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KEYNOTE INTERVIEW

Specialized housing reaches an inflection point

Formerly niche, student and senior housing are suddenly topping many investors' wish lists, says Kayne Anderson's Al Rabil

Until relatively recently, the idea of an off-campus apartment building occupied by college undergraduates appearing in an institutional investment portfolio was far from the norm, but Al Rabil, chief executive and co-founder of Kayne Anderson Real Estate and chief executive of Kayne Anderson, has been investing in student housing for more than two decades.

The property type has been a large part of his Florida-based firm's demographically driven strategy, alongside high-end housing for seniors, medical offices and Class B multifamily – sometimes referred to as attainable or workforce housing. The idea, Rabil says, is to invest in recession-resistant properties, ones that would serve a critical need for specific groups of tenants regardless of broader macroeconomic conditions.

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Q How did the pandemic change the market outlook for demographically driven housing strategies?

The impact the pandemic had on the office and retail sectors served as a catalyst for investors to look at where they want to be allocating capital. These trends are not hidden from anyone. There are 15 million 80-and-older Americans today; in 2030 that number goes to approximately 20 million, and over 28 million by 2040. We have 11,000 Americans turning 65 every day. Housing that fills a need for a specific demographic will remain in demand.

We are also seeing the renter-by-necessity category grow massively, yet we have only seen about 400,000 new Class B units delivered in the past decade, compared with more than 2 million new Class A units, which are not attainable for the large renter-by-necessity population who need rental housing in this country.

Q What does the opportunity set look like today?

Attainable housing, student housing and senior housing are all at an inflection point, with massively escalating demand not being met by new supply. That is being driven by dramatically rising interest rates, sticky inflation and higher labor costs, which all deter new construction.

Coming out of a global pandemic and into a period of monetary policy tightening not seen in a decade, there has been a significant amount of dislocation because of the dramatic increase in interest rates in a relatively short timeframe. The confluence of these events – demand tailwinds, supply constraints and a buyer's market – are three legs of a stool that do not come together very often, and they will not stay in place forever. So, we are extremely bullish on the opportunity set in front of us today.

Q Are rising interest rates more of a headwind or tailwind?

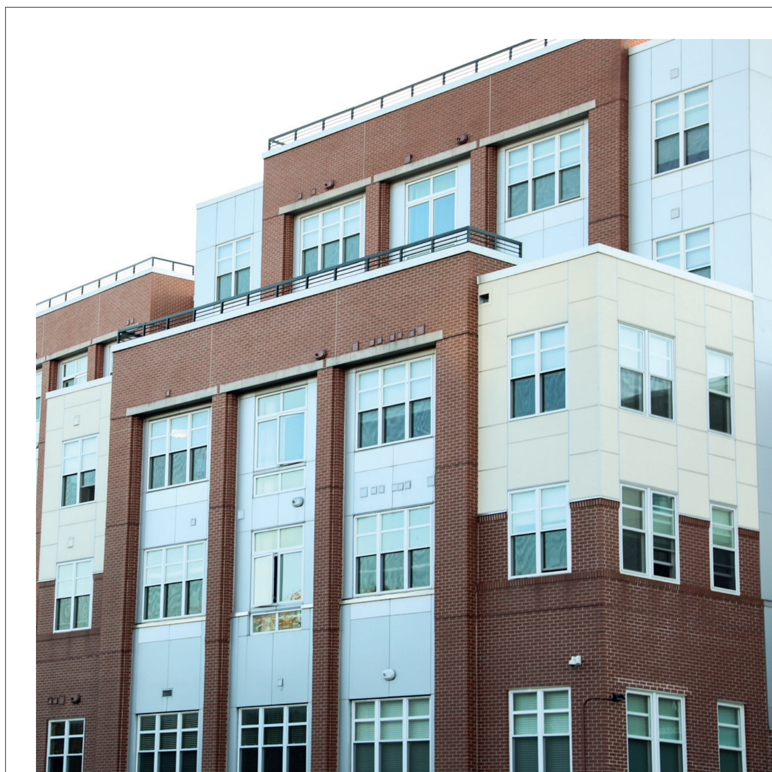
I am old enough to remember that these are not high interest rates; we have just returned, partially, to more normalized rates. But as is human nature, many became addicted to effectively free money during the past decade.

Because of this, a lot of what was bought or built from 2016 through 2022 was done on the premise that we were going to continue to have 3 to 4 percent interest rates and 4 to 5 percent cap rates. The assets themselves are performing extremely well, but the structural leverage used for those assets is not functional anymore in a much higher interest rate and cap rate environment.

We love to lean in during times of dislocation. We did so in 2020, and we are doing so now. The best real estate buying opportunities are in our asset classes. The approach has met expectations and then some.

We are buying at close to 7 percent cap rates for many assets. For Class B multifamily, we are probably buying in the low 6s, but these are super high-quality assets that were selling at 25 and 50 percent lower cap rates just 24 months ago. We see a more constructive interest rate environment moving forward. We are not basing that on a certain number of expected interest rate cuts by the Fed, but rather we see a longer-term trend of interest rates not going up any more.

At some point, they will come down. In the meantime, we continue to have massive demand escalation in the asset classes we are investing in, and there is no line of sight on when significant incremental supply will become available in the market; it is going to take a while. Also, the financial system is not



Q How do reports of declining populations of college-age Americans and fewer Americans attending college impact your outlook on student housing?

It really is a tale of two cities. There are approximately 5,500 universities in the US, but we are only interested in schools that have strong demand growth, 40,000 or more undergraduate students and brand name recognition. For many schools that do not have those dynamics, the pandemic and remote learning changed things massively. I think we are going to see fewer universities in the US as we move forward.

But the dynamic that exists in the university markets in which we invest is the same as seniors housing and Class B multifamily: escalating demand that is not being met with new supply. There is also a lack of physical space near these schools. We are only investing in Class A student housing that is walkable to major public universities where demand growth is not only inelastic but is escalating.

going to become massively liquid in the next 24 months.

Q How should investors approach assets with structural leverage issues?

We have done a significant amount of buying over the past 12 months and plan for that pace to continue for the next 24 months. We think 2024 and 2025 will be the two best vintage years for real estate in the past decade and the next decade. But you have to distinguish between opportunities where the structural leverage does not work but rental and occupancy rates are strong, and those that have both leverage issues and significant operational challenges. In this regard, demographically driven assets have outperformed.

Historically, we have looked at transitional assets, ones with occupancy rates in the low- to mid-80s, and used our operational expertise to get occupancy to 100 percent. Today, we have an opportunity to buy fully stabilized, Class A assets that do not need repositioning. We have not seen that since the GFC. This is happening now because there are many forced or motivated sellers.

My career effectively started a millisecond before the savings and loan crisis ensued in 1988. That was a stark example of everything that could go wrong in real estate going wrong all at one time. So, the firm and I have always been very focused on return of capital, return on capital and appropriate risk-adjusted returns. Leverage is not the enemy; inappropriate use of leverage is the enemy.

We have always concerned ourselves with what the opportunity set is and how can we create strategic advantages to consistently outperform. That goes through everything that we have done. Being a disciplined investor is lonely; you are going in when others are going out, and you are going out when others are going in. And, by definition, you are not in the majority; you are in a very small minority. It is almost an antisocial feeling, but we are fortunate at this moment in time to have taken that approach.

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Q How are investors engaging with specialized residential strategies today?

This is really the first time in our history that investors are proactively looking at demographically driven asset classes. I like to say, "Find the demand, and let it run you over," and that is essentially what investors are saying today. They see where demand is going and the asset classes that make sense over a long period moving forward. That is the reason we chose student housing, Class B multifamily and higher-end senior housing.

We have had to slog through these assets being deemed 'niche alternatives' or not mainstream asset classes, and today that is beginning to change. But these verticals do require a significant amount of operating expertise and asset knowledge, so that remains a barrier to entry.

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Q What about the difficulties sourcing debt in this current environment?

It's important to build true partnerships with finance partners and lenders, to educate them about the assets we target and about our strategies. We also do not competitively bid our debt transactions; we are much more concerned with making sure we always have access to debt capital rather than trying to get it five basis points less expensive this time.

Our perspective is that shaving five basis points or even 10 basis points off a debt financing cost is not going to make a material difference in returns at the end of the day, but having access to debt capital when others do not is a massive strategic advantage and will add huge incremental value for investors. That philosophy served us extremely well during the pandemic, and it is serving us well today as liquidity has become far more constrained than it had been from 2012 to 2020. ■