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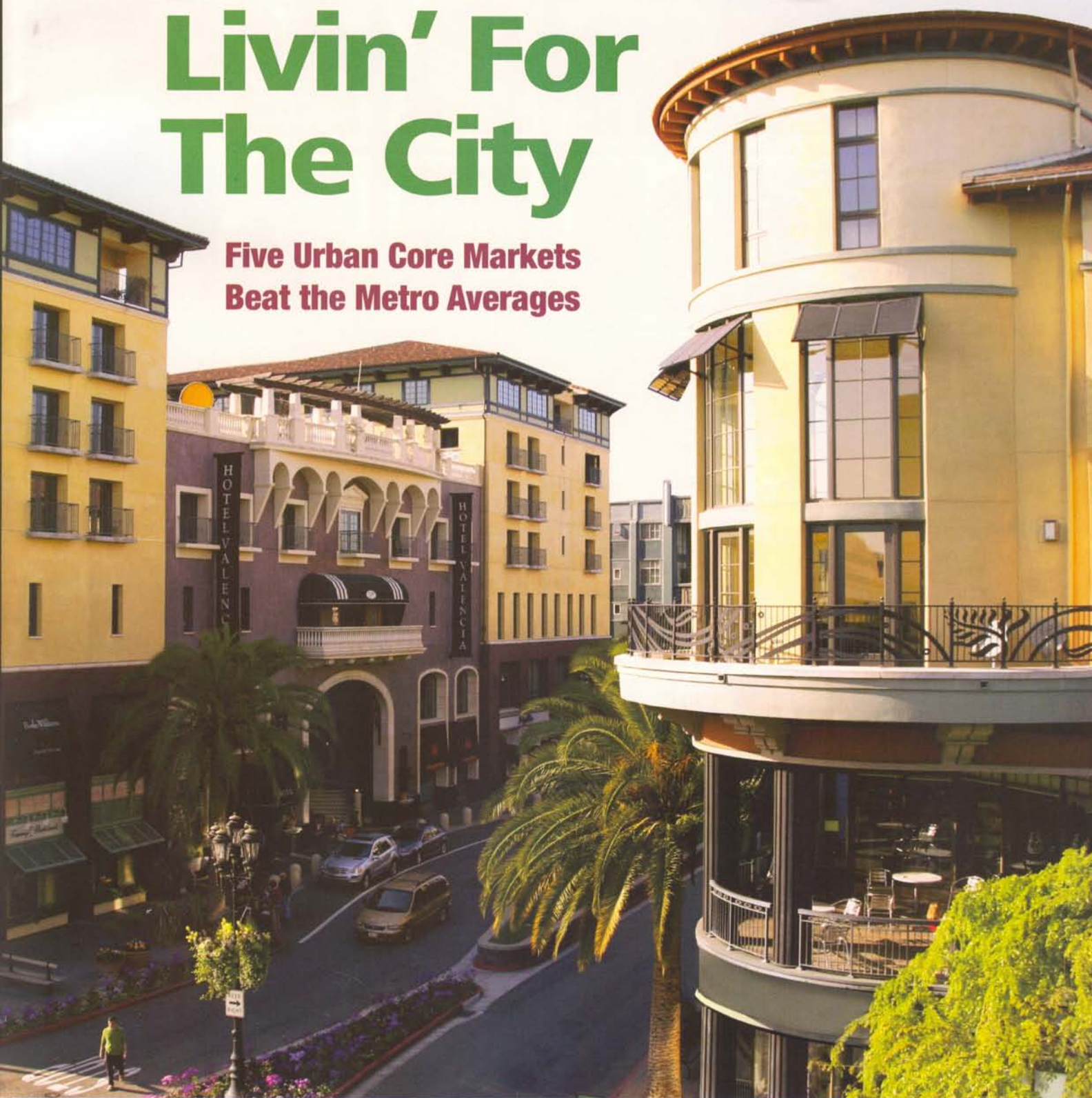
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# Supplying Demand

*Financially exhausted universities are eager to work with private apartment developers to help build and provide the high-quality housing their students demand.*

BY DANIEL BERNSTEIN

**C**olleges and universities might appear to be havens during a challenging job market, but university leaders will be the first to admit that they've been hit worse than most by the current economic storm with not enough beds, not enough time to adapt and now, more than ever, not enough money.

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 enrollment highs. Against this backdrop, university leaders are increasingly seeking relief from the private sector in the form of privatized housing.

For student-housing developers such as Campus Apartments, public-private partnerships with well-established colleges and universities can offer tremendous opportunities. These partner-

ships, if structured properly, afford developers access to precious and normally unobtainable land that, considering the recession-resistant position of higher education, should result in attractive, risk-adjusted returns for decades.

However, as is often the case, there's a catch—positioning a firm to participate in student housing-oriented public-private partnerships requires a thorough understanding of student-housing drivers, deal structures and, most importantly, the operations side of this management-intensive real estate niche.

## High Demand Projected

Children of Baby Boomers, often referred to as Generation Y, are individuals born between 1977 and 1997. This generation was 88.5 million strong as of the latest Census Bureau estimate in 2008, and is as large as the Baby Boomer generation born



Campus Crossings, Franklin & Marshall College, Lancaster, Pa.



between 1946 and 1964. In 2003, 4 million Americans turned 18. By 2010, that number is estimated to peak at 5.5 million and will remain above the 5 million mark annually through 2020.

These population projections should translate into steady undergraduate enrollments throughout this period, providing an added layer of security to student-housing investors. However, despite these attractive demographic and national trends, savvy student-housing investors must still pay close attention to regional and institutional trends, not to mention a particular market's barriers to entry and current off-campus housing supply.

And as always, the real estate mantra "location, location, location" remains a central theme within the student-housing arena. Those who are able to strike partnerships with institutions, and thereby gain access to unparalleled locations, nearly always will outperform the market.

### Parents' 'Dorm' Won't Cut It

With the expected enrollment increases during the next decade, institutions nationwide are facing the same sticky situations: Much of their on-campus housing stock is comprised of tired, antiquated, 1950s- and 1960s-built dormitories that may no longer carry debt, but do require a tremendous amount of ongoing capital. These mostly fail to meet the higher expectations of today's students.

As a result, university administrators are left wondering how they can possibly afford to replace these outdated buildings with new, highly amenitized residence halls. Still, most also will admit that they cannot afford not to. If there is one thing that Generation Y has university officials brutally aware of, it's this:

The double-occupancy, cinder block room from their mother's dorm simply won't cut it. And if the housing doesn't cut it, this generation of students may decide to go elsewhere.

Funding challenges vary between institutions. However, the general theme remains that capital spending budgets are extremely tight, with most institutions preferring to preserve their debt capacity for those projects that support the core academic mission. Meanwhile, university leaders have come to realize that housing is one area where someone else is willing to foot the bill—and it no longer requires a blind leap of faith.

The multitude of transactions that have taken place during the past decade has established a set of proven best practices regarding deal structures and operating arrangements. Today's university leaders are well aware of the benefits associated with these transactions. Paramount benefits are real-estate expertise and reduced risk with a minimal impact on institutional credit and debt capacity.

### Free Land, Strings Attached

In most public-private partnerships, the developer is not required to purchase land because the university already owns it. This results in total development costs that typically are less than off-campus projects of the same scope, where land costs can be a significant part of the overall development budget. Add to the equation that the development parcel usually is in a prime on-campus location, and the developer has the makings of an attractive opportunity.

However, while free land is certainly a great start, it does not always equate to high returns. Depending on the deal structure,



### Public-Private Partnership Structures

1. University-owned land with a ground lease to the developer
2. University-owned land with a ground lease to the developer, plus a master lease
3. Foundation-owned project/fee development
4. Joint ownership Public-Private Partnership Structures

Campus Crossings at Briarcliff, Emory University, Atlanta



## Why Universities Shouldn't Go It Alone

**F**ollowing are two ways private-sector apartment firms can leverage their value to college administrators:

- **Real Estate Expertise.** Most college administrators recognize that their time is best spent on their core mission: educating students. Often, few colleges have developed more than a handful of residence halls within the last decade. They will readily admit that housing development is not what they do best and that leveraging the private sector's expertise can be invaluable in managing project costs and building design. Additionally, the private sector's efficiency and streamlined approach generally translate into expedited delivery.
- **Reduced Risk and Minimal Impact on Institutional Credit/Debt Capacity.** This often is the underlying motivation behind university leaders' desire to partner with the private sector. Despite their need for either additional or updated student housing, they're concerned with protecting the institution's credit rating and borrowing capacity. Simply put, partnering with a private developer can enable them to have their cake and eat it, too. They benefit from the use of a state-of-the-art student-housing facility while the developer typically assumes the entire financial burden and risk associated with the project. The end result is that the university usually incurs only indirect debt, which greatly minimizes the project's impact on its credit rating and debt capacity. —D.B.

there may be strings attached that can pose unique challenges to the developer, some of which may ultimately threaten a project's financial viability.

For example, if the development firm wants to sell its interest in the project, there may be restrictions that limit its rights because the developer is not the fee-owner of the land and the university will want to know who its future partner will be. Additionally, the institution's level of involvement in project design can substantially increase costs when compared to off-campus projects. Finally, an institution may seek to cap rental rates or restrict rent growth, either of which may negatively impact returns.

These issues can and should be clearly defined and agreed upon well in advance of a project's inception. If handled correctly, they should not represent significant obstacles. From Campus Apartments' vantage point, the benefits that accompany these partnerships certainly outweigh the challenges. The key is open communication with the university partner and, in some instances, education on how certain deal points affect project viability.

### Let's Make a Deal

There are several ways to structure a public-private partnership. The most central elements to consider are that the institution will want to maintain control in some capacity and the developer will want to strike a balance between mitigating risk and maximizing return. These partnerships can last for decades, so it is important that both sides feel good about the deal that's been struck.

The structure that has been most commonly implemented in Campus Apartments' public-private partnerships is university-owned land with a ground lease to the developer. The developer obtains a long-term ground lease of a university-owned parcel of land and commits to financing, constructing and managing the property while the university maintains fee-ownership of the land. When negotiating the ground lease arrangement, the longer the term, the better; 60 years to 80 years is the norm.

In 2007, Campus Apartments delivered a project at Franklin & Marshall College



Campus Crossings at Briarcliff, Emory University, Atlanta





Campus Crossings at Briarcliff, Emory University, Atlanta

(F&M) in Lancaster, Pa., using this structure. The college's president sought a public-private partnership to develop a mixed-use campus gateway project that not only would provide new housing, but also would invigorate campus life by transforming the college's under-utilized north campus into a retail destination for the region. F&M signed a 60-year ground lease with Campus Apartments, entrusting the firm to construct, finance, lease and manage the facility.

One thing that stood out about F&M's involvement was that the administration understood what it takes to compete with peer institutions. President John Fry says that the partnership "helped us achieve our goal of upgrading the college's residential and retail infrastructure. Students are looking for a full amenity package in terms of dining, residences and shopping. They do not want to live in dormitories any more. They want to live independently in real apartments."

Another possible deal structure involves a ground lease and a master lease. This structure mirrors the arrangement previously outlined, but adds 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. The master

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lease often is negotiated for a multi-year period but does not typically extend through the length of the ground lease. It is worth noting that institutions are often reluctant to sign a master lease because it imposes a financial obligation that directly impacts balance sheets and borrowing capacity. It is best to find a hybrid solution that both reduces the developer's risk and imposes minimal impact to the university partner's balance sheet.

Student housing is an ideal candidate for tax-exempt bond financing because of its ability to generate consistent revenue streams that enable it to amortize a long-term bond while maintaining a prescribed debt-service coverage ratio. The fee-development structure carries the least amount of developer risk because it normally does not require the developer to shoulder any financial burden.

Under this arrangement, the university typically enters into a long-term ground lease with an independent 501(c)3 foundation. Tax-exempt bonds are issued to fund the project and are later repaid through project revenues. The developer receives a fee for its services, which typically includes coordinating bond financing, collaborating with the architect, managing construction and finally delivering the project. The developer is often hired to manage the property upon completion.

The final high-level deal structure that Campus Apartments has 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 to 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 shouldering all construction risk. Campus Apartments has implemented this structure in its partnerships with the University of Pennsylvania, and has found that the flexibility of both the university and the developer is critical within this structure.

### Post-Development Options

The management team's responsibilities can take a few different routes. Campus Apartments operates under one rule—if it has invested equity in the project, then it will need to manage the property. If the company were simply hired as a fee developer, it would welcome the management component, but it would not be a requirement.

In terms of residence-life services, there are two common approaches. Many institutions want to shape the freshman experience and want to be directly involved in

providing residence-life services to these students. In this instance, Campus Apartments may only oversee the facilities management of the building. In other instances, Campus Apartments provides both residence-life services and facilities-management services. Whatever the case, it's important to remain sensitive to the university partner's approach toward student development.

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 joining them. Reduced endowments and declines in state funding have caused colleges and universities to think creatively and search for alternative methods of financing capital projects. Within the last few years, institutions have issued requests for proposals that seek the development and private financing of not only student housing but also stadiums, parking garages, cafeterias and recreation centers. University leaders across the country are cognizant of the need to address their antiquated facilities. And, even if institutions wanted to push these capital projects to the back burner, today's students would never allow it.

Here lies tremendous opportunity for the private sector to step in and help meet this need. But remember: Creating win-win public-private partnerships for student housing requires a developer to know more than simple sticks and bricks. ■



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