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How Colleges Manage to Afford Big Projects in Lean Times

By **LEE GARDNER**

CONSTRUCTION CRANES are rising again on public-university campuses, sometimes many cranes at once. The University of California at Merced is in the middle of a \$1.3-billion expansion. The University of Kentucky just finished building more than \$900 million worth of new housing, dining, and other facilities. Several other big public universities have sweeping construction projects worth hundreds of millions each. How can universities afford such large projects in an era of tight budgets and lean state support? Some of them are taking advantage of private capital obtained through long-term public-private partnerships — also called P3 deals — struck with private developers.

In years past, colleges have used such partnerships mainly to build residence halls, since student-housing fees create a relatively reliable revenue stream to

pay back the initial investment. But more deals at public institutions now run into nine figures and use private capital to build academic, administrative, and student-life buildings as well.

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need to beg or borrow millions. A public college can remake its campus in years, rather than decades, often for a lower cost than with the traditional process. At the same time, the bigger the deal, the more complexities — and potential complications — it brings.

In a typical higher-education P3, a private developer provides capital and construction services to build a facility on land owned by the college. The company owns the resulting building but leases it back to the institution for an annual fee. Most such deals extend for 30 to 35 years — at which point most campus facilities will need renovating or replacing anyway — and then ownership reverts to the college.

Many universities are still wary of such arrangements. When Kentucky announced its huge private-capital development deal, in 2011, “People said, ‘Aha, it’s finally the tipping point,’” says Robert Bronstein, president of Scion, a company that owns, operates, and advises on student housing. Seven years later, most such deals at colleges are still limited to building a dorm or two.

But more and more universities are asking questions about whether such partnerships might be right for them, Bronstein says. “Even schools that ultimately build and operate buildings in the traditional way will explore P3s as often as not at this point.”

Eric N. Monday, executive vice president for finance and administration at Kentucky, has hosted dozens of visits from leaders of other institutions curious about big P3s. Many of them face the same dilemma Kentucky did. “We can go with the traditional model, and we can try to build through the traditional state process and state timeline, with the state regulations and requirements that exist in most public universities,” Monday says. “At the same time, is there a marketplace that can respond?”

WHEN DOROTHY Leland took over as chancellor at Merced, in 2011, the institution, which opened in 2005, was already stretched to its physical limits. All the residence halls had waiting lists. Students pored over textbooks while sitting in corridors because of a lack of study space. Classes were scheduled not only on weekdays but also late into the evenings and on Saturdays. Enrollment was projected to keep growing for years to come.

Merced needed to expand quickly: It needed classrooms, labs, offices, recreational space, and parking. It also needed to extend roads, water lines, and other infrastructure to serve any future facilities built on the adjacent land it already owned. The university looked into building a couple of dorms through traditional financing, but the infrastructure expenses would have made the new housing too expensive.

Leland compares the early process of deliberating to a gerbil wheel: “People were going round and round and round, looking at the typical routes forward, and nothing was working.” Georgia College & State University, where she had previously served as president, had constructed some housing with private capital. Perhaps a P3 might work at Merced?

This fall the university will open the first phase of its Merced 2020 project, which will add about 1.2 million square feet of space, nearly doubling the size of the existing campus, and enable the institution to raise enrollment to about 10,000 from about 8,000. While about half of the \$1.3-billion cost of the project will be covered with University of California funds, the rest is financed by the Plenary Group, a private developer. Once the first buildings are in use, the university will begin paying Plenary an annual leasing fee for the next 35 years.

It took Merced about three years to decide what it needed, consult with development firms, and draft a detailed request for proposals. But once the university decided on its private partners, in 2016, it broke ground in 2017 and plans to move about 1,700 students into new beds this fall. The whole project is scheduled to be finished by 2020 — shocking speed, by higher-education standards.

The University of Kansas faced a different problem. It had plenty of beds, classrooms, and labs, but many of its facilities were decades old and outmoded. “One of our main science buildings was built before men walked on the moon,” says James Modig, the university architect.

The need to replace, and add to, existing facilities led Kansas to forge a \$350-million deal with Edgemoor Infrastructure & Real Estate for its Central District project, which includes a new science building, new housing, and a new student union, plus parking facilities and a new utilities plant.

Doing it as one big project held distinct appeal for the university, Modig says. First, it could save the trouble of building the new facilities piecemeal, where “you’ve got to deal with five or six different architects and five or six different contractors,” he says. Second, “if we did it business as usual, it’d probably be 10 or 15 years down the road before we had these facilities.” The project, which was begun in 2014, will be completed this spring.

LARGE P3S can offer universities speed and scale, but they wouldn’t be nearly as tempting if they didn’t offer potential financial advantages as well.

Private capital is plentiful, especially compared with the sources of funds that typically support building projects in public higher education. State support for capital projects is ever more scarce. Donors may be coaxed into paying for a new science building, but they tend to balk at new dorms, much less new parking lots. During the 27 years that Modig has been at Kansas, he says,



A sculpture titled "Beginnings" frames a crane at the U. of California at Merced, where a \$1.3-billion expansion is underway.

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With the help of a public-private partnership, the rapidly growing U. of California at Merced is constructing new student housing, laboratory facilities, and other buildings.

only about 10 percent of capital-construction funds have come from the state, and only about 25 percent from philanthropy.

Public universities typically can't simply borrow money for building projects. Since they are arms of state government, they must usually seek its approval for taking on any significant debt. When Kansas was first considering how to meet its construction needs, an austere budget climate meant that the state was not interested in approving bonding, Modig says. "So that takes that option off the table." (States must often approve P3s at public colleges.)

Private capital has become even more accessible for universities in the past few years, according to Bronstein, the housing consultant. A decade ago, P3s for student housing were unfamiliar to most investors, and the relatively low rate of return less attractive than other, higher-flying real-estate opportunities. Now that deals with colleges have become more commonplace, and other markets have cooled, "there's a phenomenal amount of equity that is attracted to safe, stable projects," he says.

Large construction projects can also offer colleges economies of scale. "If you buy 2,000 cubic yards of concrete, you're going to get it at one price," Modig says. "If you buy 30,000 cubic yards of concrete, you're probably going to get it for slightly less."

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There are also savings associated with spending just a few years rebuilding your campus rather than a decade. Thanks to inflation, a million dollars buys more now than it will in five years. Modig estimates that the Central District project at

Kansas would cost about \$12 million to \$15 million more for each additional year it would take to complete.

One of the biggest financial benefits of these private-capital deals is their potential for holding down maintenance costs. Private developers are contracted

not only to finance and construct the facilities, but also typically to handle upkeep, too. That has the potential to mitigate one of the more insidious and costly challenges that college leaders face: deferred maintenance.

Renovating aging campus facilities often gives way to more-urgent spending priorities or falls victim to fluctuations in state support or tuition revenues. But those unaddressed fixes can add up — California's public colleges need at least \$47.5 billion to cover replacement, renovation, and repair on their campuses over the next five years, according to a recent report.

At Merced, the university's partners are responsible for keeping everything it builds in top shape through the 35-year life of the contract. According to Richard Cummings, director of strategic communications at Merced, the arrangement ensures that any necessary repairs actually get made when needed, which gives the university's budget more long-term stability.

Public-private partnerships aren't simple, however — especially when they involve universities. The deals can seem daunting to boards of trustees, system administrators, and legislators. Merced 2020 faced pushback from system officials at first. "They were not convinced we could do it," says Leland, the chancellor. "They were not convinced we *should* do it. We had to work through that."

Big P3s can be so consuming and complex that universities must brace themselves for the work involved in making them successful. The Merced project has been "all-consuming" for many on the campus, Leland says. She likens it to a series of parallel swim lanes, each brimming with tasks — negotiating with local government officials in one lane, negotiating with unions in another — each needing attention to keep the project on track. At Kentucky, the staffing costs and

administrative time for its P3 project easily amounted to 1 to 2 percent of the project's total cost, says Monday, the vice president.

University leaders must make sure they allocate ample time and resources to communicating with stakeholders about their projects. Appalachian State University, in North Carolina, is in the midst of arranging two large P3 projects — one that will revamp one end of its football stadium to add club seats, dining, and an orthopedic clinic, and another that will add 2,000 new beds to campus. Paul Forte, vice chancellor for business affairs, says people often assume that the university is privatizing its housing. He explains that, while the project's financing comes from outside, the four new residence halls will be run by the same staff that runs the existing dorms. "There are a lot misconceptions out there," he says. "You have to be able to clearly explain what you're doing, how you're doing it, and why it's of benefit to the institution."

Universities must also weigh whether such projects are, in fact, of benefit or not. Merced can add thousands of new beds in part because it can count on California's robust student demographics for continued enrollment and thus for revenues to help meet annual payments to its private partners. A university that contracted to build housing it couldn't fill would still be on the hook for decades of payments.

For potential P3 projects that blend facilities with revenue streams attached, like housing and dining, as well as for those that don't, such as classrooms or labs, leaders must make sure the projects make long-term financial sense. For example, students at Kansas agreed to a fee hike that helped make building a new union possible.

Before coming to Appalachian State, Forte served as controller at the University of Rhode Island, which opted not to pursue private funding for a construction project during his tenure. "If you're doing, say, a single residence hall, have good debt capacity, and have built other ones in the past successfully, I might say, Why do you want to do that?" he says of P3s. "It's not the right answer for everybody."

But as more and more institutions are looking to replace or upgrade aging facilities to stay competitive, deals with private developers are likely to remain tempting. "The P3 world is evolving," Leland says. "There are a lot more models out there now."

And in this economic climate, she says, the public-private partnership is one that universities shouldn't overlook. ■