P3 Projects at University Campuses

Universities are increasingly turning to public private partnerships to deliver major projects on their campuses. The University of California has developed approximately 65 projects on a P3 basis during the past 15 years. These projects range from student housing to hotels to research laboratories and to medical office buildings. The new Neurosciences Building at the UCSF campus is scheduled to be completed in 2012; this project, with an estimated project cost of approximately $200 million, will be considered one of the landmark facilities at its Mission Bay campus. The project is being delivered on a P3 basis.

Elsewhere in the country, P3 projects are becoming more and more common. For example, the University of Kentucky is about to enter into an agreement with a P3 developer to upgrade and expand over 9,000 residence hall beds over the next decade. Similarly, Ohio State University is about to embark on a P3 relationship concerning improvements and operations of its parking garages and lots. And the University of Arizona has just announced that it will be developing on a P3 basis two new student housing facilities, one of which will include significant space for commercial and retail use.

Why use P3s?

Generally speaking, budgetary issues are forcing universities to find a creative means for developing projects for their campuses. P3s allow projects to be affordable. If a university does not want to, or cannot, increase its direct levels of borrowing, P3s enable the universities to develop projects on an “off-balance” sheet basis, allowing the schools to maintain their credit rating and debt capacity. This permits the universities to use their limited resources for other educational needs.

In addition, P3s allow the universities to take advantage of the skill and expertise of the private sector in developing projects. It is widely felt that the private sector has a better track record in delivering projects on time and on budget. Moreover, with P3s, the universities reduce risks: most of the development risks of the design and construction process are transferred to the developer.

Moreover, with a P3 project, the developer must take into account the life cycle and operations & maintenance costs of the completed project, thus providing the university with assurance that a quality project will be developed.

From the developer’s perspective, P3s are attractive in that student housing fees – or other dedicated revenue sources available to universities – are considered a reliable source of payment throughout the term of the ground lease to pay for the project.
Of course, there are trade-offs in delivering projects on a P3 basis. First, the university loses certain control over the project – particularly with the programming of the project. Per the University of California’s development guidelines, complex projects that require substantial technical input from multiple user groups warrant close examination for P3 eligibility since many of the P3 efficiencies in schedule and cost may be illusory.

Second, P3 projects, by definition, represent a long term commitment on the part of the schools. This compromises the University’s flexibility in responding to future program needs.

Third, there is a concern that, by privatizing the maintenance and operation of campus facilities, the universities affect their core mission to provide an educational environment for their students. For housing projects, some universities have addressed this issue by, for example, reserving the right to select the directors of the residence halls. This allows the universities to control the available programs and amenities at the residences.

Structure of Typical P3s

As is common for most P3 projects, a ground lease is the central component of the P3 model for university projects. Generally, the lease will have a duration of at least 20 years. If private financing is used, the ground lease may have durations of as much as 40 to 60 years.

Often times, to take advantage of tax exempt financing, the private developer and the university collaborate to form a separate 501(c)(3) non-profit corporation. The motivation for doing this is that the non-profit is able to issue tax-exempt bonds to finance the project. The non-profit serves as a conduit between the university and the developer. It contracts with the developer for the development of the project, with the developer (or affiliated entities) being responsible for the design, construction, operation and maintenance of the project.

The non-profit also enters into the ground lease with the university. During the term of the lease, the non-profit pays a nominal amount of annual rent to the university. For most housing projects, student fees are paid to the non-profit to pay for the debt service and capital costs of the project, as well as the ongoing operations and maintenance costs, along with capital reserves. The ground lease typically restricts the amount of student fees that can be charged during the duration of the lease based on relevant comparable housing market rental data. For most projects, the ground lease terminates upon the developer receiving a minimum rate of return for the project, and the ownership of the project is then transferred to the university.

Legal Issues re Ground Leases

A host of legal issues is raised by the ground leases for P3 projects. Obviously, a lot of the issues stem from the long duration of the lease. The lease needs to provide for the myriad of conditions that may occur during the term of the agreement. This includes not only rent adjustments under the lease, but also the financial capacity of the contracting parties to the lease.
For P3s, the issues are further complicated due to the financing component of the project delivery. The developer / non-profit needs to provide the financing sources with adequate protection in the event that the payments from the project are not sufficient to cover the costs of the project. This issue is key since, in the event that there is a default under the applicable agreements, it is unlikely that the university would have agreed to subordinate its fee simple interest in the land to allow the financing entity to have priority. Thus, the finance sources need to be assured that there is a reliable and stable source of payment. Often times, as part of the ground leases, the universities agree to restrict further development of comparable projects in the surrounding areas. For housing projects, the university may agree to guarantee a minimum rate of occupancy for the P3 project.

Another major issue that needs to be addressed in the P3 documents is the condition of the project upon the termination of the ground lease. During the last years of the lease, the developer’s financial interest is to continue to defer the costs of performing major capital replacements so that the universities are forced to bear those costs after the lease has expired. Obviously, from the university’s perspective, they will want the project to be in “first class condition” at the time of turnover.

University of California Davis West Village Project

The West Village Project at the University of California Davis campus is one of the largest P3 university projects in the country. For this project, approximately 660 apartment units will be provided for students, as well as 343 for-sale homes for faculty and staff. The amenities include a 15,000 square foot recreation facility, consisting of a multi-purpose theater room, swimming pool fitness center, and the like. In addition, approximately 42,500 square feet of commercial space is included. In addition, the village will include a center for the local community college district. All of these improvements are scheduled for completion in the 2011 / 2012 general timeframe.

One of the unique aspects of the project is the project’s environmental sustainability design. The project is claimed to be the largest Zero Net Energy development in the United States. Energy conservation measures are predominate throughout the development, including solar panels, public transportation-oriented design, and energy efficient appliances.

The project is being developed on a P3 basis. The duration of the ground leases range from 65 years (apartments and retail) and 99 years (faculty / staff housing). The total project is estimated to cost approximately $280 million. Based on the sustainability features of the project, grant funding was made available by state and federal government.

Conclusion

As universities continue to be challenged by limited or unavailable government resources and funds, we can expect the trend of P3 projects on university campuses to continue to grow.