STUDENT AFFAIRS LEADERSHIP COUNCIL

Replenishing Housing Stock through Public-Private Partnerships

Custom Research Brief • June 11, 2010

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WASHINGTON, D.C.

I. Research Methodology

Project Challenge:

Leadership at a member institution approached the Council with the following questions:

- *How have other institutions structured agreements with external partners to support the construction and renovation of residence halls?*
- *How are operational and financial responsibilities shared by universities and external partners in public-private partnerships?*
- *Do partnerships with private firms permit universities to avoid negative impacts on their balance sheets and credit ratings?*
- *How do institutions ensure the seamless integration of externally-developed areas with the rest of campus?*

Project Sources:

- Advisory Board's internal and online (www.educationadvisoryboard.com) research libraries
- The Chronicle of Higher Education http://chronicle.com
- National Center for Education Statistics (NCES) http://nces.ed.gov/
- Council for the Advancement of Standards in Higher Education, CAS Professional Standards for Higher Education (6th Edition)
- Moody's Investors Services "Special Comment: Privatized Student Housing and Debt Capacity of US Universities"

Research Parameters:

- Per the requesting member's guidelines, the Council targeted its outreach to private institutions that have pursued public-private partnerships to meet campus housing needs.

I. Research Methodology

A Guide to Institutions Profiled in this Brief

Institution	Location	Enrollment (Total / Undergraduate)	Classification
University A	West City: Midsize	67,100/53,300	Public: Research Universities (very high research activity)
[redacted]	[redacted]	[redacted]	[redacted]
University C	South Suburb: Large	6,100/5,900	Public: Baccalaureate Colleges--Diverse Fields
[redacted]	[redacted]	[redacted]	[redacted]
University E	Midwest City: Large	53,700/40,200	Public: Research Universities (very high research activity)
[redacted]	[redacted]	[redacted]	[redacted]
University G	West City: Large	39,700/29,400	Public: Research Universities (very high research activity)
[redacted]	[redacted]	[redacted]	[redacted]

Source: National Center for Education Statistics

Note: The Council also contacted-

- The state economic development corporation for University B, which serves as their third-party partner for residence hall development
- The system office of real estate and facilities for University C
- The system office of real estate and facilities for University D

II. Executive Summary

Key Observations:

- **Public-private partnerships offer universities an opportunity to improve housing stock with minimal impact on the university balance sheet; however, ratings agencies have recently expressed uncertainty regarding these partnerships.** Although most public-private partnerships at contact institutions do not affect the university's credit, ratings agencies may begin to scrutinize arrangements that are integral to campus strategic plans. If agencies suspect that a university might be obligated to assume financial responsibility for a privately-developed property in case of unforeseen circumstances, these properties may begin to affect university credit negatively.

- **In the most common public-private arrangement, the university (and/or government) establishes a non-profit foundation that issues bonds to fund development and serves as the property owner until the debt is paid.** Revenues from student rent are first used to service debt; remaining revenues are allocated to the university and are frequently used to fund future residence hall projects. The foundation model allows the university to protect its interests while shielding it from financial obligations.

- **In a less common form of partnership, several contact institutions lease land to a for-profit development company that then invests their own equity to fund development.** Although this method generally expedites construction and has a lower impact on university finances, the participating university must cede greater levels of financial and managerial control to the for-profit entity than it would to a non-profit development foundation.

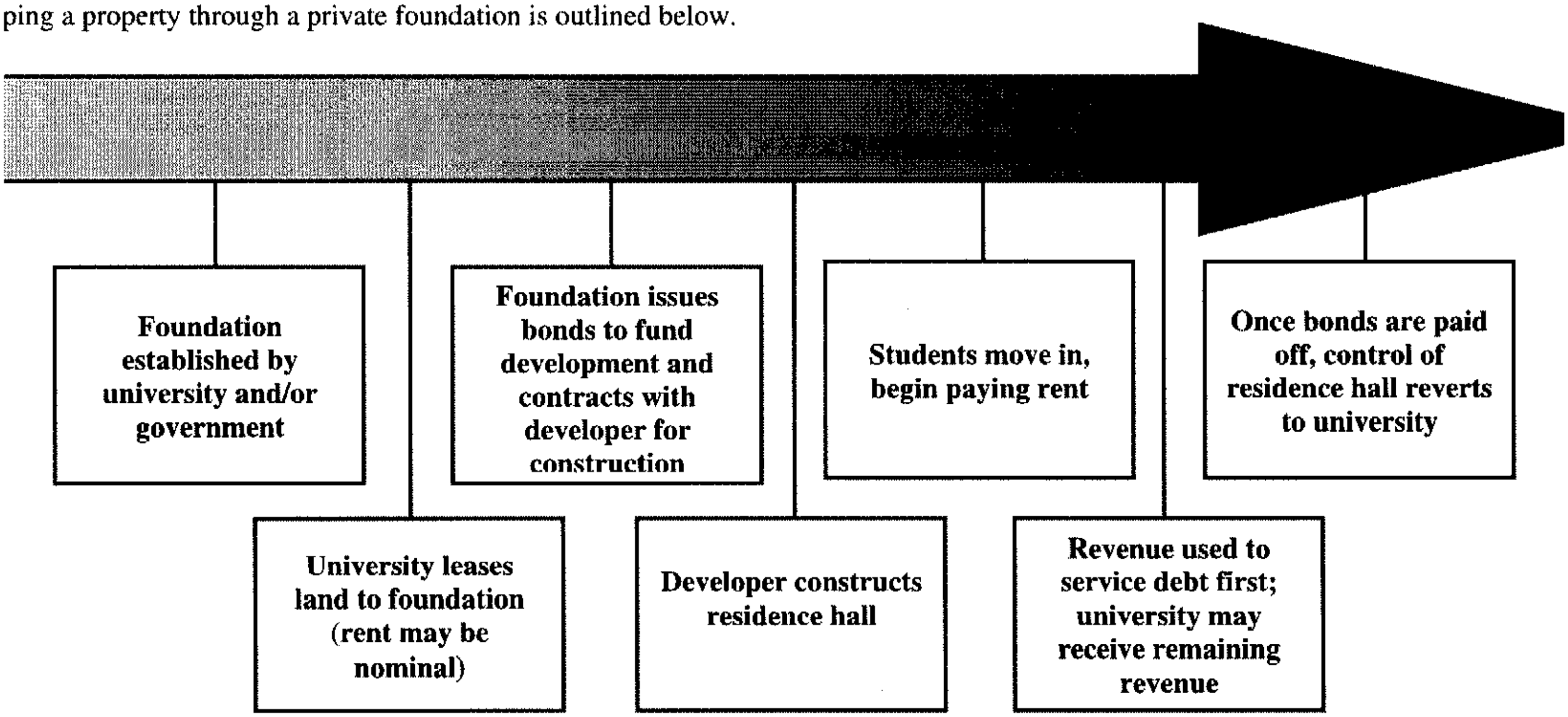
- **To ensure a seamless student experience, universities typically oversee the residence life function in privately-developed residence halls.** Although the property owner may outsource facility management responsibilities to avoid overburdening university staff, the university can enhance the student experience by creating integrated service portals and including private management staff in the university housing office.

- **Partnering with a private entity may lead to conflict if the entity is not committed to providing a student-friendly housing experience.** To ensure that partnerships promote university and student interests, contact institutions mandate that private entities provide the same level of service to students as does the university housing department. Regular meetings between discrete housing staffs and standardization of terms and conditions across properties also reduce conflict between university and private entities.

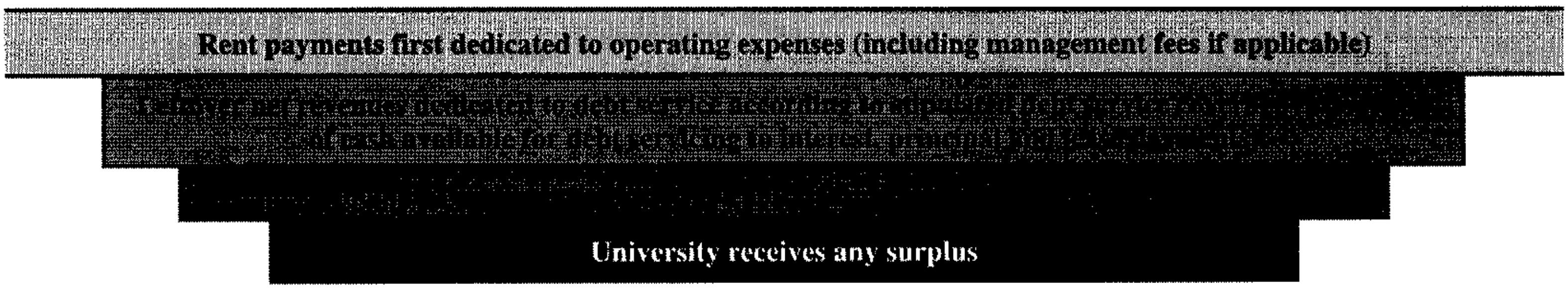
[ODEL A: NON-PROFIT DEVELOPMENT FOUNDATIONS

)lishing a Development Foundation

nost common model of using public-private partnerships to pursue residence hall construction, institutions (and sometimes state ments) establish non-profit entities that take ownership of the new property and assume most financial risk. The typical process for ping a property through a private foundation is outlined below.



nstitutions that use this model of public-private partnership allocate revenues from student rents according to "waterfall" agreements:



Sample Agreement Details

The table below provides additional details of contact institutions' public-private partnerships under the foundation model.

Agreement Details for Foundation-Model Partnerships at Contact Institutions					
Institution	**Debt Service Coverage Ratio**	**Fees and Other Financial Obligations**	**Rent Collection**	**Maintenance**	**Residence Life**
University D	1.2	• One-time development fee • Management fee: $240,000 per year • Debt issuer's fee: $200,000 per year (paid to state educational housing authority) • university guarantees rent shortfalls for bond insurance	✗	✓	✓
University B	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
University A	1 to 1.2 (varies by property)	• One-time development fee • Fixed management fee for maintenance • University charges foundation 2.5% management fee for one property	✗	✓	✗
University G	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
University C	No set coverage ratio	• One-time development fee • Fixed management fee	✗	✓	✗
University F	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

In the above chart, a "✓" indicates that a service is provided by a third party, while an "✗" indicates that the university maintains responsibility over a particular function.

Impact of Foundation Model on University Balance Sheets

Debt issued by third-party foundations to fund residence hall construction is generally considered to be *indirect debt* on the university's books. Currently, indirect debt does not negatively impact university credit ratings; however, ratings agencies are in the process of reconsidering how indirect debt affects university credit scores.

Prior to the credit crisis, third-party-developed residence halls were frequently considered to be "on books, but off balance": debt issued by foundations appeared on university balance sheets, but the university had no legal obligation or liability for the debt. As credit markets have tightened, universities are facing increased pressure to assume responsibility for the debt. Bond insurers often refuse to insure bonds unless the university guarantees revenues from student rents (i.e., the university commits to fund any rent shortfalls).

Although a consensus has not yet emerged regarding indirect debt's impact on credit scores, a recent special comment by Moody's suggests that properties integral to a university's strategic growth (e.g., housing for first-year students on the central campus) may affect credit ratings more than properties with less relation to a university's strategic plan.

Outsourcing to Third-Party Management Companies

Third-party developers that specialize in student housing (e.g., Capstone, American Campus Communities, etc.) frequently have housing management divisions, and several contact institutions opt to outsource some property management responsibility to these companies under completion of construction. The varying degrees to which contact institutions work with third-party management companies are detailed below.

Less Involvement — **More Involvement**

No Third Party Involvement

University F purchases all third-party-developed residence halls upon completion, assuming all debt. These residence halls are fully integrated with the campus and are managed completely by university housing and residence life services.

Outsourced Operations

At **University A**'s and **University G**'s foundation-developed properties, private management companies oversee residence hall maintenance and facilities; however, the universities oversee residence life operations (e.g., hiring residence advisors, community programming, etc.)

[redacted]

Contacts at **University C**'s system office note that institutions within the system are trending away from using third-party management companies in order to improve the integration of privately-developed residence halls with the rest of campus. Managing residence halls in-house generally results in cost savings for the institution, despite increases in workload for existing housing management staff.

III. Model A: Non-Profit Development Foundations

Advantages and Drawbacks of Development Foundation Model

Advantages

- ✓ **Alignment of Interests:** In this model of public-private partnership, the non-profit foundation generally exists solely to facilitate residence hall construction and lacks incentives to charge additional fees to the university. Contact institutions report that foundations consistently ensure that work is completed on time and according to budget.
- ✓ **Opportunity for University Control:** Agreements are typically structured to transfer ownership of properties to the university after all debt is paid, helping to promote the seamless integration of residence halls with the rest of campus.
- ✓ **Revenue Generation:** Once debt service and fees are paid, remaining revenues are transferred to the university and are frequently dedicated to the renewal of housing stock.

Drawbacks

- × **Uncertain Impact on Credit:** As discussed earlier, the impact of privately-developed residence halls on university balances and credit ratings may change in the future. As a result, institutions and their foundations may face increased borrowing challenges, and institutions may be held more liable for debt.
- × **Issuer Fees:** Although foundations are not-for-profits, they frequently charge issuer's fees to institutions to finance foundation operations. State regulations may increase the costs of using this model by requiring institutions to issue debt through certain entities that charge higher fees. Contacts at **University D** suggest that issuing debt through the state-mandated educational housing authority dramatically increased project expenses.

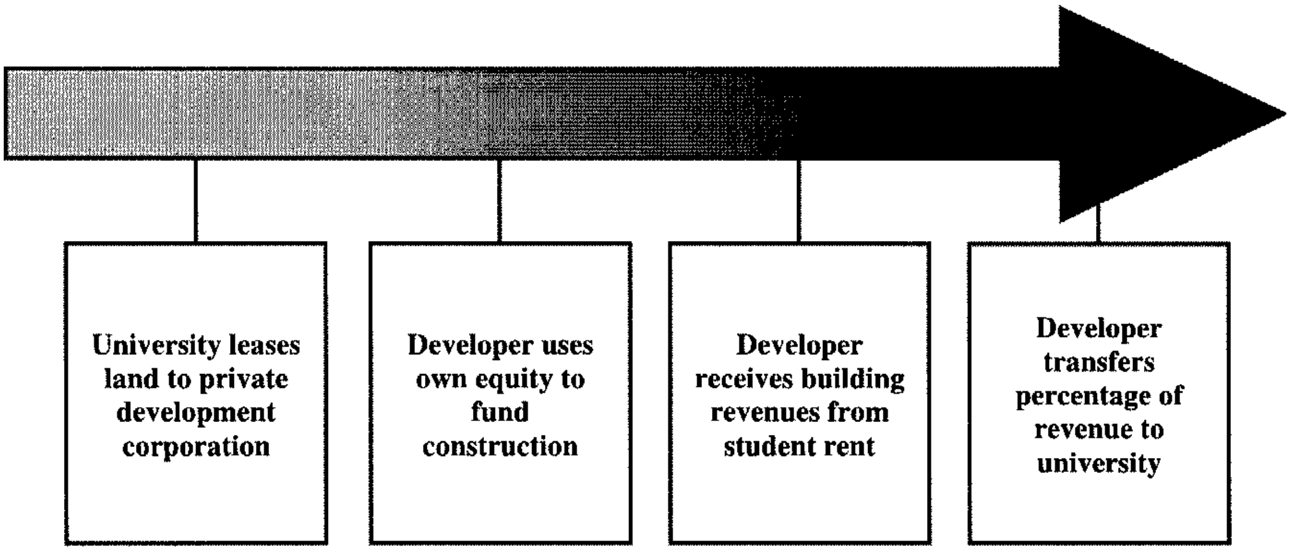
Choosing Cheaper Financing over Off-Balance Development

Depending on state regulations, bond insurer demands, and procurement laws, universities may be able to issue debt at a lower interest rate than foundations. **University G** elected to self-finance new residence hall projects because bond insurers required the university to guarantee foundation-issued debt, which would obligate the foundation to comply with state compliance laws and ultimately raise construction costs. Because issuing its own debt at a lower interest rate than the foundation would offset the university's higher construction costs, the university ultimately abandoned the foundation model.

IV. Model B: Third Party Equity Financing

Financing Development through Equity

University A and **University H** have both used this less-common model to facilitate residence hall development. Under this model, institutions contract with for-profit corporations that assume financial risk by using equity to fund residence hall construction. Universities typically sign long-term contracts with private developers to ensure that a developer will recover the initial investment; for example, University A's equity agreement extends for 65 years with two 10-year extension options, while University H has a 25-year equity agreement that will likely be renewed. This model allows projects financed by equity to be executed faster than projects managed by foundations, with a lower impact on university balance sheets. The typical process for developing a property through equity financing is outlined below.



Universities receive a share of facility revenues; however, contacts at University H report that the university's share (5.5 percent) is not sufficient to cover costs of providing residence life support to the privately-developed buildings. Although University A receives a higher percentage (8.1 percent of gross revenue), these funds are dedicated to the central administration for debt service and do not support the university's housing operation.

Impact of Equity Model on University Balance Sheets

Although uncertainty remains regarding rating agencies' assessments of public-private partnerships, equity development partnerships currently do not impact university balance sheets and are considered completely off-credit. However, contacts report two cases where projects funded by a private corporation's own equity may be reflected on the university's balance sheet or credit rating:

- *The corporation issues bonds in addition to using equity to fund development.* Contacts suggest that in this case, the portion of the project funded by bonds will be considered indirect debt on the university's balance sheet.
- *Extreme circumstances force the university to assume control of property on institution-owned land.* At University H, several externally-developed properties sit on university-owned land; in the case of unforeseen circumstances that prevent the partner from carrying out responsibilities (e.g., bankruptcy), the university would likely assume control and financial liability in order to maintain continuity of service to students.

IV. Model B: Third Party Equity Financing

Managing Equity-Financed Properties

Property management duties are shared by the institution and private partner under equity financing arrangements: the partner generally manages most facilities and maintenance operations, while the institution manages residence life. Although these arrangements remove the burden of operations management from universities, challenges can arise in providing a seamless residential experience to students who live in privately-controlled residence halls. During negotiations to establish partnerships, institutions must demand that private partners commit to providing equitable housing experiences to students. Potential management challenges are highlighted below.

Mandating Vendors

Private developers and management companies may resist using the same vendors as the institution, resulting in variations in service quality for students. **University A** created an MOU with American Campus Communities (ACC) articulating that the private company would provide the same level of service that is available to students on the rest of campus; this agreement prevented ACC from using a different internet provider in its residence hall, which would have provided lower-cost but lower-quality service.

[redacted]

[redacted]

Ensuring Student-Friendly Policies

Contacts at University H warn that institutions must ensure that private managers' terms and conditions match university housing policies. While the university automatically cancels housing for students who graduate or withdraw, the management company requires students living in its residence halls to sign year-long leases that are not dependent on student status. Under this policy, students who graduate are held responsible for the full value of their leases; therefore, the university frequently pays students' lease penalties and is working to renegotiate these terms and conditions.

IV. Model B: Third Party Equity Financing

Advantages and Drawbacks of Equity Model

Advantages

- ✓ **Off balance sheet, off credit:** Barring a significant change in ratings agency policy, public-private agreements financed by a private corporation's equity have no impact on the university's balance sheet or credit rating.
- ✓ **Low financial risk to university:** Neither contact institution using this model is required to guarantee revenues or occupancy rates for privately-held properties. The responsibility for management and development costs lies with the private partner, not the institution.
- ✓ **Quick solution to housing shortages:** Institutions may avoid a lengthy bond-issuing process, as corporations are frequently willing to invest equity and begin construction upon deal closure.

Drawbacks

- × **Loss of university control:** Institutions have less oversight over private entities' construction procedures and terms and conditions (foundations generally must make financial data public and often include members of the university in financial discussions). The university must ensure in the beginning of negotiations that the private entity will provide high-quality service to students.
- × **Sacrifice of revenue opportunity:** Properties developed under this model exist primarily to provide revenue to the investor, not to the institution. Although the institution may receive a small percentage of property revenues, contacts report that this share may either be dedicated to other university financial obligations or insufficient to cover housing expenditures on the privately-controlled property. Furthermore, a reduced share prevents institutions from using housing revenues to create a housing renovation and refurbishment fund. For this reason, contacts at **University H** suggest that they would not pursue an equity model partnership in the future; furthermore, a University H branch campus has elected to use a foundation to facilitate residence hall development rather than an equity arrangement.
- × **Very long-term contracts:** To recoup initial investments, private entities generally expect a long-term engagement with the university. If the university is unsatisfied with the private entity's practices, it may have few opportunities to renegotiate or end agreements.

V. Additional Challenges and Strategies

Both the foundation and equity models provide promising means to increase housing stock on campus while limiting direct costs to the institution; however, universities must ensure when working with private partners that projects fully meet campus needs. Three common challenges to successful partnerships and potential solutions are discussed below.

Challenge	**Building Integration with Campus:** When undertaking public-private partnerships, university administrators worry that externally-developed properties will not complement existing structures visually or functionally and may offer a different student life experience to residents.
Strategies	• **Incorporate partnerships into strategic plans:** The board of regents for **University** C's system requires institutions to incorporate public-private partnerships into campus master plans before approving any externally-developed real estate ventures. This requirement forces institutions to consider long-term goals and implications of public-private partnerships, as well as the project's relationship to the rest of campus. • **Require design approval by campus leaders:** To ensure that externally-developed projects are aesthetically integrated with the rest of campus, **University D**'s system grants individual campuses authority to approve designs for new developments.

Challenge	**Relationship Management with Private Party:** Collaborating with a private party to facilitate residence hall projects, rather than performing all property development in-house, creates opportunities for miscommunication. Furthermore, for-profit development and management firms may face financial pressure to provide different levels of service to students than the university would provide. Miscommunication and misaligned incentives can sour relationships between institutions and private partners.
Strategies	• **Include Institutional Leaders in Foundations: University F**'s director of housing sits on the board of the university's non-profit development foundation, ensuring that university interests are represented. • **Establish Integrated Housing Offices:** To facilitate communication between the university and private partners, both **University A** and **University H**'s housing offices include private partner staff. At University A, ACC has appointed a dedicated university liaison who works in the housing office. The housing office also hosts monthly meetings with representatives of all private partners, which has successfully reduced infighting between private partners and the university. • **Create Non-Negotiable Service Standards:** By mandating in MOUs that private management companies must provide the same level of service to students as the university housing department, **University A** was able to bar a management company from selecting a lower-quality internet provider for a residence hall.

Challenge	**Increased Workloads:** Public-private partnerships offer an effective way to quickly increase housing stock; however, institutions may lack the infrastructure and staff to serve increased numbers of residential students.
Strategies	• **Request Service Fees from Private Partners:** For one foundation-owned property, **University A** charges the foundation a $100-per student fee to defray expenses incurred by the university in marketing the property to students; the university also receives a management fee (2.5 percent of gross revenue) from the foundation. • **Create a Decentralized Management Structure:** To manage a dramatic increase in residential students, University A created a "neighborhood" management structure. The main campus was divided into four neighborhoods, and each satellite campus was considered a neighborhood. Each neighborhood is served by a student housing council and a housing director; contacts suggest that a neighborhood housing director has a similar workload to that of a housing director on a small residential campus. This relatively decentralized housing management structure has resulted in quicker response and solution times to an array of housing issues, ranging from maintenance requests to billing and assignments.

