



A public-private partnership between The Annex Group and the University of Memphis recently announced plans to develop a 540-bed residence hall on the university's campus in Tennessee.

Features

Student Housing

Economic Environment, High Tenant Demand Spur Increase in Public-Private Student Housing Projects

February 15, 2024

In a way, the dynamics of public-private partnerships (P3s) are the same as they've always been.

"The reasons why universities elect to go the P3 route haven't changed much," says Michael Baird, managing director of municipal finance for RBC Capital Markets. "For many, the decision is made based on speed to market. This happens when other alternatives can take years — resulting in an opportunity cost of not being able to provide housing to students that need housing now, in addition to increased development expenses as construction costs continue to increase year over year."

These costs — both the ones saved and the ones incurred by the university — have become increasingly important in today's economic climate. The cost of construction materials has increased by an average of 19 percent since 2020, notes facility and construction insights provider Gordian. Meanwhile, the annual student housing rent at purpose-built communities rose by an average of 8.8 percent between November 2022 and May 2023, according to RealPage.

Construction costs make it easy to see why it's more difficult to get projects to pencil right now...and increasing demand shows why it's more important than ever to get them off the ground.

Jay Pearlman, senior vice president of advisory services for The Scion Group, acknowledges P3s can certainly add speed while reducing costs, but that doesn't necessarily make these partnerships simple nowadays.

"Rising interest rates and the inflation of building costs have pushed many on-campus projects beyond the point of feasibility," he says. "Yet these financial pressures are precisely what makes alternative financing attractive to institutions who are selective about their finite debt capacity."

Pearlman notes his firm is assisting with more strategic planning and feasibility work than ever before.

"Institutions are taking the time now to critically evaluate their housing programs and assess their long-term needs so they can make quick yet informed decisions when financial dynamics improve," he continues.

Current Market Realty

Baird noted that a school's reason for executing a public-private partnership hasn't changed much, but the level of motivation may have.

"The increased P3 activity is largely driven by pent-up demand," he says. "During COVID, many thought that distance learning might undermine demand for student housing. They could not have been more wrong...most students found that they still desire a traditional on-campus experience. As such, demand for on-campus housing at many universities increased after COVID."

This is particularly true, Baird notes, at many state institutions where price-conscious students can still get an on-campus experience while paying a lower tuition rate.

Jim Hennessy, head of P3 development at Harrison Street, has seen a similar increase in P3 demand from institutions.

"Many universities today are considering adding more housing to their undergraduate population on campus," he explains.

Hennessy adds that many institutions believe students have a better college experience if they live on-campus beyond their freshman year.

"Students also get better grades and graduate on time," he continues. "And, with anxiety and depression becoming a bigger issue for this demographic, many universities believe they can mitigate some of these concerns for students if they live on-campus longer because of the increased proximity to university resources. These are just a few reasons we are expecting P3s to become even more prevalent in the near future and are seeing it already in our pipeline of deal opportunities."

Jared Everett, managing director of university partnerships at Greystar, adds that P3s are also being tapped for more than new housing developments.

"I believe the use of P3 in higher education will continue and grow and even accelerate," he says. "This is not only the result of resource constraints on universities, but the diversification of the product types being requested. We are seeing more P3s being renovations or repositions, mixed-use, larger master developments, and inclusion of other services like energy, food service and sustainability."

Greystar is working with the University of Hawaii, for example, on multiple needs. These include a new and expanded childcare center, more traditional and apartment-style student housing, and funding for a few strategic campus core projects.

"Their solution through the P3 process was to partner on the development of two new facilities, including a new childcare center, and to monetize two existing housing projects that were on the edge of campus so the proceeds could fund the campus core projects," Everett explains. "We are in the process of monetizing those assets now, and those assets will remain on a ground lease so they revert back to full university ownership in as little as 30 years."

During those 30 years, the ground lease and partnership terms ensure the monetized assets continue to operate in a manner that advances the University of Hawaii's mission, Everett further notes. In addition to the initial monetization, the deal will provide an annual revenue sharing mechanism that will continue to be an economic benefit for the campus.

Big Benefits

Pearlman adds that current constraints on budgets and debt capacity are also driving the popularity of public-private partnerships beyond new development.

“Scion has noticed an increase in interest surrounding mechanisms such as ground leases to provide external funds to accomplish needed renovations and deferred maintenance,” he says.

Raoul Amescua, regional vice president of development for The Michaels Organization, believes the P3 platform is particularly attractive right now for deferred maintenance projects.

“The P3 delivery model is the only delivery model that contractually locks in — via the required funding of reserve accounts — the long-term maintenance of the asset being delivered in order to avoid future deferred maintenance and obsolescence,” he says. “The contractual long-term obligation of a required maintenance level is critical for colleges and universities because deferred maintenance is usually the largest capital cost on any campus capital improvement plan.”

Student housing’s annual turnover and high wear-and-tear nature also mean these housing facilities tend to have the largest deferred maintenance needs over time, Amescua points out.

“In a P3 delivery, campus administrators are solving for this upfront so that their predecessors will have one less deferred maintenance housing concern in the future,” he continues.

Public-private partnerships can also be a hedge against inflation, Baird notes.

“P3s often offer an accelerated process that allows the partners to move quickly to lock in construction costs and deliver more beds sooner,” he explains. “As such, inflation risk associated with ever-increasing construction costs is mitigated, interest rates are locked in, base rents are set earlier, revenues start flowing sooner and, ultimately, student needs are met on an expedited basis.”

Earlier this year, the College of William & Mary in Williamsburg, Virginia, entered into a public-private partnership with Provident Resources Group and Balfour Beatty Campus Solutions to address its need to upgrade the university’s aging housing and dining facilities. This needed to be done while balancing affordability and the school’s commitment to a carbon-neutral campus by 2030.

“To meet these goals, William & Mary elected to utilize a P3 financing structure to finance the development of approximately 1,200 beds of a new student housing facility and an 800-seat dining facility on the main campus,” Baird adds. “To overcome increasing construction costs and elevated interest rates, the P3 partners used multiple construction enhancements and alternative sources of funds to increase operating efficiencies and creative financing solutions to develop an efficient plan to meet the goals of the university.”

The new facilities will be built to LEED Silver standards. They will include two geothermal fields and solar energy systems that will deliver drastic energy savings and eliminate carbon production from the heating and hot water systems. This will allow the project to qualify for ‘Inflation Reduction Act’ credits that will be used to help fund additional phases of the master plan.

Baird believes it is this type of creative thinking and financing that will allow universities to not only reduce costs and risks, but get them through this challenging economic environment while achieving their goals.

“We utilized the innovative combination of a contingent lease financing for the student housing, a master lease financing for the dining facility, and bond insurance with a reserve fund surety in two series of bonds to provide a low, fixed-rate financing that will enable William & Mary to offer affordable room-and-board rates for the life of the facilities,” Baird adds.

He further explains that a privatized student housing project typically only merits a low investment-grade rating. However, by incorporating the contingent lease from the university, a higher underlying rating can be achieved, thereby opening the door for uniquely structured bond insurance that has an annual premium (versus the more costly upfront version). As such, this project had no negative impact to the university's rating or balance sheet.

And the benefits of P3s on a school's balance sheet cannot be overstated, Hennessy asserts.

"Public-private partnerships have a range of benefits, which include transferring risk and cost from the university balance sheet to the private sector while maintaining the controls necessary to ensure their students receive the same positive college experience," he says.

Harrison Street recently partnered with Duquesne University in Pittsburgh on a third P3 project that is scheduled for completion in fall 2024. At the topping out ceremony in October, the university president acknowledged that these three P3s had allowed Duquesne to renovate two existing residence halls; build a new residence hall (opening in fall 2024) for the first time in a decade; and use the proceeds saved from the P3s to build a new College of Osteopathic Medicine (opening in summer 2024). All three projects support the university's efforts to increase enrollment.

Persisting Challenges

There may be many advantages to the public-private partnership structure, but that doesn't mean deal volume resembles anything like the pre-COVID years. Or even 2019, depending on who you ask.

"Our Advisory Services team has not actually seen an increase in successful P3 transactions," Pearlman admits. He clarifies that interest remains very high, however, and there is reason to be optimistic about the future of P3 partnerships.

"When looking across various current projects, overall occupancy and rental income are up, and the need for supplemental institutional support is down," he says. "These factors, in addition to consistent debt service coverage, has created investor optimism as evidenced by improved bond ratings and outlooks by the agencies. Should interest rates begin to taper off sometime in 2024, on-campus P3 projects should show improved feasibility and become more attractive to both bond and private equity investors."

These partnerships can also be cost and time consuming, Baird adds.

"P3s come with higher financing costs than more traditional university-supported financings like direct debt or master lease financing," he says. "They take a lot of coordination from all of the partners, including the university, the non-profit owner, the developer and the whole finance team. In difficult markets like we are in today, it also takes commitment and experience to develop and implement an effective financing solution."

This is where long-term relationships can really come into play, Amescua notes. That was the case at UC Davis where The Michaels Organization recently closed on its third phase of student housing development within its Orchard Park project. The \$318 million project has delivered 1,549 student housing beds, two community centers, solar photovoltaic canopies over carports, parking and open space improvements.

"This project was a massive success because it was delivered ahead of schedule and significantly under budget," he says. "The success was really due to having a strong team dynamic and partnership with UC Davis. Their team was absolutely committed to the project's success from day one, and that commitment never wavered throughout the entire project delivery lifecycle. The university pushed Michaels to get the best project possible, and they were always reasonable and willing to work collaboratively to help the team solve challenges."

Everett adds that states can even contribute to whether a P3 is viable for all parties or not.

“There are numerous states and programs that are best in class in supporting P3s, students and private investment in social infrastructure, but there are other examples that hinder these efforts,” he says. “One of the challenges we see with P3s on a national scale is how different states have different levels of P3 enabling — or non-enabling — legislation. States also have numerous programs to encourage the development of affordable housing, but many of those programs do not apply to student housing, yet students are also greatly in need of attainable housing options.”

Limiting the duration of a ground lease is one example of a state policy that can hinder P3s, Everett notes.

“While they may have good intentions to keep public optionality in the mid-term, sometimes those durations are too short to attract private investment,” he adds.

Still, the appeal is there for universities, especially as they broaden their horizons both figuratively and literally.

“We are seeing student housing developments being bundled with other campus needs to drive economies of scale,” Everett continues. “We are seeing more examples where a university has a master plan for their campus expansion, and they are utilizing the P3 model to realize that plan, which often goes beyond housing. Sometimes the cross-collateralization of product types can assist a certain component to be developed that otherwise, on its own, could not.” —*Nellie Day*

This article was originally published in the November/December 2023 issue of *Student Housing Business* magazine.