Stanbic IBTC

INFRASTRUCTURE FUND NEWSLETTER

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Asset Management

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Dear Investors,

In this newsletter, we take a close look at the investment opportunities in student accommodation in tertiary institutions across Nigeria and seek to answer the following questions:

- What are the current gaps in the supply of bedspaces for tertiary students in public universities?
- Why has this sub-sector not attracted funding over the years?
- What transaction structures are available to a discerning investor looking to tap into the opportunity?
- What is the return potential, and how does Stanbic IBTC Infrastructure Fund help to bridge the funding gap?

Introduction

According to the National Universities Commission ("NUC"), there are 221 universities in Nigeria with Federal and State Universities accounting for c.50%; 10 years ago, this number was 120[1] universities. The increase is driven by a rising number of applicants into the universities. Over 1.7 million candidates apply for undergraduate admission annually even as universities can only conveniently admit about 400,000 students. Meanwhile, the total population of students currently enrolled is over 2 million[2] and the estimated annual growth rate is over 10%.

This estimated growth in student applicants will put a strain on available facilities in public institutions and one area expected to be severely hit is student accommodation. Public tertiary institutions and some of their private counterparts have been challenged by a lack of adequate and suitable purpose-built accommodation for enrolled and prospective new students as housing demand significantly outweighs housing supply. According to a representative of the NUC, universities are mandated by the commission to provide accommodation to 60% of their student populace. However, the reality is that universities are only able to provide for about 10%. This leaves a supply gap of over 1.5 million bed spaces. The supply gap is driven by many problems but topmost of these is a lack of appropriate funding by the government to the universities.

The recent collaborative initiatives by the Infrastructure Concession Regulatory Commission ("ICRC") and the Federal Ministry of Education to permit universities to go into Public-Private Partnerships ("PPP") to deploy private capital towards development of student accommodation is therefore a step in the right direction in closing the supply gap and providing Purpose-Built Student Accommodation ("PBSA").

This formed the basis for the recently hosted webinar series by Stanbic IBTC Infrastructure Fund. The webinar series brought spotlight to the challenges in the student accommodation subsector and the emerging investment opportunities. Panelists on the webinar included a representative of the NUC, the Dean of Student Affairs of a Federal University, experienced developers of student accommodation and a legal practitioner. To watch a replay of the webinar, please click the link **here.**

[1] www.researchgate.net - An Overview of University Education and Administration In Nigeria
[2] www.theconversation.com - New universities in Nigeria? Absolutely not

Overview of the Student Accommodation Market

Student accommodation is a niche subsector of the real estate market, and the market in Nigeria is in its infant stage and relatively unfamiliar to a lot of investors. There is also a lack of data to aggregate the number of developers, the bed spaces provided (both on and off campus) and bed spaces required. However, noticeably clear within the niche market is a general supply gap and an increasing private capital interest, albeit uncoordinated, to bridge this gap given the demand-supply dynamics referenced earlier.

To meet the PBSA criteria- especially in public universities, accommodation provided needs to cater for conditions which include affordability, basic infrastructure, comfort, safety and security, accessibility, sanitation, socio-cultural adequacy and much more.

We highlight below, some of the areas of challenge which have hitherto hampered growth within the student accommodation space in Nigeria and viable solutions that could be explored by stakeholders – tertiary institutions, developers, regulators, and financiers:

Access to long term funding:
Inability of developers to access affordable long-term funding (15 years and above) has been a major constraint given the high interest rate environment in Nigeria and unwillingness of traditional lenders to provide facilities with appropriately matched tenors. As at January 2023, Monetary Policy Rate ("MPR") hit 17.5% p.a[3] thus, resulting in developers accessing loans at interest rates of over 20%.

[3] www.nairametrics.com - MPC increases MPR to 17.5% in January 2023

This is quite expensive for developers who require single digit lending rates to enable them to tick the affordability or sustainability criteria, build at scale and generate a modest return. Workable solutions that can be explored to secure long term funding are as follows:

- Developers possibly seeking longer term concessions within the confines of the target university's act.
- Provision of minimum revenue guarantees by universities or the government to cover shortfalls in occupancy ratio.
- The possibility of a PBSA development fund by stakeholders into which developers can tap.
- Exploring avenues to tap equity funding through established funds such as REITs, Infrastructure Funds or Private Equity Funds with real estate investment appetite.

Unfamiliar asset class:

Student accommodation is an unfamiliar asset class to many investors. We find that the student accommodation market is filled with sub-standard PBSA facilities. To solve this problem, a lot of market education backed by research covering areas such as supply gap across universities, price points based on affordability, student population and more will enable stakeholders - financiers and developers make informed financing decisions.

Concession agreement

For developments that require concessions, the attractiveness of the PBSA opportunity to both developers and financiers is highly dependent on the wordings of the concession agreement. Key features that could be of interest are length of the concession, exclusivity clause, termination, right to set prices, revenue/profit share, guaranteed occupancy levels etc. In some cases, on a Federal University level, universities are only allowed to grant ground leases or tenancy for a term of 21 years. Developers would typically seek tenors ranging from 25-30years to make the deal attractive, they would also want to factor in conditions to review prices and retain the operations and maintenance rights of the facility; all to improve the Internal Rate of Return (IRR) of the project. It is critical for universities, developers, and financiers to be aligned in the drafting and wording of the concession agreement with focus on making the proposal bankable and solving the critical issue of bridging the supply gap.

Deal structuring

The typical concession agreement in the student accommodation market is a Build – Operate – Transfer (BOT). In addition, lenders typically seek comfort from the assessment of the cashflows generated from operating the facility. This is particularly pertinent as the registration of security via a legal mortgage on the PBSA is restricted by the Act governing public universities. Transaction structures for a PBSA are:

- First, where there is a single sponsor (the developer) who establishes a Special Purpose Vehicle ("SPV"), provides equity, and then sources debt finance to develop the project. Rental income flows to the SPV and services loan repayment.
- Alternatively, the developer and university may enter a Joint Venture ("JV") agreement from which an SPV is established.
  The JV agreement spells out the contribution from each party- land, equity and also share of revenues and profits. The SPV will then source for debt financing for the project. Further considerations could be for the university to be the anchor tenant and will ensure collection of rental payments from the students for onward remittance to the SPV or for the SPV to lease directly to the students and the university provides a revenue shortfall guarantee. However, this is subject to Treasury Single Account ("TSA") limitations which public universities are subject to as it relates to rental collections going into the central university account in this case.
- Universities may, subject to their enabling laws be able to borrow directly to finance the PBSA.

Therefore, there is a need for developers and financiers to come up with innovative structures that make the deal bankable for all parties. Stakeholder engagements to review relevant laws to foster deal structuring that benefits the ecosystem can also begin.

Cost of construction

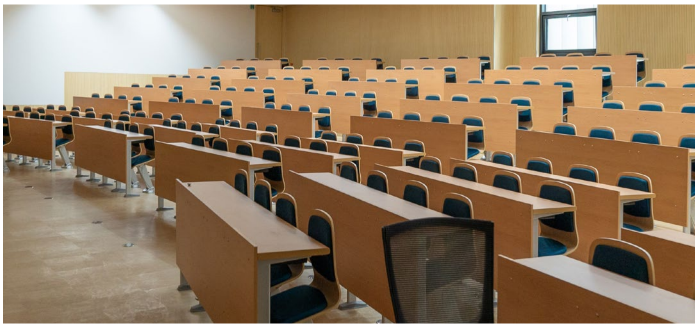
Delivering projects at cost, on time and at the right quality is a key tenet of real estate finance. In a high inflationary and import dependent environment, locking in prices either through Fixed Price Engineering, Procurement and Construction (EPC) contracts or early payments to suppliers and following strict timelines to prevent cost overruns is particularly important. Latest trends have shown that developers are seeking alternative building methods and materials to bring down development cost. However, this is hampered by lack of access to Foreign Exchange (FX) as the alternative materials require importation. Developers need to establish a professional team with the right knowledge and experience to uphold contracts for conducts and timelines to prevent delays and cost overruns. It is noteworthy that cost of construction has a direct influence on pricing of bedspaces.

Pricing

Affordability is a key component of bridging the student accommodation supply gap. Facilities built and operated by the universities have fixed pricing, however, the facilities built by developers have flexibility in price setting. Even with such flexibility, some universities have imposed price caps on prices the developers are able to charge. Developers will need to constantly research the market to find a price point (with periodic escalations embedded in the concession agreement) that works and strike a balance between scale, affordability and the need for investors and developers to earn a return.

Strike Risk

In the student accommodation market in Nigeria, a recurring cause for concern is strike action by public university lecturers. In October 2022, the Academic Staff Union of Universities ("ASUU") called off an 8-month-old strike stemming from ongoing disagreements between the government and the union[4]. This is the 16th strike in a 23-year period[5] and the issue of strike is a never-ending problem till there is a change in the funding structures of universities. Developers should aim to have a balanced portfolio of private and public accommodation facilities in which the public facilities which are susceptible to strike risk are built to be adaptable (for example, used as a venue for conferences) such that cashflows are not completely shut off. Additionally, pricing structures should be such that payments are made annually, similar to rental payments in a residential facility. Furthermore, universities and developers can explore the possibility of concession agreements having provisions for extension by additional months based on aggregated number of months of strikes or shutdowns. However, this is subject to the enabling laws of the target university. All points mentioned above can help de-risk cashflows in a strike event.



Facility management:

Managing a student accommodation facility is different from managing a residential or commercial facility. During the concession period, facilities are managed by the developers and the universities set up a committee that ensures that the hostels are being managed to standard. It is quite important for developers to hire facility managers with the right skill set and understanding of student accommodation such that the facility is managed appropriately and efficiently so as to manage cost, extend the useful life of the facility, and avoid termination of contracts. It is also considered best practice for the facility management to be outsourced to third parties for accountability.

[4] www.nairametrics.com - ASUU explains why it called off 8-month

[5] www.punchng.com - ASUU embarks on 16 strikes in 23 yearsstrike

Process for application:
Contrary to the perception that the process of obtaining a concession agreement is ambiguous and tedious, engagements with different universities show otherwise. For instance, at the Obafemi Awolowo University ("OAU"), a developer will need to write an application to the Student Village Development Committee and the Vice Chancellor following which the application is reviewed and the developer is invited for assessment which involves determining the developer's capacity, funding capabilities and technical knowhow to execute to specification and within timelines. Once all stipulations are met, an approval is given to the developer and all preliminary agreements will start.

We recognize that to grow the market and bridge the supply gap, there has to be a collaborative effort from all stakeholders, that is, government, regulators, universities, developers and long-term financing partners.

Furthermore, the student accommodation sector is one of the critical focus sectors of the Stanbic IBTC Infrastructure Fund and the interest of the fund is in curating a portfolio of well-structured deals and projects that meet the PBSA criteria whilst also being affordable and delivering good returns.

DID YOU KNOW?

Stanbic IBTC Infrastructure Fund recently closed its Series III offer. The offer which was opened for 27 days was over-subscribed by 22.26% as a total of NGN24.449 billion was raised from different categories of investors such as Pension Fund Administrators, High Net-worth Individuals, Religious bodies, and Insurance companies compared to the NGN19.997 billion on offer.

The Fund also made its fourth semi-annual distribution to investors for the 6 months period ending 31 December 2022 in the month of January 2023. Investors were paid NGN6.10 per unit held in the Fund. This puts cumulative distributions, since it commenced operations in October 2021, at N15.56 per unit.

We welcome your feedback; kindly send your comments or questions to
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