85% covered by adjusted earnings. Property valuations were lifted by rental growth, operational progress, full occupancy and a further tightening of market yields. The current year will benefit from a full contribution from Scape Bloomsbury and a first-time contribution from Circus Street, Brighton.

Positive fundamentals support growth and returns

Growing dividends are supported by continuing strong fundamentals in DIGS's chosen markets and should be covered by adjusted earnings on a fully operational basis. The shares trade at a small discount to NAV, despite share price and NAV returns since the IPO continuing to be well above the 8–10% target, and good potential for further income and capital growth.

Real estate investment trusts

12 September 2019

Price 163.0p

Market cap £632m

NAV* 165.52p

Premium/(discount) to NAV (1.5%)

*EPRA NAV (including income) as at 30 June 2019

Yield* 3.8%

*Based on Q419 DPS of 1.56p annualised of 6.24p

Ordinary shares in issue 413.6m

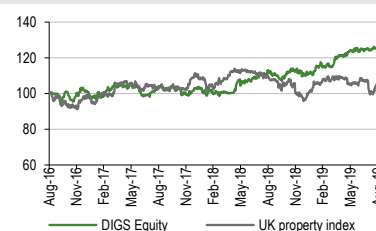
Code DIGS

Primary exchange LSE

AIC sector Property – UK residential

Benchmark N/A

DIGS vs UK property index (3 years)



52-week high/low 156.2p 138.4p

NAV high/low 146.9p 138.4p

Gearing

Loan to value* 26%

*As at 30 June 2019

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GCP Student Living is a research client of Edison Investment Research Limited

Exhibit 1: GCP Student Living at a glance

Investment objective and fund background

GCP Student Living is a specialist UK real estate investment trust (REIT) investing in student residential assets, with a focus on London. The company seeks to provide shareholders with attractive total returns in the longer term through the potential for modest capital appreciation and regular, sustainable, long-term dividends with inflation-linked income characteristics.

Recent developments

- 4 September 2019: annual financial report to 30 June 2019 – EPRA NAV 165.52p (cum-income) from 149.12p at 30 June 2018. Total DPS declared in period 6.15p (FY18: 5.95p). One-year share price total return (dividends reinvested) 14.8% and NAV total return 15.4%.
- 3 September 2019: portfolio update. Operational assets fully let for 2019/20 academic year with like-for-like student rental growth 4.4%.

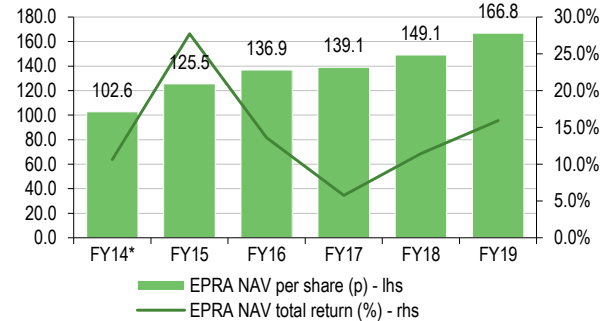
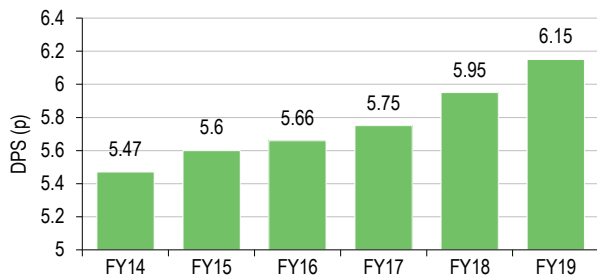
Forthcoming		Capital structure		Fund details	
AGM	November 2019	Ongoing charges	1.31% (excluding direct property costs)	Group	Gravis Capital Management
H120 results	Mar 2020e	Loan to value	26% (June 2019)	Manager	Nick Barker
Year end	June	Annual mgmt fee	1.0% of NAV	Address	24 Savile Row, London W1S 2ES
Dividend paid	Mar, Jun, Sep, Dec	Performance fee	None	Phone	020 3405 8500
Launch date	May 2013	Trust life	Indefinite	Website	www.gcpstudent.com
Continuation vote	November 2021	Loan facilities	£335m (£252m drawn at 30/06/19)		

Dividend policy and history

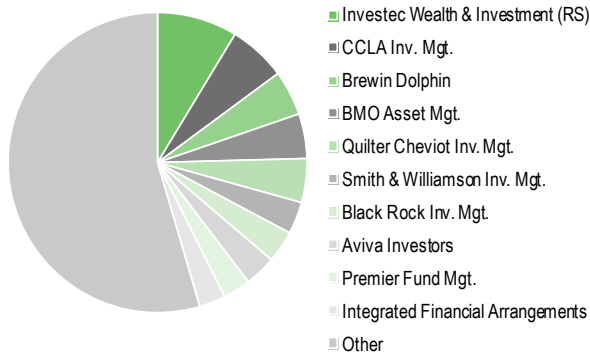
DIGS pays dividends quarterly. A key objective is to provide regular, sustainable, long-term dividends. FY14 is pro rata the 6.10p in dividends declared for the accounting period 20 May 2013 to June 2014, as published by DIGS.

EPRA NAV per share and EPRA NAV total return history

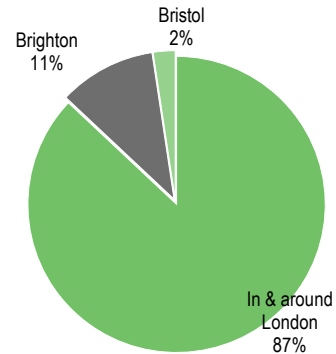
EPRA NAV total return from IPO to end-FY19, with dividends reinvested, has been 13.9%. Based on the share price performance over the same period with dividends reinvested, annualised shareholder total return has been 12.9%.



Major shareholders



Geographic exposure by property value (at 30 June)



Portfolio summary (at 30 June 2019)

Property	Location	Date of completion	Valuation (£m)	NIY*	No. of beds
Scape Mile End (formerly Scape East)	East London	2012	154.5	4.58%	588
Scape Wembley	North London	2017	97.3	4.85%	578
Scape Shoreditch	East London	2015	208.9	4.33%	541
Scape Bloomsbury	Central London	2018	189.6	4.10%	432
Scape Greenwich	East London	2014	58.1	4.68%	280
Podium	Egham	2017	31.5	5.65%	178
The Pad	Egham	Phase 1: 2012/Phase2: 2015	33.9	5.80%	220
Scape Surrey	Guildford	2015	28.4	5.15%	141
Circus Street**	Brighton	2019e	55.5	N/A	450
Water Lane Apartments	Bristol	2015	21.9	5.35%	153
Scape Brighton***	Brighton	2020e	42.1	N/A	555
Total			921.6	4.54%	4,116

Source: GCP Student Property. Note: *NIY is net initial yield. **Circus Street is a forward-funded new development under construction or refurbishment at 30 June 2019 and expected to complete in 2019 at a total cost of c £70m. ***Scape Brighton is a forward funding agreement that is expected to complete in 2020.

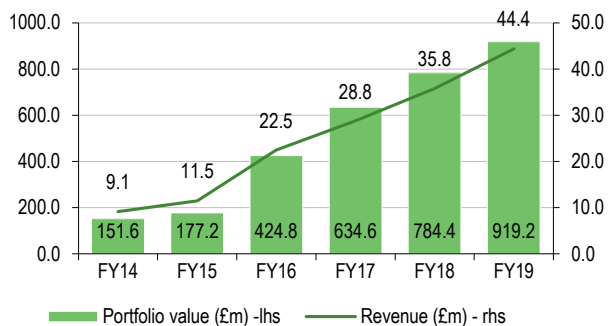
London-focused student accommodation

DIGS is a specialist UK REIT investing in student residential assets and differentiated by a focus on assets in and around London, 87% by value at 30 June 2019 (FY19). The shares have been listed since May 2013 and the company has a premium listing on the FCA's Official List, trading on the Premium segment of the Main Market of the London Stock Exchange. The investment objective is to provide shareholders with attractive total returns in the longer term through regular, sustainable dividends with inflation-linked characteristics and the potential for modest capital appreciation. DPS has increased steadily since IPO and the annualised EPRA NAV total return from IPO to end-FY19, with dividends reinvested, has been 13.9% (15.4% in FY19). Based on the share price performance over the same period with dividends reinvested, the annualised shareholder total return has been 12.9% (14.8% in FY19).

The student housing sector continues to attract investor interest for its favourable risk-adjusted yields, good levels of rental growth and less exposure to the economic-led cycles that affect traditional commercial property sectors such as offices, industrial and retail property. DIGS is differentiated by a focus on properties that are located primarily in or around London and invests in other markets with similar supply-demand characteristics (eg Brighton), where growing student numbers significantly outstrip the supply of student accommodation. London continues to see increasing numbers of international and post-graduate students, driving demand for purpose-built student accommodation (PBSA), while planning restrictions and competing demands limit supply. The investment manager targets high-specification, modern, purpose-built accommodation with proximity to a suitable higher education institution and/or a major transport hub. Such properties may be more likely to both appeal to students today and offer longevity of income potential to support long-term value creation, even if the current yields may be lower.

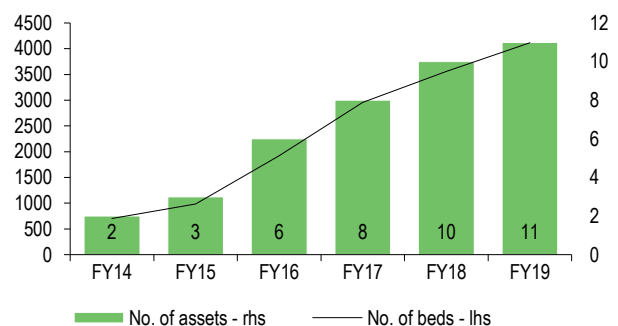
At end-FY19, the portfolio comprised the 11 assets shown at the bottom of Exhibit 1, providing c 4,100 beds, of which c 3,500 will be operational and fully let for the 2019/20 academic year. The portfolio was externally valued at £921.6m (before lease incentive adjustments), reflecting a net initial yield (NIY) of 4.54%.

Exhibit 2: Portfolio value* and revenues since IPO



Source: Company data, as at 30 June 2019. Note: *Balance sheet carrying value net of lease incentives.

Exhibit 3: Number of assets and beds since IPO



Source: Company data at 30 June 2019

Management and governance

Fully independent board

DIGS has a fully independent non-executive board that is responsible for the effective stewardship of the company's affairs, including corporate strategy, corporate governance, risk assessment and overall investment policy. DIGS has been chaired since IPO by Robert Peto, who has extensive

corporate, property sector and board experience. He will retire from the board at the AGM to be held late in 2020 and will be replaced by David Hunter, who joined the board in May 2019. David Hunter is a qualified chartered surveyor and a professional strategic adviser focused principally on UK and international real estate. He is on the board of listed and unlisted companies in the UK and overseas, including as chairman of Custodian REIT and ICG-Longbow (the real estate division of Intermediate Capital Group), senior independent director of Yatra Capital, a director of Saffron India Real Estate Fund and is an adviser to French family office, Quilvest.

The other four independent non-executive directors and their dates of appointment are Malcolm Naish (2013, IPO), Marlene Wood (March 2015) and Gillian Day (February 2018). Full board biographies may be found on the company's [website](#).

DIGS has an unlimited life, although the company's articles require regular continuation votes to be put to shareholders. The first vote was held in November 2018 and, given DIGS's outperformance of the return targets that were set at IPO and the continuing strong fundamentals of the markets in which it operates, shareholders overwhelmingly supported continuation. Future votes are at three-yearly intervals, with the next to be held at the AGM in 2021.

Investment manager – Gravis

DIGS has appointed Gravis to provide day-to-day investment management services. Gravis was established in 2008 and is privately owned by its directors and founding members. At 30 June 2019 it was managing £2.7bn in assets, including two other listed closed-end vehicles. Nick Barker from Gravis is the fund manager with day-to-day responsibility for the provision of investment advice to DIGS. He is a qualified surveyor who joined Gravis in 2015 after eight years with Schroder Real Estate Management, where he was head of alternatives for the real estate business and a member of the fund management team. Investment management fees are accrued daily and paid quarterly in arrears at 1% of NAV from which Gravis is responsible for the asset management fees of 0.25% of NAV.

Asset and facilities management – predominantly Scape

Scape Student Living (Scape) is the principal asset and facilities manager for DIGS, in respect of all the Scape-branded assets as well as The Pad and Podium. Collegiate provides asset and facilities management for the Water Lane Apartments in Bristol. As a developer and manager, Scape has extensive expertise in the construction, design and operation of student accommodation and its branding proposition is to provide high-quality but affordable student accommodation with a modern design. The first Scape building was launched in London's Mile End in 2012 and today it designs, builds and operates buildings for students across the globe, with 18,000 beds in operation or under development. Scape manages the DIGS facilities while the actual asset management costs (such as on-site staff, utilities, etc) are paid directly by DIGS, a structure that is both operationally and tax-efficient, avoiding additional non-deductible VAT expenses that may otherwise arise. The Scape fees (0.25% of NAV pa) are paid by Gravis out of its (1%) fee entitlement. DIGS has benefitted from the close relationship between Scape and Gravis, whose owners have a 50% interest in Scape, through preferential access to pipeline assets.

FY19: Strong income growth and increased DPS cover

The portfolio continued to perform well in FY19, benefiting from the supply-demand imbalances for high-quality, modern student facilities in those locations targeted by the company. The assets under development are on track to deliver further income growth and the company continues to identify attractive opportunities for further investment.

Rental income grew strongly (24.1%), benefiting from new assets becoming operational, above inflation rental growth and continued full occupancy. Profitability is also showing the benefit of scale

economies, with adjusted earnings and adjusted EPS up 37.5% and 30.5% respectively. Increased dividends (up 3.4% in the year) have been set and investment decisions made based on the investment manager's expectation that they will be covered by earnings on a fully developed and let basis. With dividends covered 85% by adjusted earnings (we estimate cover of 89% in H219), the company is well on track to achieving this. EPRA (and IFRS) NAV per share increased by 11.0% during the year to 165.52p. Including the reinvestment of dividends paid during the period, the NAV total return was 15.4%.

Exhibit 4: Financial results summary					
£m unless stated otherwise	FY19	FY18	FY19/FY18	H119	H219
Rental income	44.4	35.8	24.1%	20.9	23.5
Property operating expenses	(9.4)	(7.9)	17.8%	(4.5)	(4.8)
Gross profit	35.0	27.8	25.9%	16.4	18.7
Gross margin	78.9%	77.8%		78.4%	79.4%
Administrative expenses	(8.8)	(7.4)	18.5%	(4.0)	(4.8)
Operating profit before gains on investment properties	26.2	20.4	28.6%	12.4	13.8
Operating margin	59.1%	57.0%		59.4%	58.8%
Fair value gains on investment properties	73.9	47.6	-35.6%	39.9	34.0
Operating profit	100.1	68.0	47.3%	52.3	47.8
Net finance expense	(7.3)	(6.9)	5.8%	(3.4)	(3.9)
PBT	92.8	61.1	52.0%	48.9	43.9
Tax charge	0.0	0.0		0.0	0.0
IFRS profit for the year	92.8	61.1	52.0%	48.9	43.9
Adjust for:					
Fair value gains on investment properties	(73.9)	(47.6)		(39.9)	(34.0)
License fees on forward funded developments	2.3	1.5		1.0	1.3
Exceptional items	0.0	0.4		0.0	0.0
GCP adjusted earnings	21.2	15.4	37.5%	9.9	11.2
IFRS basic EPS (p)	22.92	15.89	44.3%		
GCP adjusted EPS (p)	5.23	4.01	30.5%		
DPS (p)	6.15	5.95	3.4%		
Dividend cover (Adjusted earnings)	85%	67%			
IFRS and EPRA NAV per share (p)	165.52	149.12	11.0%		
Net asset value	684.7	574.2	19.2%		
Investment property value	919.2	784.4	17.2%		
Net debt	(235.8)	(205.8)	14.6%		
LTV	25.7%	26.2%	-2.2%		

Source: Company data

The key financial highlights from the FY19 results were:

- The 24.1% growth in rental income to £44.4m was driven by a first-time (c nine-month) contribution from Scape Bloomsbury, which opened for the 2018/19 academic year following refurbishment, and average 3.5% rental growth across the portfolio. The portfolio was again fully occupied for the 2018/19 academic year.
- The scale benefits of the growing portfolio can be seen in both increased profits and enhanced profitability. Gross profit increased by 25.9% to £35.0m with the gross margin increasing slightly to 78.9%. At 18.5%, the growth in administrative costs, which comprise fund running costs, including the investment manager's fee and other third-party service provider costs, was lower than the growth in gross profit. As a result, the operating margin increased to 59.1% (FY18: 57.0%) and operating profit before property valuation movements increased by 28.6% to £26.2m.
- The increase in net finance expense was just 5.8%, reflecting a modest increase in debt during the year as the company began to use its re-drawable debt facility. Property investment during the year was additionally funded out of cash resources, which included £42.3m net proceeds from new equity issuance.
- The carried value of the investment portfolio (adjusted for lease incentives on the small amount of commercial space attached to the portfolio) has increased to £919.2m, including £59.6m investment spending on the Circus Street, Brighton and Scape Brighton forward-funded assets and a net fair value movement of £73.9m. Revaluation movements were driven by rental growth, operational progress and yield compression, with the latter given evidential support by a number of important market transactions in and around London. The end-FY19 blended net

initial yield on the DIGS portfolio was 4.54% compared with 5.04% at end-FY18 and 4.74% at H119.

- Including the revaluation gains, IFRS earnings increased by 52% compared with FY18, to £92.8m. Adjusted earnings, which excludes the valuation gain, adjusts for other one-off items, and includes licence fees on forward funding developments, increased by 37.5% to £21.2m. Adjusted EPS increased 30.5% to 5.23p.
- Aggregate dividends declared for the year were 6.15p, an increase of 3.4% and, as the company had previously guided, dividend cover increased strongly. Adjusted earnings covered DPS by 85% in the year compared with 67% in FY18 and on a fully operational and let basis, DIGS continues to expect dividends paid to be fully covered by earnings.
- Post the year-end the company's operational portfolio achieved full occupancy with respect to the 2019/20 academic year, with like-for-like growth in student rents of 4.4%.

Investment strategy and portfolio update

The company's property portfolio consists of high-quality, modern, purpose-built accommodation primarily in and around London (Exhibit 1). Some of the assets include a relatively small amount of complementary commercial space, contributing c 6% of the FY19 gross rental income. In London, a shortage of suitable accommodation, tight constraints on new supply and growing demand, particularly from overseas students, is a supportive backdrop to occupancy and rent levels, providing visibility over income. These same supply constraints can also present a challenge to asset growth, but the relationship with Scape has been particularly effective in helping DIGS access attractive properties that meet its investment criteria and steadily grow its portfolio. The London Plan, expected to be introduced later this year, is likely to create new barriers to the development of such properties and increase the investment attraction of existing assets.

Most of DIGS' student accommodation is directly let to students from a broad range of nationalities (124) attending a diverse group of higher education institutions (80). Reflecting the London focus of the portfolio and the popularity of London with international students, 63% of rooms are let to non-EU international students, 14% to EU students and 23% to UK students. Of these, 70% are undergraduates and 30% are postgraduates.

Scape Bloomsbury delivered ahead of schedule

Scape Bloomsbury, providing 432 beds in the heart of central London, was completed ahead of schedule, in time for the 2018/19 academic year. DIGS had initially expected to open the first five floors in September and the top three in December but was able to fully open in September with higher than budgeted overall initial occupancy. Annualised rental income is c £9m and Scape Bloomsbury contributed for around nine months in FY19, with a further income uplift to come through in FY20 from a full-year contribution and a step up to full occupancy. The planning consent for Scape Bloomsbury permits occupation by non-students outside of the academic year that, given its prime location, is likely to prove a useful additional source of revenue. It was valued at £189.6m at end-FY19, reflecting a net initial yield of 4.10%, and contributed significantly (£18.7m) to the FY19 property revaluation surplus.

Brighton forward-funding assets on track

In May 2019, DIGS acquired **Scape Brighton**, its second asset in Brighton, having entered into a conditional contract to acquire and forward fund the asset in July 2018. Like London, Brighton is a difficult market in which to acquire direct-let, purpose-built student accommodation owing to tight land supply and strict planning constraints. Scape Brighton is situated on the University of Brighton's main campus and on completion, expected in time for the 2020/21 academic year, will provide 555 beds and extensive communal areas, with c 1,500sqft of retail space. The planning

consent allows for the property to be available to accommodate students from any of Brighton's higher education institutions in addition to any language school students during the summer period. During the construction phase, DIGS will benefit from licensing fees in respect of the development funding extended, providing a 5.5% coupon pa and included in adjusted earnings.

Construction work on the c 450-bed, forward-funded office project at **Circus Street** in central Brighton is proceeding in line with expectations and nearing completion in time for the 2019/20 academic year. Unlike most of DIGS assets, Circus Street is let on a 21-year, RPI-linked lease to Kaplan at an initial rent of £2.9m. The development includes a standalone, speculatively developed Grade A office building, which is generating strong interest from potential occupiers and investors given a tight Brighton market. It will be retained or sold and the capital recycled when completed and stabilised, depending on the nature of the tenant. During the construction phase, licencing fee income, at a rate of 5.5% pa of the funding extended, has been recognised in adjusted income.

Further growth in the pipeline

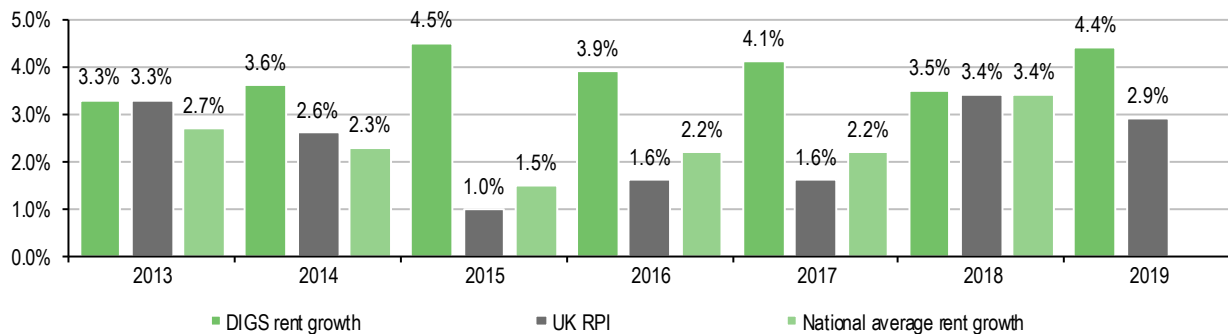
DIGS also benefits from a future contractual arrangement to acquire **Scape Canalside**, a 412-bed, new-build asset located adjacent to Queen Mary University of London, a strong Russell Group higher-education institution, and is considering the optimum way to finance its acquisition. The asset is a high-specification, purpose-built private student accommodation residence, the design of which and its market positioning are complementary to the existing 588-bed Scape Mile End (formerly Scape East) that is in the same locality. Scape Canalside achieved practical completion in July 2019 and has been fully let for the 2019/20 academic year. Through its investment manager, DIGS has secured attractive pricing through the forward purchase agreement, which the company expects will result in an uplift in the valuation post purchase, expected to coincide with the start of the academic year. The actual acquisition price will be determined by independent valuation, but the company has said this is likely to be in excess of £90m.

Additionally, the company has entered into a conditional forward-purchase agreement to acquire a well-situated, high-specification, purpose-built asset with 403 beds in the same locality as its 141-bed Scape Guildford asset. **Guildford** is home to the University of Surrey (a UK top 20 university), the University of Law and the Academy of Contemporary Music, contributing to an undersupply of private student residential accommodation and full occupation at Scape Surrey in each year since its acquisition in 2015. DIGS has provided no financial details at this stage. The property is expected to complete in time for the 2020/21 academic year.

Continuing above-inflation rental growth

In terms of income returns, DIGS targets regular sustainable dividends with inflation-linked characteristics. A relatively small proportion of rental income is contractually directly linked to RPI (Circus Street at completion will be an exception), so the inflation-linked characteristic relies on the selection of suitable assets and locations with favourable demand-supply dynamics that have the potential to deliver continuing rental growth. Exhibit 5 shows that DIGS has been able to sustain rental growth in excess of both RPI and the market over several years, achieving average like-for-like rental growth of 3.5% in the academic year beginning in 2018 (and reflected in the FY19 results) and 4.4% for the academic year commencing in 2019 (to impact on FY20).

Exhibit 5: Rental growth



Source: DIGS. Note: DIGS sources national average from CBRE.

Funding in place, with increased flexibility

At the end of FY19, DIGS had available debt facilities of £335m, of which £252.1m had been drawn. Allowing for the £15.5m cash balance, net debt was £235.8m and the loan to value ratio (LTV) was 25.7%. The blended average cost of the drawn debt was 2.94%, with an average weighted maturity of c seven years.

The debt facilities comprise £235m of fixed-rate borrowing at an average 2.96% and £100m of more flexible floating rate debt.

Towards funding the continuing growth of the portfolio, in FY19 the company raised gross proceeds of £43.1m by way of two non-pre-emptive placings of new ordinary shares and secured additional debt facilities amounting to £100m. The new debt facilities, with Wells Fargo, comprise a three-year re-drawable credit facility of up to £45m at a margin of 1.85% above three-month Libor and a development facility of up to £55m at a 3.1% margin over three-month Libor during the construction phase, falling to 2.0% over Libor once the asset has been completed and stabilised.

The re-drawable credit facility provides more flexible debt finance than fixed long-term debt and will be available for use in funding the completion of Circus Street, Brighton, and initial construction costs at Scape Brighton, as well as general corporate purposes. The development facility will be drawn over time and is intended to part-fund the construction of Scape Brighton. Once Scape Brighton is completed and stabilised, the development loan will be refinanced, allowing it to be repaid by the due date (December 2021 with a conditional option to extend for a further 12 months).

DIGS's immediate investment plans at end-FY19 include the remaining forward funding commitments to Circus Street and to Scape Brighton, and the expected purchase of Scape Canalside under the forward purchase agreement. DIGS has indicated that if the acquisition of Scape Canalside were to be funded entirely with new borrowings, the LTV would increase to a c mid-30s percentage as the forward-funded assets complete over the next 12–18 months.

No decision has yet been made as to whether to proceed with the conditional forward-purchase agreement in respect of the Guildford asset.

Positive market developments

The London difference

The demand for full-time higher education and the supply of purpose-built accommodation is not evenly distributed across the UK. From a student demand-supply perspective, the differentiating features of the London market, where 87% of DIGS's assets are located, can be summarised as:

- It is home to 23 universities, with more ranked in the top 40 by The Times Higher Education World University Rankings than any other city in the world.
- As a result of the high standard of education available and the wider appeal of London as a place in which to live, a quarter of all international students studying in the UK are based there.
- London universities are only able to supply accommodation to c 30% of their first year and international students. New supply is constrained by planning restrictions and competing demands limit supply.

Brighton shares similar market dynamics to London. It is home to the University of Sussex (a UK top 20 university) and the University of Brighton, with an aggregate c 32,000 students including c 8,000 international students. The city is also home to two of the largest English language foundation course providers in the UK.

International student numbers continue to increase

Data from the Universities and Colleges Admissions Service (UCAS) show that at the 30 June 2019 application deadline for the 2019/20 academic year, international (excluding EU) student applications were ahead by 8.9% compared with 2018/19, with Chinese applications particularly strong (+30%). This is a very positive development for DIGS, for which international students currently account for 63% of the total. In addition to the strength of demand, international students are often less price sensitive than domestic students when it comes to choosing suitable accommodation. EU applications (14.0% of the total for DIGS) were also up, but by a smaller 1.1%. Helping to counter Brexit uncertainties, EU students who entered in the previous 2018/19 academic year were guaranteed the same fee rates as UK students, as well as access to student finance for the duration of their courses. Including UK applications (down 1.1%), total applications were up by 0.2% to 638k. The decline in UK-domiciled applicants seems largely driven by demographics, although the long-term decline in the number of UK 18- to 20-year-olds should begin to reverse from 2020, while the desire to go to university, measured by participation rates, has continued to increase. Applications by UK students continue to significantly outstrip place/acceptances by a margin of c 30%.

Government encouraging further international growth

In March 2019, the UK Department for Education and International Trade published a plan to increase international student numbers by more than 30% and their income contribution to the economy from an estimated c £20bn currently to £35bn by 2030. There is no limit on the number of international students that can study in the UK and among the measures being suggested to achieve the new targets are proposals to extend the post-study period during which students may remain in the UK and potential measures to support them into UK employment.

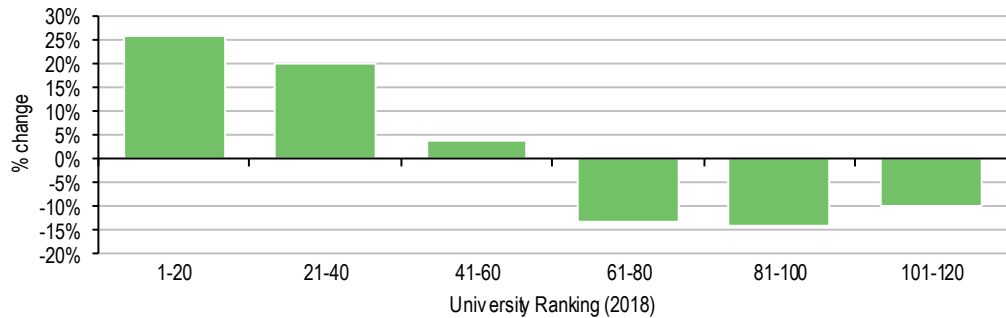
Augar proposals are positive

In May 2019 the report of the Augar Review of higher education suggested a reduction in tuition fees from the current £9,250 pa to £7,500 and an extension of student repayment periods from 30 to 40 years. The report also suggested a return of maintenance grants to assist poorer students. It is unclear whether and to what extent the proposals will be adopted by the government but, should this be the case, enactment should have a positive impact on UK student applications.

Migration towards top-performing universities

Since the UK government raised tuition fees to a maximum of £9,000 pa in 2012 (and subsequently increased to £9,250), which was followed by a removal of the cap on undergraduate student numbers in 2015, there is clear evidence that many students are influenced in their choice of university by its cost and the expected future benefit. This has enabled the top universities to grow in size while maintaining their academic requirements. Given its concentration of top universities (home to six of the top 40), London has benefited.

Exhibit 6: Change in student applications by ranking of UK universities (2012–18)



Source: DIGS, UCAS, Complete University Guide

The London Plan

The London Plan, prepared by the Mayor of London, is expected to be introduced later this year. It has been reported that it will require new student developments to be in partnership with higher education institutions and let under nomination agreements with them. The plan is also expected to require the provision of affordable student accommodation within each new scheme. It seems likely that such measures will negatively affect new private schemes by increasing complexity and diminishing the expected returns, adding further to supply constraints. This is likely to increase the scarcity value of DIGS's existing and pipeline London assets, but it will also make further London growth more difficult, underling the value of the relationship with Scape.

London investment transactions supporting yields

Investor sentiment towards the asset class remains positive and this is reflected in £3.9bn of student assets having been traded or being under offer so far in 2019. This compares with £3.2bn of investment in the whole of 2018. The favourable supply-demand environment and anticipation of the impact of the new London Plan can be seen in transactions relating to London assets and the continuing compression in London yields, also reflected in the DIGS portfolio.

We have previously commented on the August 2018 acquisition of a £350m stake in the £1.1bn, 5,100-bed Chapter portfolio, alongside existing investor Greystar Real Estate Partners, by Allianz and PSP Investments. Gravis estimates the transaction to have been at an NIY of c 4.0%. In March 2019, the same group of investors, through the Chapter portfolio, agreed to acquire an additional prime London student housing asset from Apache Capital. The transaction values the 458-bed Paul St East, EC2, purpose-built student accommodation block in Shoreditch at more than £160m, which Gravis estimates reflects an NIY of 3.75%, which is tighter than the NIY for Scape Shoreditch of 4.15% for the student accommodation and 4.33% overall (including the commercial space).

Also in March, Watkin Jones completed the £90m forward funding and sale of Kelaty House, a 599-bed student development in Wembley, to the real estate investment business of DWS, the investment management arm of Deutsche Bank of Germany and a new entrant into the UK student accommodation market. Gravis estimates that the 4.90% agreed forward-funding yield on the asset

is consistent with a stabilised investment yield of c 4.5%. Although Kelaty House and Scape Wembley are comparable in terms of size, the stabilised yield for Scape Wembley is 4.85% despite it benefiting from closer proximity to underground transport links. In August 2019, DWS followed up its Wembley investment by acquiring the regional Vita portfolio of c 3,200 beds for £600m at a yield estimated by Gravis to be c 5.30%.

Valuation and performance

Performance continues to outpace 8–10% return target

The 8–10% long-term return target that DIGS set at IPO reflects the anticipation of continued rental growth to drive income earnings and dividends, with a corresponding positive impact on capital values, assuming broadly stable yields and a positive impact from modest gearing. Returns since IPO have been well ahead of this target and the trend continued in FY19.

In the period from IPO (20 May 2013) to the last published quarterly NAV at 30 June 2019 (end-FY19), DIGS has generated an EPRA NAV total return (dividends reinvested) of 121.5% on the opening NAV per share (after issue costs) of 97p, or an annualised compound return of 13.9%. Over the same period, the share price total return (dividends reinvested) was an aggregate 109.8% on the IPO price of 100p, or an annualised compound return of 12.9%. The closing share price at 30 June 2019 was 162.2p.

Exhibit 7: Annualised returns performance

Annualised % return	One year	Three years	Five years	Since IPO
DIGS share price total return*	14.8	11.7	13.2	12.9
DIGS NAV total return**	15.4	10.9	14.8	13.9
All-UK property index total return	(5.9)	6.1	4.1	5.1
FTSE All-Share total return	0.9	11.0	6.3	6.0
Benchmark UK 10-year bond total return	6.6	2.7	5.9	4.5

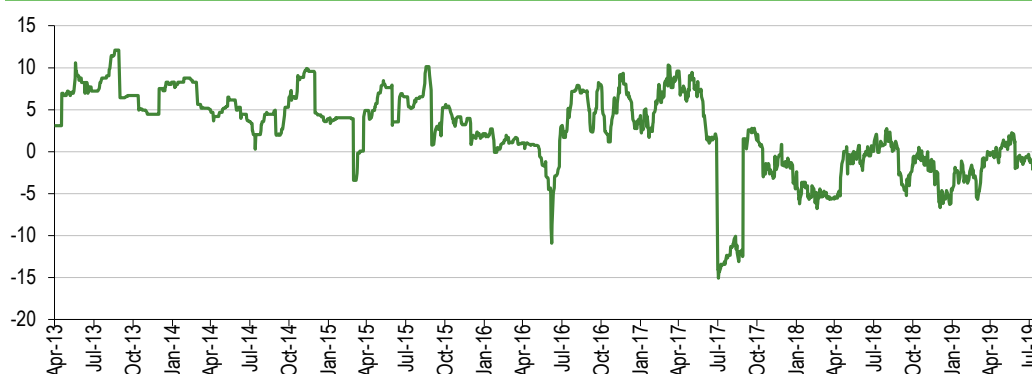
Source: Company data, Refinitiv, Edison Investment Research. Note: Data to 30 June 2019. Note: *Share price return since IPO based on IPO price of 100p. **NAV total return since IPO based on opening NAV, after issue costs, of 97p.

The DIGS returns are ahead of the broad UK commercial property sector, the FTSE All-Share Index and UK gilt returns over one, three and five years and since inception. The outperformance of DIGS compared with the broad UK commercial property sector has accelerated in recent months as the latter has been negatively affected by stresses in the retail subsector and more general economic uncertainty.

P/NAV below historical average

Recent strong growth in DIGS's NAV has outpaced the increase in the share price, which trades at a small c 1.5% discount to EPRA NAV. This compares with an average premium of c 2.5% since IPO and a peak premium of 12.1%.

Given that student accommodation as an asset class benefits from a more stable yield, with lower volatility than mainstream commercial property, the small discount to NAV appears attractive. Positive fundamentals in DIGS's target markets point to further rental growth. Combined with the completion and letting of assets under development, this should support future income growth and capital values, particularly given the continuing strong investor-led interest in PBSA assets, especially in London.

Exhibit 8: Share price premium/discount to NAV (including income) since IPO


Source: Refinitiv

In Exhibit 9, we show a summary valuation and share price performance comparison for the three UK-listed student accommodation companies, DIGS, Unite and Empiric. DIGS offers a higher dividend yield compared with Unite and trades at a lower P/NAV. Empiric has a higher yield but as it continues to reposition itself from internally driven trading problems in 2017, the prospects for dividend growth are modest. DIGS and Unite have both clearly outperformed the broad UK property sector and the FTSE All-Share Index over the past year.

In the near term, the continuing strong fundamentals in DIGS's target areas of the market and the further benefit to earnings, cash flow and dividend cover from the completion of assets under development are positive indicators for DIGS's performance. Perhaps even more important is DIGS's focus on larger and more efficient, well-designed and purpose-built assets, in good locations in supply-constrained markets, which provide comfort that the portfolio will be capable of sustaining performance over the long term.

Exhibit 9: Student accommodation valuations and performance

	Price (p)	Market cap (£m)	P/NAV (x)	Yield (%)	Share price performance			
					1 month	3 months	12 months	From 12m high
GCP Student Living	163	674	1.00	3.8	0%	0%	9%	-2%
Unite	1028	2985	1.25	2.9	0%	8%	16%	-6%
Empiric Student Properties	93	559	0.86	5.4	1%	2%	-3%	-7%
Average			1.04	4.0	0%	3%	7%	-5%
UK property index	1,671			4.1	5%	0%	-4%	-5%
FTSE All-Share Index	4,028			4.8	2%	0%	0%	-4%

Source: Company data, Edison Investment Research. Note: Prices at 11 September 2019. Based on last reported NAV and trailing 12-month DPS declared.

Exhibit 10: Financial summary

Year ending 30 June (£000's)	2014	2015	2016	2017	2018	2019
INCOME STATEMENT						
Rental income	9,132	11,505	22,482	28,806	35,790	44,410
Property operating expenses	(1,664)	(2,529)	(4,600)	(6,281)	(7,946)	(9,364)
Gross profit	7,468	8,976	17,882	22,525	27,844	35,046
Gross margin	81.8%	78.0%	79.5%	78.2%	77.8%	78.9%
Administrative expenses	(2,357)	(2,001)	(5,712)	(6,072)	(7,434)	(8,808)
Operating profit before gains on investment properties	5,111	6,975	12,170	16,453	20,410	26,238
Operating margin	56.0%	60.6%	54.1%	57.1%	57.0%	59.1%
Fair value gains on investment properties	5,010	25,660	27,156	11,855	47,565	73,865
Operating profit	10,121	32,635	39,326	28,308	67,975	100,103
Net finance expense - recurring	(2,412)	(1,336)	(3,366)	(4,794)	(6,917)	(7,317)
Non-recurring finance expense	0	0	(7,635)	0	0	0
PBT	7,709	31,299	28,325	23,514	61,058	92,786
Tax charge	0	(18)	3	(40)	0	0
Profit for the year	7,709	31,281	28,328	23,474	61,058	92,786
Adjust for:						
Fair value gains/(losses) on investment property	(5,010)	(25,660)	(27,156)	(11,855)	(47,565)	(73,865)
Fair value movement on financial derivative & close out fees	599	0	0	0	0	0
EPRA earnings	3,298	5,621	1,172	11,619	13,493	18,921
License fees on forward funded developments	0	0	0	1,421	1,490	2,263
Exceptional finance and other costs	0	0	8,519	394	427	0
Other	0	0	0	189	0	0
Adjusted earnings	3,298	5,621	9,691	13,623	15,410	21,184
Average number of shares (m)	73.4	109.9	183.0	290.5	384.3	404.8
IFRS EPS (p)	10.50	28.46	15.48	8.08	15.89	22.92
EPRA EPS (p)	4.49	5.11	.64	4.00	3.51	4.67
Adjusted EPS (p)	4.49	5.11	5.30	4.69	4.01	5.23
DPS declared (p)	5.47	5.60	5.66	5.75	5.95	6.15
Dividend cover (Adjusted earnings)	82%	91%	94%	82%	67%	85%
BALANCE SHEET						
Investment property	151,560	177,220	424,787	634,640	784,424	919,203
Other non-current assets	956	308	815	308	2,956	308
Non-current assets	152,516	177,528	425,602	634,948	787,380	919,511
Cash & cash equivalents	3,629	106,292	66,337	55,110	29,213	15,509
Other current assets	1,362	18,683	6,867	7,517	9,005	17,242
Current assets	4,991	124,975	73,204	62,627	38,218	32,751
Interest bearing loans & borrowings	(39,456)	(39,569)	(128,174)	(217,469)	(232,771)	(249,111)
Other non-current liabilities	(956)	(522)	(815)	(308)	(308)	(308)
Non-current liabilities	(40,412)	(40,091)	(128,989)	(217,777)	(233,079)	(249,419)
Financial liabilities	0	(117,422)	0	0	0	0
Other current liabilities	(4,240)	(7,261)	(11,349)	(12,804)	(18,309)	(18,180)
Total current liabilities	(4,240)	(124,683)	(11,349)	(12,804)	(18,309)	(18,180)
Net assets	112,855	137,729	358,468	466,994	574,210	684,663
EPRA adjustments	(47)	214	0	0	0	0
EPRA net assets	112,808	137,943	358,468	466,994	574,210	684,663
Period end number of shares (m)	109.9	109.9	261.8	335.8	385.1	413.7
IFRS NAV per share (p)	102.7	125.3	136.9	139.1	149.1	165.5
EPRA NAV per share (p)	102.6	125.5	136.9	139.1	149.1	165.5
CASH FLOW						
Net cash flow generated from other activities	5,943	6,356	4,171	14,168	21,398	25,614
Net cash used in investing activities	(87,038)	0	(210,561)	(195,469)	(101,439)	(66,199)
Net cash flow generated from financing activity	84,724	96,307	166,435	170,074	54,144	26,881
Change in cash	3,629	102,663	(39,955)	(11,227)	(25,897)	(13,704)
Opening cash	0	3,629	106,292	66,337	55,110	29,213
Closing cash	3,629	106,292	66,337	55,110	29,213	15,509
Debt as per balance sheet	(39,456)	(156,991)	(128,174)	(217,469)	(232,771)	(249,111)
Unamortised loan arrangement fees	(544)	(431)	(1,826)	(2,531)	(2,229)	(3,039)
Drawn debt	(40,000)	(157,422)	(130,000)	(220,000)	(235,000)	(252,150)
Net debt	(36,371)	(51,130)	(63,663)	(164,890)	(205,787)	(236,641)
Net LTV	24.0%	28.9%	15.0%	26.0%	26.2%	25.7%

Source: Company data

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