

CMBS Research

What Happens to Student Housing When the U.S. Isn't First Choice Among International Students

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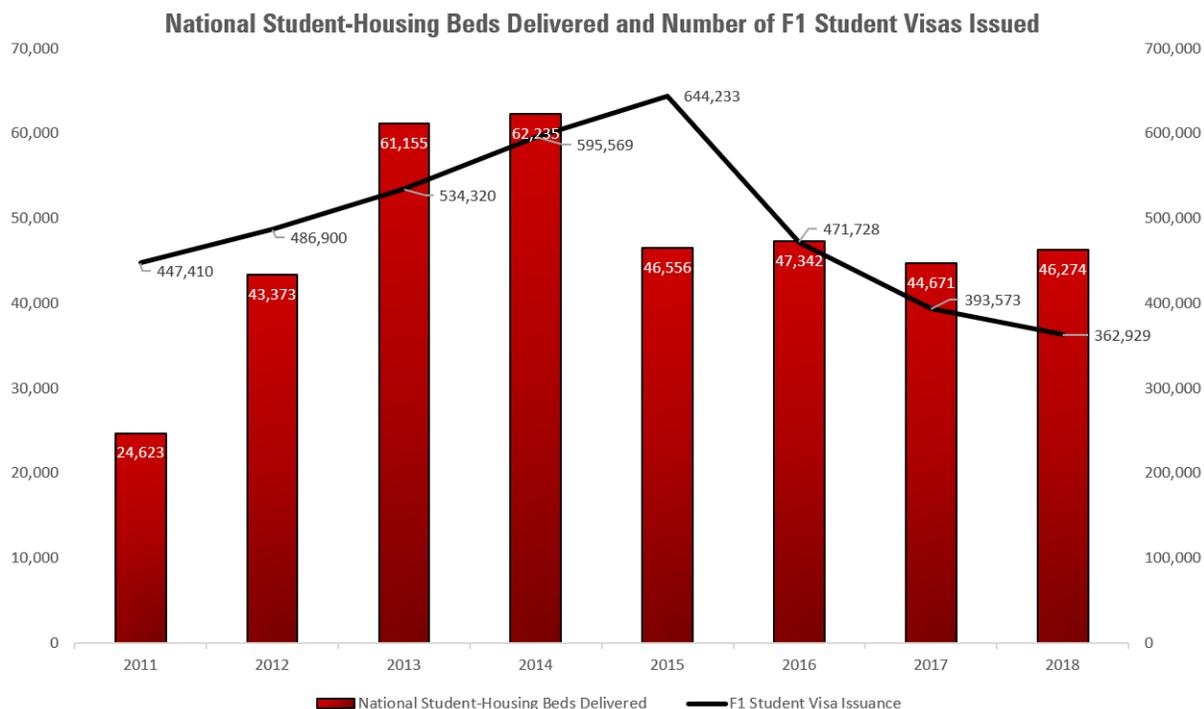
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Morningstar Perspective

The annual volume of student-housing loans in commercial mortgage-backed securities has surged to more than \$2 billion in 2018 from about \$100 million in 2010, according to Intex Solutions. With a total outstanding balance of about \$12.46 billion, however, the delinquency rate for student-housing loans also more than doubled to 7.0% in June 2019 from 3.1% at the beginning of 2018. According to Morningstar Credit Ratings, LLC's research, the rising delinquency rate correlates with a decline in student-housing occupancy, which can be partly related to the decrease in international student enrollment.

In today's political climate, international students at higher-education institutions face greater obstacles to completing their degrees and working in the United States. In July 2018, a policy memorandum gave U.S. Citizenship and Immigration Services "full discretion to deny applications, petitions, and requests" without seeking additional clarification, striking down a 2013 policy memorandum that had required a justification. This policy change, among others, has coincided with a drop in international student enrollment at higher-education institutions in addition to a decrease in occupancy rates for student housing.

In fact, student visa issuance dropped 39% since year-end 2014, according to the U.S. Department of State. The exhibit below shows that this drop correlates with the decline in the number of new beds delivered to off-campus student housing annually, a decrease of 25.6% in 2018 since its peak in 2014, per RealPage, a software and data analytics company for real estate. In analyzing student housing and international enrollment rates across the country, we found that noncoastal states, in comparison with coastal states, experienced greater loss of international student enrollment and, therefore, the greatest decrease in overall student-housing occupancy rates. In the wake of these trends, among others, lenders appear to be risk-averse toward student-housing loans in their CMBS pools.



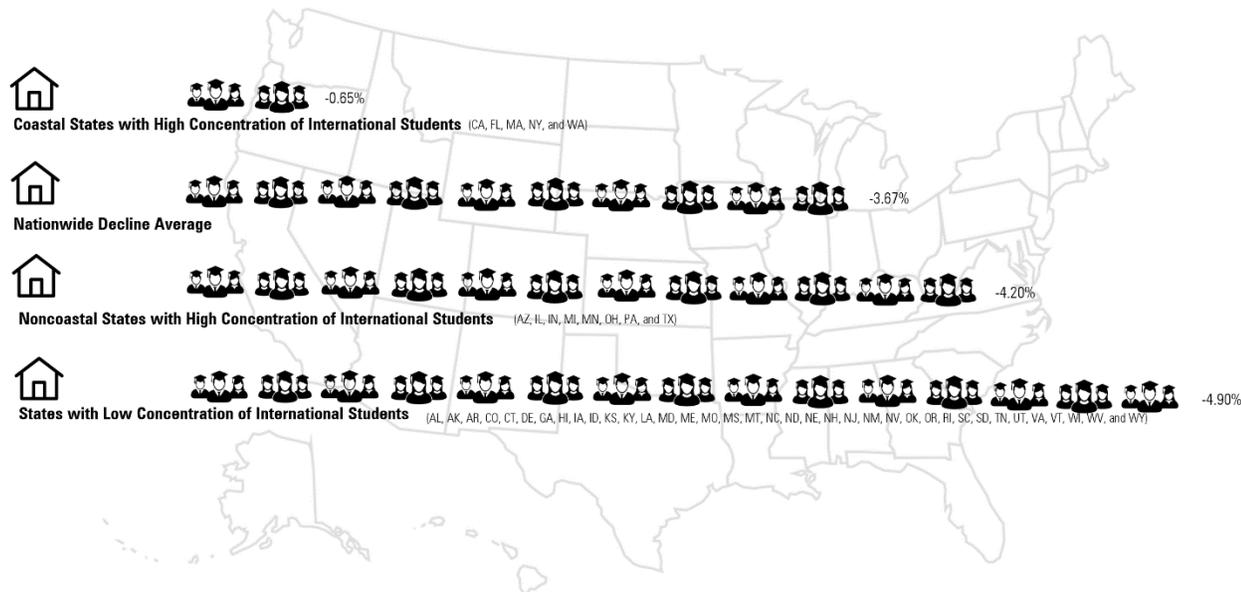
Sources: U.S. Department of State and RealPage

Student-Housing Occupancy Rates Are Down From Coast to Coast

Across 318 CMBS deals since 2010, the weighted average occupancy rate for student housing from the securitization date to the most recent occupancy date decreased 3.67% across all 50 states, according to Trepp, LLC’s student-housing data. We define the most recent occupancy date as the most recent physical occupancy date. If that data point is not available, we use the prior fiscal year physical occupancy date. To further break down the data, we categorize all 50 states into two groups: states with one or more colleges that ranked in the top 20 in terms of highest international student enrollment for seven of the past 12 years (Group 1) against all other states (Group 2). Group 2 experienced a higher rate of decline for student-housing occupancy, decreasing 4.90% from the securitization date to the most recent occupancy date, while the rates for Group 1 decreased by only 2.92%. As a result, we attribute the difference between the two groups to the high occupancy rate for student housing associated with universities in Group 1, which include colleges with the highest international enrollment per academic year, such as New York University, the University of Southern California, and Boston University.

We further divide Group 1 into two subgroups based on their geographic locations: coastal (Group A) and noncoastal states (Group B). Between the two subgroups, coastal states, such as California and Florida, tend to have a more stabilized weighted average occupancy rate in their student housing than noncoastal states such as Illinois and Ohio. The weighted average occupancy rate for student housing in coastal states (Group A) declined by only 0.65% between the securitization date and the most recent occupancy date. On the other hand, universities in noncoastal states (Group B) experienced a more noticeable occupancy decline of 4.20% during the same time period. The exhibit below shows how the group and subgroup percentages compare against the national average occupancy decline.

Occupancy Rate Decline of Student Housing



Sources: Trepp, LLC

International Students Are Opting Out of Certain Markets

Similar to the weighted average occupancy rate, international student enrollment at U.S. universities is decreasing at a higher rate in secondary, noncoastal markets in comparison with primary, coastal markets. Moreover, in light of the “America First,” anti-immigrant policy landscape, fewer employers are likely to extend full-time offers to international students because of the perceived uncertain outcome of the work visa lottery system and the potential rising corporate costs of securing work visas for them.

In July 2018, President Donald Trump signed an executive order establishing a National Council for the American Worker focused on “the skills crisis and the importance of STEM education,” which will “make sure that we have the workforce development programs we need to ensure these jobs are being filled by American workers.” The obstacles for international students to obtain full-time employment in non-coastal, secondary markets often lead them to be less inclined to seek college enrollment in these areas, which drives up the vacancy rate of student-housing properties in these markets, especially those with second-tier colleges that heavily rely on international student enrollment.

For example, the University of Illinois at Urbana-Champaign has experienced a decline in enrollment of Chinese citizens, who have historically accounted for half of the school’s international student population. In 2017, the university obtained a three-year insurance policy from Lloyd’s of London to protect against a 20% decrease in revenue from Chinese student tuition within a single academic year. This precaution reflects the essential role international students play in maintaining the economic vitality of the university, local economy, and student-housing network. Moreover, the anxiety of university officials regarding the economic risk of declining international student enrollment is not unfounded: As Chinese student enrollment declines, One North and One South, a 1,576-unit off-campus student-housing community associated with the university, has been facing challenges with a much larger than expected no-show of students of about 8% in 2018, per Trepp. According to DBRS Viewpoint, the student-housing property backs a \$28 million loan in FREMF 2013-K30 that matures in 2022.

One North and One South

	2017	2018
Occupancy (%)	73	64
Net Cash Flow (\$)	2.2 million	1.8 million
Senior Note DSCR (x)	1.28	1.01
Total International Student Enrollment	10,834	10,577

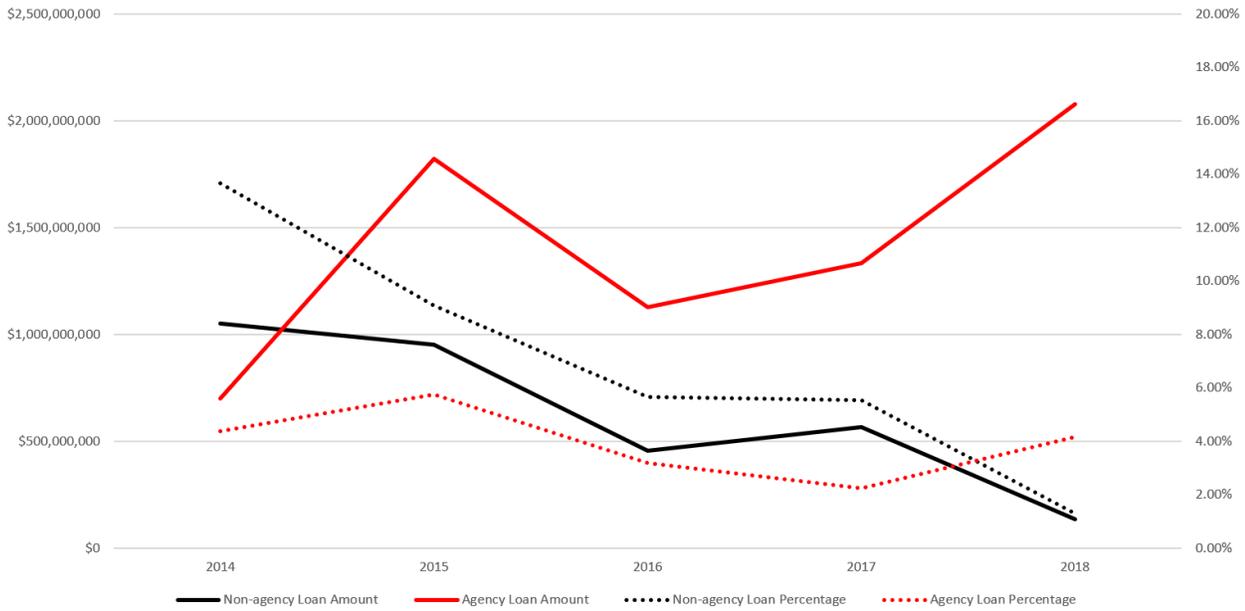
Sources: DBRS Viewpoint and University of Illinois at Urbana-Champaign International Statistics reports

Although the uncertain immigration environment could still be an issue for international students in colleges in coastal states, they are more likely to attend these colleges with a more promising and friendlier employment outlook, hence making the effect on occupancy rate for student housing in these markets nearly negligible. According to the U.S. Census Bureau, coastline counties are more ethnically and racially diverse than the United States as a whole. This further illustrates the discrepancy between the occupancy rate for student housing between coastal and noncoastal states where colleges accept a large number of international students.

Student Housing Is Falling Behind In CMBS

In recent years, student-housing loans have been gradually appearing less often in total loan pools, reflecting lenders' risk-averse approach toward accepting this type of asset class into the pool. Since government agency deals (Freddie Mac and Fannie Mae) allow less financing cost, more leverage exposure, and additional subordinate debt financing, the cutoff balance for student-housing loans has been increasing for agency deals over the last few years, as the exhibit below indicates. However, the loan percentages represented in total pool balance in both agency pools and nonagency conduit pools show a general declining trend since 2015, just as the vacancy rate for student housing started to tick up and international student enrollment started to drop. This decreasing trend indicates that the decline of international student enrollment at U.S. universities has contributed, among other factors, to the decrease in occupancy rates for student housing and, ultimately, the increasingly negative risk perceptions surrounding student-housing loans.

Student-Housing Loan Cutoff Balance and Cutoff Balance Percentage in Terms of Total Pool Balance



Source: Intex Solutions

Our research indicates that the decline in international student enrollment at higher-education institutions is disproportionately affecting student-housing properties in noncoastal states, resulting in a sharper increase of vacancy rates than those properties in coastal states. Although the effect is negligible, in the upcoming years, vacancy rates for student-housing properties could climb at large top coastal universities if international enrollment continues to decline. In effect, declining rates of international student enrollment at U.S. universities threaten to destabilize student housing for campuses both on and off the coasts to varying degrees.

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