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BIG THEME

Tap into soaring student demand for undergraduate housing in the UK

Property funds, but not as you know them

Commercial property is a popular sector for income seekers – but expensive. Investors can look to niche property sectors for better value

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In the endless search for income, commercial property funds have been standout performers and are now painfully expensive as a result. But property isn't all about office blocks and shopping centres. You could be making healthy returns from student accommodation, care homes and online retail warehouses at less of a premium to the funds along the beaten track.

One of the newest areas in the specialist property sector has come from the expansion of real estate investment trusts (Reits) investing in student property. **GCP Student Living (DIGS)** and **Empiric Student Property (ESP)** both invest in high-quality student accommodation in the UK and generate solid income streams at relatively low risk by tapping into soaring student demand for university housing in the capital.

Despite tuition fees rising last year, the number of students flooding to the UK continues to increase and the amount they spend on accommodation is rising, too. Last year saw the highest ever intake of students to the UK, with over 500,000 new undergraduates, creating a shortfall of 170,000 beds. Meanwhile the international student population in the UK, who tend to be less price-sensitive when choosing accommodation, is already at a global high and London has the largest student population of any city in the world.

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But there is a shortage of new buildings to house that mushrooming student population, with universities constrained by cost pressures and planning restrictions. Tom Ward, partner at GCP Student Living, says: "London has the largest supply and demand imbalance for student accommodation in the UK and a growing number of international students."

GCP and Empiric are the only two listed Reits investing in UK student property and both are very new but are already delivering high returns and yields. GCP Student Living, which floated in 2014, targets a total return of 8-10 per cent per year and delivered a 5.5 per cent dividend yield last year. Empiric will this month be included in the FTSE Small Cap index. It has returned 7 per cent in the year to date and is targeting a yield of 6 per cent for the 2015 financial year, having already paid out 2p per share in dividends for the second half of 2014 and first half of 2015.

Both trusts invest in high-grade, prime student buildings with high rents. These are being snapped up by a growing population of overseas students and the value of the properties is already soaring, pushing up the net asset value of the portfolios. Empiric's NAV was 98.1p per share at launch and now stands at 100.2p, according to the Association of Investment Companies (AIC), while GCP's had reached in excess of 100p within four months of its initial public offering (IPO).

Both trusts' premiums have risen fast since they floated on the stock market. GCP Student Living is trading at a 10 per cent premium to NAV while Empiric trades at a premium of 8 per cent. Of the two, Empiric has a larger market cap and a wider mix of assets, with smaller universities considered as well as the UK's top-tier institutions. Empiric now has 14 student assets and forward funding for two more.

Innes Urquhart, analyst at Winterflood Securities, says: "The investment opportunity is attractive and the focus on smaller lot sizes should mean that the fund is well positioned to source investment opportunities."

Both trusts have undertaken a series of capital raisings to purchase new properties and, as part of that process, have issued new shares. However, this did not bring down the premiums, as it might have. GCP last month raised £120m in an oversubscribed share issue in order to buy three new assets, doubling its portfolio to six assets.

Ross Garrard, stockbroker at Canaccord Genuity, says: "GCP's purpose-built luxury student 'studios' are a far cry from the traditional digs their ticker code implies, replete with delis, foreign language schools, free wifi, 24-hour receptions and gyms.

"So far, GCP's performance is worthy of distinction. Its three current London premises enjoyed 100 per cent occupancy for the 2014-15 academic year (all on 51-week tenancies) and grew rents by 3.6 per cent, well ahead of retail prices index inflation (RPI). The trust has also reduced gearing to 23 per cent and significantly lowered its cost of debt from 5.25 per cent to 3 per cent. The net result is a 17.1 per cent annualised total return for shareholders."

Mr Garrard says: "With only one listed peer, we consider that the shares offer genuine scarcity value and an above-average dividend yield. GCP Student Living's new 'C' shares commenced trading on 30 June and are a cheap way to access high-end, high-yielding student digs."

Healthy yields from medical assets

At the other end of the demographic spectrum is **Target Healthcare REIT (THRL)**, which invests in purpose-built care homes and delivers a solid income stream through assets with very long leases. With the population of over 85s set to double in the next 15 years and 15 per cent of that group expected to end up in care homes, the demand for high-grade accommodation is clear.

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However the stock of care homes in the UK varies widely and the sector has been hit by controversy in recent years, with provider Southern Cross, for example, falling into financial difficulties and closing in 2011. THRL buys only care homes with high-grade characteristics and manager Kenneth MacKenzie says the range of investable properties is limited.

The company owns 29 care homes across the UK after exchanging on its latest asset, in Kingston-upon-Hull, in June for £6.2m. Mr MacKenzie says: "The underlying fundamentals are all about the baby-boomer. Demand is significant looking forward and the other aspect is that there are 480,000 beds in the sector today, but only about 70,000-80,000 beds with wet rooms that are truly fit for purpose and that is the only area we invest in. Across the UK there are only about 6,000 beds added per year and we think, with the demographic bulge anticipated, that needs to grow."

The trust only invests in properties with leases of around 25-30 years which are not breakable. That compares with the average seven-year lease in the commercial property sector. The care home leases are also linked to RPI and one is a fixed-uplift arrangement, which means that year on year the income received increases in line with inflation, meaning it delivers a sustainable dividend stream to investors.

Target aims for a dividend yield of 6 per cent and has a dividend yield of 7.49 per cent, according to Morningstar. At the end of last year, THRL had generated rental income of £4.5m across the portfolio – almost three times its income at the same point last year.

The uplift in the value of the trust's properties also means that NAV increases throughout the year, while total return is also lifted. Mr MacKenzie says: "Fundamentally it is an income investment, but because rents are rising by 1-2 per cent the NAV will go up too so there should be a 7, 8 or 9 per cent total return with no yield shift."

Rents in the portfolios typically rise by about 1-2 per cent per year and the sector remains on a steadier growth and yield track than student property, where yields are likely to be higher. Compared with GCP Student Living the income and total return is likely to be slightly lower due to the smaller size of transactions the fund engages in.

Another fund in the healthcare space is **MedicX (MXF)**, which invests in healthcare infrastructure via modern, purpose-built properties in the UK. It has a portfolio of 143 properties, mainly leased to GP surgeries and NHS trusts as well as pharmacies and other related tenants.

The majority, 39 per cent, of its leases are 15-20-year contracts and 41 per cent of its assets are under five years old. Due to a solid track record of returns – the trust has returned positive results every year since 2008, aside from a 1.72 per cent fall in 2009 – and a yield of 7.2 per cent, it is trading on a hefty premium of 23 per cent.

Big dividends from big boxes

Tritax Big Box REIT (BBOX) is the only Reit to invest solely in the 'big box' warehouses used by online retailers to store the ever-growing collection of goods sold online. The growth of online retail is a well-documented investment story and this fund is a clever way to access the trend – it invests in the infrastructure used by online giants like Amazon without investing directly in the companies.

The distribution centres and warehouses used by retailers are in high demand in the UK, but in short supply due to planning restrictions and the size of the space needed. Tritax Big Box REIT offers a low-risk way to tap into this high-yielding property sector and remains reasonably priced at a premium of just 3.8 per cent.

The trust generates its healthy, yet low-risk, dividend and capital appreciation by buying the pre-leased distribution centres of major high-street brands such as Tesco, Morrisons, Marks and Spencer and Next and then takes income from the rental uplift. Listed in December 2013, by the end of 2014 it had purchased 14 sites and now owns 22.

Tritax is targeting a yield of 6 per cent based on an IPO price of 100p and says it is on track to achieve that in 2015, as well as a net total return over the medium term of 9 per cent a year. The yield is currently 5.27 per cent, based on dividends paid already in the year. In 2014 it returned 8.9 per cent, but in the year to date has already generated a total return of 8.5 per cent.

The trust has embarked on a series of share issues in recent months in a bid to build up its portfolio, having raised £175m in March. The company issued 159.1m shares at 110p per share, a 3.8 per cent premium to the NAV per share at the end of 2014. The demand for the shares meant that the trust expanded the issue beyond its original £150m target.

Getting in before the premium rises further could be a good idea.

Discounts, charges and yield of niche property funds

Fund	Ongoing charge (%)	Discount/premium (%)	Current yield (%)
Target Healthcare REIT	1.66	13.52	7.42
GCP Student Living	4.25*	10.12	4.7
Empiric Student Property	Too early	8.01	5.54
Tritax Big Box REIT	1.1	4.1	5.3
MedicX	3.34	23.2	7.2

*GCP Student Living disputes this figure. Source: Morningstar and AIC, as at 6 July 2015

Performance (cumulative total return %) for recommended funds

Fund	1-mth	3-mth	6-mth	1-yr	3-yr
Empiric Student Property	0.8	5.9	7.2	10.3	
GCP Student Living P	1.6	14.2	14.9	26.5	
MedicX	0.0	-1.3	1.4	4.3	31.3
Target Healthcare REIT	1.2	3.5	10.2	9.1	
Tritax Big Box REIT	0.1	-1.4	8.5	15.4	

Source: FE Trustnet, as at 6 July 2015