CAPITALIZING ON THE UNDERSERVED STUDENT HOUSING MARKET IN CANADA: INDUSTRY OVERVIEW AND CAPITAL RAISING STRUCTURES

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The rising demand in the underserved student accommodation market in Canada has created an entry point for private sector investment. Full-time post-secondary enrollment across Canada has grown at a significant pace,[1] particularly due to the number of international students coming to Canadian universities to pursue studies. Over the last decade, international student enrollment has more than doubled,[2] further increasing demand for student accommodation.

Some universities are building new residences to address the student housing shortage and the increase in demand; however, these buildings take years to build and are typically reserved for first year students. As a result, students must engage in the private rental market to secure accommodation off campus.[3]

Provincial governments are implementing various initiatives to alleviate the student housing shortage. For instance, the British Columbia government pledged to invest $450 million in 5,000 additional student accommodation spaces and enabled post-secondary institutions to take on debt for new student housing initiatives.[4] Despite government efforts, students struggle to find suitable housing in cities with competitive rental markets.

The purpose-built student accommodation ("**PBSA**") market has emerged in response to the housing shortage, whereby private real estate developers provide housing specifically for students. However, PBSA markets are still in their early stages in Canada. In 2021, PBSA residences collectively were only able to accommodate approximately 200,000 students out of the estimated 1.6 million full-time students at the time.[5] Comparatively, more established PBSA markets in the United States and United Kingdom generated approximately US$10 billion and US$4 billion of investments respectively in 2016, compared to Canadian PBSA markets, which attracted less than US$200 million between 2013 and 2016.[6] The increasing gap between the rising demand and the limited supply of student accommodation presents a lucrative development and investment opportunity.

This bulletin sets out the primary legal structures and financing methods available to asset managers, real estate developers, exempt market dealers and private equity investors in the PBSA market.

Partnerships Between Universities and the Private Sector

Universities have entered into partnerships with private sector participants to address increasing student housing needs; such partnerships are often referred to as public-private partnerships ("**PPPs**" or "**P3s**"). Student housing PPPs do not have a universal structure and take different forms depending on the university's demands and the private sector partner. For instance, some universities may prefer to maintain ownership of assets, cash flow and marketing in their PPPs, whereas other universities delegate more responsibilities to their private sector partner. PPPs present an opportunity for universities to invest resources toward the academic needs of students, while providing housing options through the partnership of a private sector partner.[7]

There is lucrative investment potential and growth of the higher education P3 market. In 2021 in the United States, there were a total of 21 P3 student housing deals closed, with an average deal size of US$177 million. Comparatively, the average deal size of P3 deals in the United States for student housing in 2014 and 2016 were US$79 million and US$68 million respectively.[8] In addition, on August 9, 2022, the global investment firm Blackstone Inc. announced the completion of the acquisition of American Campus Communities, Inc., the largest developer, owner and manager of student housing in the United States for US$12.8 billion.[9] As of 2018, approximately 43,000 beds reserved for students in the United Kingdom were provided as part of partnerships between universities and the private sector, representing 17% of the total beds owned by universities at the time.[10]

While the PBSA market in Canada is comparatively underdeveloped, Canadian universities are increasingly relying on and engaging private-sector participants to provide accommodations for students.[11] For example, developers and lenders may consider partnering with Canadian universities by way of a university property development trust, the development entity of choice for many universities across Canada. For additional information, please refer to our bulletin about University Property Development Trusts and how they work here.

Capital Raising Methods and Structures

Private sector participants seeking to participate in the underserved student accommodation market in Canada can raise capital: (i) as a private equity real estate fund (a "**Fund**"); (ii) as a private real estate investment trust; and (iii) through traditional debt financing.

I. Private Equity Real Estate Fund

PBSA capital can be raised through Funds, commonly structured as limited partnerships. The terms of limited partnerships are established by a limited partnership agreement. A Fund typically holds its real estate assets either directly or indirectly through one or more subsidiary limited partnership(s) on an asset-by-asset basis. Such subsidiary limited partnerships facilitate investment by investors (often institutions) seeking to invest solely in a specific asset of the Fund (as opposed to all of its assets) and to compartmentalize liability respecting each underlying asset.

Typically, these Funds are closed-ended with capital raising occurring in one or more rounds of financing at the front end of a Fund's lifecycle, with few (if any) redemptions permitted by limited partners during the term of the Fund and a fixed term which, depending on the nature of the underlying assets of a Fund, generally ranges from five to twelve years. In some instances, Funds have the ability to extend the term, typically in one or two-year increments in order to avoid forced liquidation if the market for the Fund's assets is suboptimal. Alternatively, Funds may be open-ended, with capital raising occurring throughout the lifecycle of the Fund and opportunities for limited partners to redeem, subject to certain restrictions. In Canada, closed-ended Funds with underlying real estate assets continue to be more prevalent while open-ended Funds are less common. In practice, the illiquid nature of many real estate investments make the redemption feature associated with open-ended Funds less attractive to managers, with land transfer taxes in certain provinces creating a further obstacle to such a structure.

Fund units are generally not "qualified investments" for registered plans including registered retirement savings plans ("**RRSPs**") and tax-free savings accounts ("**TFSAs**") under the Income Tax Act (Canada) (the "**ITA**"). Accordingly, Funds typically have a relatively small number of investors, frequently consisting of institutions and/or high net worth individuals for whom an investment being registered plan eligible is not necessary.

Funds typically operate pursuant to the investment criteria or objectives established at formation, such as the types of assets in which the Fund may invest and related rules. A corporation (the shares of which are typically controlled by the principals of the Fund) is appointed as general partner and is responsible for the day-to-day management of the Fund. Often the General Partner delegates the majority or a portion, of its management responsibilities in respect of the Fund to an affiliated pre-existing or newly formed management entity. In addition, Funds can create an advisory committee to perform any number of functions including general oversight, addressing conflicts of interest, working with Fund auditors and ensuring compliance with or granting waivers from, Fund investment objectives and criteria.

Limited partners typically capitalize the Fund at inception. Alternatively, investment may be subject to capital calls by the Fund on an as needed basis up to the amount of their aggregate capital commitment. By utilizing a capital call structure, Funds are able to deploy capital only when needed, instead of sitting on large cash balances.

For additional information, please refer to our bulletin about Structuring Private Equity Real Estate Funds in

Canada here.

II. Private Real Estate Investment Trust

PBSA capital can be raised through a private real estate investment trust ("**REIT**"), a trust passively holding interests in real property. REITs are formed pursuant to a trust declaration that also serves as the governing document for the REIT. Similar to the board of directors of a corporation, a REIT has a board of individual trustees or in some instances, a corporate trustee.

Although private REITs are not technically tax-exempt vehicles, they are typically administered to ensure all of the taxable income of the REIT is distributed to unitholders as distributions of cash, units or other in-kind distributions. The effect of such distribution policies is the income of such a REIT is taxable in the hands of the REIT unitholders rather than at the REIT level.

Unlike Fund units, REIT units are generally qualified investments for registered plans such as RRSPs and TFSAs provided they have at least 150 unitholders and otherwise qualify as a "mutual fund trust" under the ITA including that REIT units must generally be redeemable on demand in order for the REIT to qualify as a "unit trust" and a "mutual fund trust" for purposes of the ITA. Notwithstanding the foregoing, private REITs generally have flexibility with respect to how redemptions are structured, including the number of units that may be redeemed during a specified time, penalties associated with early redemptions and the limited circumstances when the REIT may suspend redemptions for a limited period of time (for example, in order to maintain its status as a "mutual fund trust" under the ITA or to permit the orderly sale of certain illiquid assets to fund redemptions).

For additional information, please refer to our bulletin about Structuring Private REITs in Canada here.

Capital Raising

Both Funds and private REITs raise capital by selling units to investors through the exempt market. As with any non-prospectus offering of securities, in order to sell units of a private REIT or Fund, either must rely on a prospectus exemption under National Instrument 45-106 – Prospectus Exemptions ("**NI 45-106**") or if applicable, a provincial securities act. For private Funds and REITs, the two most frequently relied upon prospectus exemptions are the "offering memorandum" exemption (the "**OM Exemption**") and the "accredited investor" exemption (the "**AI Exemption**"). While REITs typically utilize the OM Exemption and the AI Exemption, Funds utilize the OM Exemption less frequently as the investor target demographic tends to be higher net worth investors than those who may only satisfy the threshold to invest under the OM Exemption. Accordingly, Funds rely more heavily on the AI Exemption or the "private issuer" prospectus exemption under NI 45-106.

In March 2023, the Canadian Securities Administrators announced amendments to the OM Exemption that came into force in March 2023 affecting PBSA Funds or REITs raising capital under the OM Exemption. For additional information, please refer to our bulletin about raising capital with the OM Exemption and new requirements focusing on real estate issuers and collective investment vehicles here.

PBSA Acquisitions and Developments Considerations

Canadian Funds, private REITs and other entities not publicly listed on Canadian stock exchanges seeking to acquire PBSA must ensure they comply with the Prohibition on the Purchase of Residential Property by Non-Canadians Act and regulations, that came into force on January 1, 2023 and were amended on March 27, 2023 (the "**Legislation**"). The Legislation bans non-Canadians from purchasing residential property, directly or indirectly, in Canada for a period of two years. Surprisingly, the Legislation applies to Canadian Funds, private REITs other entities not publicly listed on Canadian stock exchanges if non-Canadians hold 10% or more of the equity securities of these entities. Accordingly, at the outset of a potential acquisition, management must ensure a target asset is not inadvertently caught under the definition of "residential property" (which is broad) to confirm the acquisition is permitted under the Legislation. For an overview of the Legislation and amendments, please refer to our bulletin here.

III. Traditional Debt Financing

Both Funds and REITs incur indebtedness in a number of manners including traditional bank mortgages, private loans on a secured and unsecured basis, temporary bridge financing and if necessary, by providing supplementary guarantees to lenders and/or pledging securities.

Looking Forward

The rising demand in the underserved student accommodation market in Canada has created an entry point for private sector investment. Real estate developers, asset managers, exempt market dealers and private equity investors seeking to participate in the student housing market should consider the different legal structures that best fit their capital-raising goals.

If you have any questions regarding structuring capital raising for or investing in the PBSA market, members of McMillan's Capital Markets Group, Private Equity Group, Real Estate Group and Tax Group would be pleased to assist you.

[1] Statistics Canada, 2020.
[2] Statistics Canada, 2020.
[3] The Globe and Mail, "Canadian universities are rushing to address critical shortage of student housing" (August 29, 2022).

[4] Financial Post, "Student Housing Shortage Becomes Even More Acute with Record Immigration Flows" (March 31, 2023).
[5] Toronto Star citing Bonard Report, "Students are now paying 25% more for housing than the average Canadian renter - and that's pushing rents up for everyone" (September 12, 2022).
[6] Revington, Nick, and Martine August, "Making a market for itself: The emergent financialization of student housing in Canada." Environment and Planning A: Economy and Space 52.5 (2020): 856-877.
[7] Forbes, "Universities Are Increasingly Asking Private Developers To Build Their Student Housing" (June 16, 2017).
[8] Brailsford & Dunlavey, "Higher Education Public Private Partnerships: State of the Industry Report" (September 29, 2022).
[9] Blackstone Inc., "Blackstone Funds Complete $13 Billion Acquisition of American Campus Communities" (August 9, 2022).
[10] JLL, "Why Public-Private Partnerships are the Future for Higher Education" (February 26, 2018).
[11] Ashish K. Pillai, Marcelo A. Vieta & Luisa Sotomayor: University Student Housing as Business Proposition and Entrepreneurial Activity: The Canadian Case, Housing Policy Debate (2021): 1-24.

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A Cautionary Note