PUBLIC-PRIVATE PARTNERSHIPS: IT'S THE RIGHT TIME

When you couple tight capital with spiraling enrollment, colleges and universities begin to fall behind in developing facilities to accommodate growth. Read how some institutions are striking deals with student housing developers to keep up with residential requirements.

By Daniel I. Bernstein

Reduced endowments and sharp declines in state funding have produced budget cutbacks, hiring freezes, and reductions in capital spending on college campuses across America—all at a time when many institutions are experiencing all-time highs in enrollment. As student housing developers, we don't presume to have *all* the answers for the extraordinary budgetary challenges that university leaders are currently facing, but we do know this: Student housing is one of the few areas where someone else is willing to pick up the tab.

Now more than ever, we're seeing college and university leaders exploring public-private partnerships (PPPs) as a means of financing new on-campus student housing facilities. We find that the learning curve for most colleges and universities, as it relates to PPPs, is typically centered around the type of deal structure that is most appropriate for a specific project. This is closely followed by the particular set of controls that the institution should seek to maintain over the life of that project.

In either case, our advice is to approach these areas with a balanced perspective that is mindful not only of the institution's interests, but also of the interests of the potential partner. An institution can limit developer interest if an opportunity appears to be too one-sided. Additionally, since these partnerships can last for decades, it's important that both sides feel good about the deal that's been struck.

MUTUALLY BENEFICIAL ARRANGEMENTS

Public-private partnerships can offer advantages to both sides. For student housing developers, these arrangements can result in a mitigation of project-related risk, much of which is minimized by the favorable location of student residential projects. PPPs also can provide developers with access to otherwise unobtainable locations, which can offer better risk-adjusted returns over the long run. When institutions are simply seeking to tap the private sector's expertise, the developer may not be required to put any equity at risk, but will instead earn a fee for providing development services.

For colleges and universities, PPPs can substantially reduce a project's impact on debt capacity. It is this particular benefit that is largely driving administrators to explore these partnerships at the present time. Other college and university benefits include expedited development timelines, reduced construction costs, and the opportunity to gain access to the latest trends in student housing design.

OPTIONS FOR SECURING PARTNERSHIPS

These are typical deal structures and operating arrangements:

- **University-owned land with ground lease to developer.** This is the structure that has been most commonly implemented in our public-private partnerships. The developer obtains a long-term ground lease of a university-owned parcel of land and commits to financing, constructing, and managing the property. The university maintains fee ownership of the land, with the typical ground lease arrangement structured to last between 60 and 80 years.

  One of our most recent projects using this structure was with Franklin & Marshall College, Lancaster, Pennsylvania. John Fry, F&M's president, wanted to invigorate campus life by transforming the college's underused north campus into a mixed-use campus gateway development. The facilities would not only include new state-of-the-art housing, but would also offer ground-floor retail to both the campus community and the Lancaster community at large. From the beginning, Fry envisioned utilizing a public-private partnership to bring this project to fruition. F&M signed a 60-year ground lease with us, and we were responsible for entitling, constructing, financing, leasing, and managing the facility.

  The project has been deemed a great success by the F&M community, providing both the services and amenities that today's students are seeking from a lifestyle standpoint. Fry notes that the partnership "helped us achieve our goal of upgrading the college's residential and retail infrastructure."

- **University-owned land with ground lease to developer plus master lease.** This structure mirrors the previous arrangement but includes some additional risk mitigation for the developer. Under a master lease, the university extends a financial commitment to lease units within the project regardless of student demand. It is often the case that the master lease

- is negotiated for a multiyear period but does not typically extend through the length of the ground lease term.

  In some instances, an institution may be reluctant to sign a master lease, as it imposes a financial obligation that directly affects the balance sheet and borrowing capacity. In this case, it's best to find a hybrid solution that can reduce the developer's risk while imposing minimal impact on the institution's balance sheet. If you are creative, remain flexible, and work through the issues, you'll often find solutions that can accommodate both parties.

- **Foundation-owned project and fee development.** Student housing is an ideal candidate for tax-exempt bond financing because of its ability to generate consistent revenue streams that enable a project to amortize a long-term bond while maintaining a prescribed debt-service coverage ratio. Under this arrangement, the university typically enters into a long-term ground lease with a 501(c)(3) foundation that is either independent or in some way affiliated with the institution. Tax-exempt bonds are issued to fund the project and are later repaid through project revenues. The developer receives a fee for services, which typically include coordinating bond financing, collaborating with the architect, managing construction, and finally, delivering the project. It's often the case that the developer is also hired to manage the property upon completion. The fee-development structure carries the least amount of developer risk, as it normally does not require the developer to infuse equity into the project.
- **Joint ownership.** The final deal structure that we've participated in involves the developer and university sharing some form of risk and return through joint ownership. This can involve the institution contributing either land or a building into the partnership in return for a percentage of equity within the partnership. The developer contributes the remaining equity that is needed to complete the project, while also obtaining project financing and assuming all construction risk. Our company has implemented this structure in two partnerships with the University of Pennsylvania. However, it is important to note that this structure requires a greater level of flexibility from both the university and the developer than the others that have been identified thus far.

FIND A GOOD PARTNER, BE A GOOD PARTNER

Economic cycles close the door on some opportunities while opening the door to others. The current economic climate has caused business leaders across industries to shift gears and figure out how to do more with less; university leaders are no exception. Reduced endowments and declines in state funding have caused colleges and universities to think creatively and search for alternative methods of financing capital projects. Fortunately, the groundwork has already been laid as it relates to student housing PPPs. Still, as is the case for all partnerships, communication, flexibility, and transparency are the keys to long-term success.

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