

MULTI-HOUSING NEWS

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Making the Grade

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Atlanta—Colleges and universities across the nation are turning to the private sector more and more to fund, develop and manage their on-campus student housing. And while it wasn't long ago that for-profit developers and financial companies were leery of tackling this housing niche, many are now eagerly seeking these deals due to a profitable confluence of demographic and economic factors. "We have nearly 60 million kids between the ages of six and 18 enrolled in schools throughout the country—the nation's single largest demographic group," said Cecil Phillips, CEO of Place Properties, an Atlanta-based student housing developer.

"A seismic shift in that group is occurring in that an increasing number of them know that a high school education is not and likely will not ever be sufficient to get and maintain a job in the workplace," Phillips continued. "So if you were a policy planner and giving recommendations about a growth industry in the country for the next 50 years, then you wouldn't be wrong by saying it is those [institutions] that provide access to knowledge that will be the growth leaders."

At the same time that demand is accelerating for post-secondary education, housing supply on campuses across the United States is growing scarce and painfully outdated.

"The issue is schools do not have enough student housing as what they currently have was built between the 1950s and 1970s and has outlived its useful life," said David Adelman, CEO of Campus Apartments, a Philadelphia-based developer that has focused exclusively on student housing for 40 years. "And universities generally now lack the funds and overall knowledge of how to update these dorms."

And while the aging dorms at colleges that have long housed their students on-campus present one set of opportunities for developers, a

whole new market is also beginning to open: As competition for students intensifies, numerous commuter colleges are building housing for the first time, in an effort to make themselves more attractive and to improve their overall reputation.

"We have seen a number of commuter campuses building housing for the first time and the impact of that housing on their academic missions has been startling," said Ray Kimsey, vice president and principal of Niles Bolton Associates, an architecture firm active in the student housing sector. "It has really stabilized their student demographics and [attracted] many more full-time students."

Case in point: San Jose State University, where Niles Bolton is designing a 2,300-bed project for a school once primarily a commuter campus. "They've had a limited amount of housing on that campus and some of that has been demolished to create the site for this new development," Kimsey said. "As a result, the university ... really expects the character of the campus to be transformed."

David Mitani, managing principal of the Los Angeles office of The Steinberg Group, who said he has been designing a lot of on-campus housing recently, agreed that housing can really change the face of these institutions.

"Universities are smart enough now to say, 'If we bring the living environment to the campus, it can activate a 24-hour environment as opposed to classes through the day, ending in the evening and then the campus is dead the rest of the time.' I think it is very much a social [benefit] that the housing brings to the campus," he said.

Another reason that on-campus opportunities are expanding for the multi-housing industry's developers and lenders: Traditional financing sources for student housing projects are being slashed, especially at public institutions, bringing colleges and universities to the brink of a housing crisis.

"I think it is true that 48 out of the 50 states have current operating deficits. That means that everything is being cut and education is no longer the sacred cow," noted Phillips. "There is not a school in the country I know of that isn't actively considering how it is going to find alternative financing to fund its capital program for the next decade."

The result of this combination of surging enrollments and reduced funding: Post secondary schools often now have no other choice but to reach out to private sector developers to meet the growing demand for student housing. And capital providers have recently become far more interested in lending a hand, making such partnerships easier to form.

"The good news is there is more private money available in the marketplace than there is public money. What we've been able to do over the last 10 years is educate the private sources of capital—insurance companies, banks, pension funds and the like—about the opportunity to finance what up until now has been off limits to private capital," said Phillips.

"At the same time, we have been able to persuade the higher education establishments that the old ways do not work," Phillips continued. "So if they want student housing, then they are going to have to turn to private capital."

Risks & Rewards

Inevitably, a few headaches and some tension come with heading into this public-private territory. Dealing with these relatively minor issues, however, can prove vastly rewarding for developers looking to crack open the on-campus market.

"Once you enter the on-campus [arena], you are now under the university bureaucracy, their rules and the way they do business—which is okay, if you're patient," said Adelman. "Universities need to protect themselves; they need to make sure that a process is in place when



they select a private developer, and it just takes longer."

Joan Millane, managing partner of Millane Partners LLC, agreed. "Universities make decisions by consensus, which differs from the way the private sector makes decisions. It takes longer to move through a process, and private developers have to go in there knowing that."

Millane, whose career background includes commercial real estate experience, co-owns a consulting practice which helps colleges and universities successfully negotiate and execute these public-private deals. "There are a lot of synergies there; [universities and private developers] need each other," she said. "The university is providing the land; the developer is bringing housing expertise; and the students are paying the rent. So student housing is a real win, win, win."

The most typical model used to privately develop on-campus housing involves a Section 501(c)(3) non-profit foundation set up by the college or university. That foundation, designated owner of the land through a ground lease arranged with the university, can issue bonds and then contract with a developer to build and manage the student housing. Developers simply earn a fee for developing, and oftentimes managing, the housing.

"When we do on-campus housing, we use tax-exempt bonds," said Phillips. "Since 1986, for-profit companies, such as ourselves, have not been allowed to participate in the rewards of projects that use tax-exempt financing. So the rent paid by students goes to the foundation while the foundation pays the development fees, operating expenses and management fees and then keeps the net operating income to help the university."

A plus for developers, however, is the fact that no equity is required on their part, Millane explained. "Developers earn fair-market development fees and a fair-market management fee, but they don't have to put in any of their own money. So this is a different business model [than many developers are accustomed to], but there are a lot of people who like the fees that can be made and the fact that they don't have to worry about getting equity."

Yet despite the lack of developer equity and the fact that risks such as zoning problems, property taxes and environmental issues are generally avoided on campus, Jim Truitt, executive vice president and regional partner

with JPI's Campus Quarters, explained that the financial rewards can often be less than those attained in off-campus student housing.

"In the off-campus business, we own the real estate and have the ability to make profits based on cash flow or residual of the real estate that we don't have in the on-campus business," Truitt said. "So there is more risk in the off-campus developments because there is more capital invested, but you also have the opportunity for more reward."

Still, JPI is quite active on the on-campus front. In fact, the company joined forces with the University of Louisiana at Monroe earlier this year to develop a \$50 million, two-phase student housing project and provide comprehensive management services on an ongoing basis for the university's 1,700 beds in total.

Student Loans

As mentioned above, the most popular financing method for on-campus student housing is the tax-exempt bond. Indeed, approximately 80 percent of the public-private student housing deals are financed in this manner, according to Tom Daly, a senior vice president with Legg Mason Wood Walker, which has arranged a number of such financings as of late.

"Tax-exempt financing is usually the most suitable for these on-campus projects. One of the reasons why is that from the developer's standpoint, he is not required to put any equity into the project; it is an upfront, fee-driven business," Daly said. "The advantage to the [university] foundation is it is usually the most cost-effective way to borrow because rates on tax-exempt loans are usually going to be less than they'd be in the conventional market."

And Millane said that bond buyers have become quite interested in the student-housing product. "There have been a lot of these deals done recently, and they are reviewed by the rating agencies and underwritten by people who really do understand these deals. In general, I think [the bond community] feels very comfortable about them," she said. "When the bonds go to get issued, often in less than half an hour you have your money."

That is not to say that underwriters and investors do not have some concerns—because colleges, like businesses, can fall on hard times and even go bankrupt. So what bond holders or investors want to see is that they have first lien on the revenues of the project; that cash flows are steady; and that there is a lease hold mortgage

on the building, Daly explained.

"With student housing, [the financial community] wants to make sure that the university is healthy, that it is growing or at least is not losing enrollment; and that there is, in fact, a need for the housing," said Daly. "The markets will not finance 'build it and they will come' projects."

In addition, deals are underwritten with a required replacement reserve to address maintenance and other operating needs. Although that reserve stood at \$175 per bed annually when on-campus student housing first elicited private sector interest, Daly said rating agencies have upped the figure to about \$200 after viewing a number of these facilities that have been up and running for two or three years.

Legg Mason Wood Walker is just one of a handful of firms working with these public-private partnerships, but the niche's appeal is definitely growing. "This is a niche, and that is what we try to do on the public finance side," said Daly. "We try to find certain areas where there is a need, and there is such a need for new housing throughout the higher education world—it is unbelievable."

Tax-exempt financing is not, however, the only route to follow. Campus Apartments, through a direct ground lease agreement with the University of Pennsylvania, privately financed a housing project on the Ivy League campus, steering clear of the university's balance sheet and credit facilities. This allowed the developer to take a cut of the profits rather than a flat fee.

Adelman explained the process: "We achieved a loan from a bank and then, upon stabilization, we had a couple of choices. We could have gone to a life company, a conduit or Fannie Mae or Freddie Mac. We chose a Fannie Mae deal." During the entire process, Campus Apartments acted as guarantor on the debt, shielding the university from any exposure. "The whole issue is the university really wanted this to be done with a private developer's money."

