# Practical Thought About Southern Europe PBSA

**Capital allocation**

Taking inspiration from the late Charlie Munger's problem solving frameworks, we will apply some of his mental models to a relatively simple question: Where should long-term investors look to allocate capital in European real estate today? The short answer would be to look to provide capital to the sectors in most need (those with the greatest demand/supply imbalance), at the most attractive price point, which would subsequently reward investors with the most stable and growing cashflows over a long period of time. Through this lens, the PBSA market in Southern Europe looks to be a leading contender.

**Relative value in the living sector**

PBSA continues to offer an attractive yield premium compared to the private rental sector, despite offering enhanced growth. Across Europe, there are limited PBSA rental regulations, with average rental growth increasing 11% over the past two years. The rental growth rate is even higher in acutely undersupplied markets such as Lisbon and Milan where the number of students has surged and new PBSA stock is just becoming available. On a relative basis, given the combination of enhanced yield (see Chart 1 for European prime yields) and higher growth versus other living sub-asset classes, PBSA is quickly solidifying its position as a key allocation for investors and 'top of the class' within the living sector.

**Southern Europe PBSA market**

Within PBSA, Southern Europe has exhibited some of the strongest rental growth. Diving into the data, helps us understand why. This rental growth has been a symptom of the acute supply/demand imbalance. PBSA provision rates (beds per student) are as low as 3% in Portugal, 4% in Italy and 8% in Spain, as opposed to 13% across continental Europe and 33% in the UK (see Chart 2). This supply/demand imbalance does not seem to be set to improve in the near term, but rather worsen, as new supply is not keeping pace with growing demand. The result being that unmet demand (shortfall of beds) continues to grow and now stands at over 500,000 students in Spain alone (see Charts 3 and 4). In this deeply undersupplied market, those operators that can provide students with the most affordable rents will most likely benefit from sustainable demand over the long term.

**Macroeconomics and sociodemographics**

Having identified Southern Europe PBSA as being one of the most undersupplied sub-sectors, it is important to highlight some of the macroeconomic and sociodemographic factors that drive this dynamic, taking a multidisciplinary approach. First and foremost, the Southern European macro-economic environment is radically different from over a decade ago. Iberia's GDP growth has been outperforming Western Europe for a number of years, with Spain being the fastest growing advanced economy globally in 2024, ahead of America, which is even more remarkable considering the fiscal performance relative to the 6.5% budget deficit in the US. This improvement in economic stability has been recognised by international capital markets, with Spanish government bond yields trading at historically low spreads versus Germany, which are now trading even tighter than neighbours France, a major shift versus being labelled the PIGS of Europe during pervious economic cycles.

This robust macroeconomic performance, coupled with the cultural and sociodemographic trends in Spain is particularly important in the context of the PBSA market. In Spain, a large proportion of students enrol in campus universities outside of their province, estimated at over 405,000 students. This increasingly affluent and mobile group of students are driving sustained demand for accommodation across Spain. With annual leasing, PBSA continues to benefit from the robust economic performance, whilst simultaneously offering investors downside protection against slowing economic activity due to the counter-cyclical demand for education. This double hedge against both inflation and recession offers investors notable protection from alternating economic environments.

**Lollapalooza effects**

Really big effects, 'lollapalooza effects', will often come only from large combinations of factors. The confluence of forces driving demand for PBSA in Southern Europe, including a robust economic environment, growing student population, supportive governments prioritising the educational system and increasing demand for higher education as a result of impacts of technology on the workforce should be watched very closely. Particularly as these clear tailwinds for accelerating capital deployment are not being met with sufficient new supply given the increased costs of construction for new developments, scarcity of land within walking distance of universities and limited number of PBSA operators capable of managing new residences effectively. The combined result of these multiple forces impacting both demand and supply is leading to an acute and persistent under-supply of accommodation across Southern Europe, which will unlikely be resolved soon.

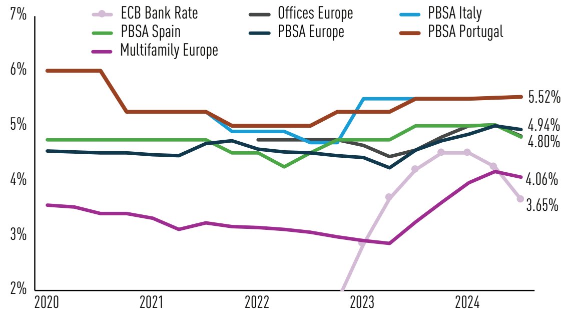
**Resilience offering downside protection**

Given these demand/supply dynamics are relatively clear, to ensure investors benefit from an allocation to Southern European PBSA over the long-term, investors must ensure they avoid unnecessary risks which could derail their investment, such as: (i) utilising excess leverage which could result in having to sell in illiquid markets during periods of market volatility, (ii) taking concentrated risk on one property or one city which does not allow for diversification to protect the investment, (iii) over reliance on assets which do not offer appropriate inflation protection (such as those under nomination agreements with no indexation) and (iv) investments in unsustainable portfolio's which may require significant capex to enhance future energy efficiency for new regulations.

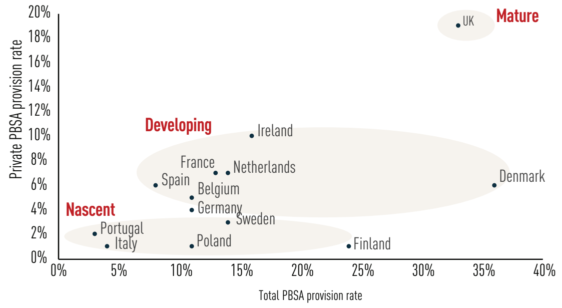
**European Student Accommodation Core Fund ('ESAF')**

In Southern Europe, ESAF has been established, specifically to support investors allocating to the PBSA sector over the long-term, whilst focusing on mitigating all of these risks. ESAF held its first close in Mar-23 and has now raised €700m+ from a series of global investors, targeting to raise €2.0bn over time to capitalise on the compelling market opportunity. ESAF is currently the largest core+ PBSA fund in Southern Europe, with 10,000 beds, operated by the award-winning operator MiCampus, which has been operating student accommodation assets since 2004. The fund is targeting core+ returns with a conservative target leverage of 30% LTV. Given the scalability of the strategy and resilience of the sector, ESAF has been structured as an open-ended fund which will support investors seeking long term allocations. ESAF is well placed to continue capitalising on the significant market opportunity, offering investors a vehicle to invest in one of the most attractive markets of one of the most compelling real estate sub-sectors. The opportunity for ESAF is very exciting to help alleviate the deep undersupply of student accommodation across Southern Europe, whilst delivering compelling returns for investors.

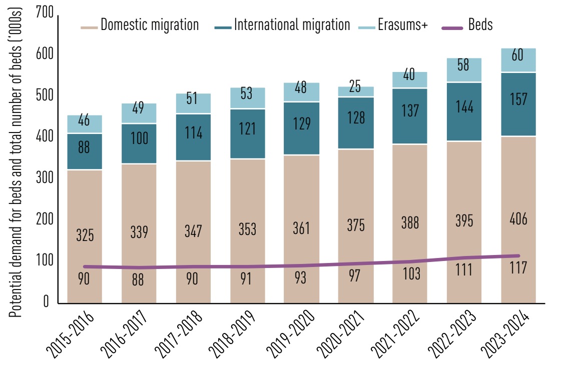
European prime NIY vs. Southern Europe

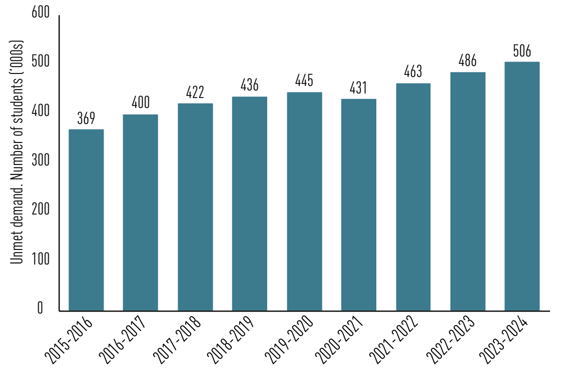



Total and private PBSA provision rates




Supply and potential demand

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