HIGHER EDUCATION PUBLIC-PRIVATE PARTNERSHIPS

2020 State of the Industry Report

BRAILSFORD & DUNLAVEY

INTRODUCTION

2020 P3 State of the Industry Report

This State of the Industry Report—our third annual—is unlike the reports of previous years, as 2020 has proven to be quite unlike previous years.

We *are* still providing a snapshot of the public-private partnership (P3) activity within higher education through our research of transactions in Part One. Additionally, though, we are sharing ample thought into and observations of P3s as impacted by Covid-19—what we've seen so far in the industry, and what we expect to see from here—in Part Two (page 18).

We'll unveil additional metrics and thought leadership throughout the year, via the online knowledge exchange, ***The Higher Ed P3 Resource Center (p3resourcecenter.com)***.

PART ONE

OVERVIEW

Today's Market

This year's report again focuses on housing and housing-anchored mixed-use projects. Additionally, the number of pipeline projects continues to grow. This pipeline, which tracks possible future P3 projects in higher education, covers project types such as innovation districts, energy deals, academic buildings, parking structures/operations, and more. While future years' reports will cover these additional project types, this year's report focuses on housing and mixed-use projects.

To be included in our database, a project must be tied to a higher education institution, meaning the projects were—or will be—built on an institution's or foundation-owned land. The goal of the report remains the same. As the many critical stakeholders (e.g., higher education leadership, developers, financiers, architects, builders, and advisors) explore development projects, we seek to empower the industry with a "snapshot" of the market's key metrics. As has been the case in previous years' reports, this year's snapshot shows a dynamic industry.

HIGHLIGHTS

HIGHLIGHTS FROM 2019

2019—An unexpected year, preceding an even more unexpected year

While this annual report series has shown that the P3 industry is quite dynamic, 2019 proved an especially unexpected year—to say nothing of what a Covid-19-impacted 2020 will look like.

2019 saw roughly the same number of housing and housing-anchored mixed-use deals closed as in recent years, from 27 in 2018 to 26 in 2019. However the average deal size *dramatically* decreased, from $101M in 2018 to $73M in 2019.

Suffice it to say, if trends seemed apparent in 2018, 2019 challenged many of them. Normally this report would dive into what might be causing these shifts, as we all look to the future. Given the impact Covid-19 is having on 2020's market and data, though, we'll save that rumination for Part Two (page 18).

2019 also saw:

A resurgence in shorter leases (those 30–39 years in duration)

An on-trend but big swing toward tax-exempt deals

A much lower percentage of projects taking place at private four-years than previously

Fewer deals in the otherwise-always-busy Northeast region

THE DATA

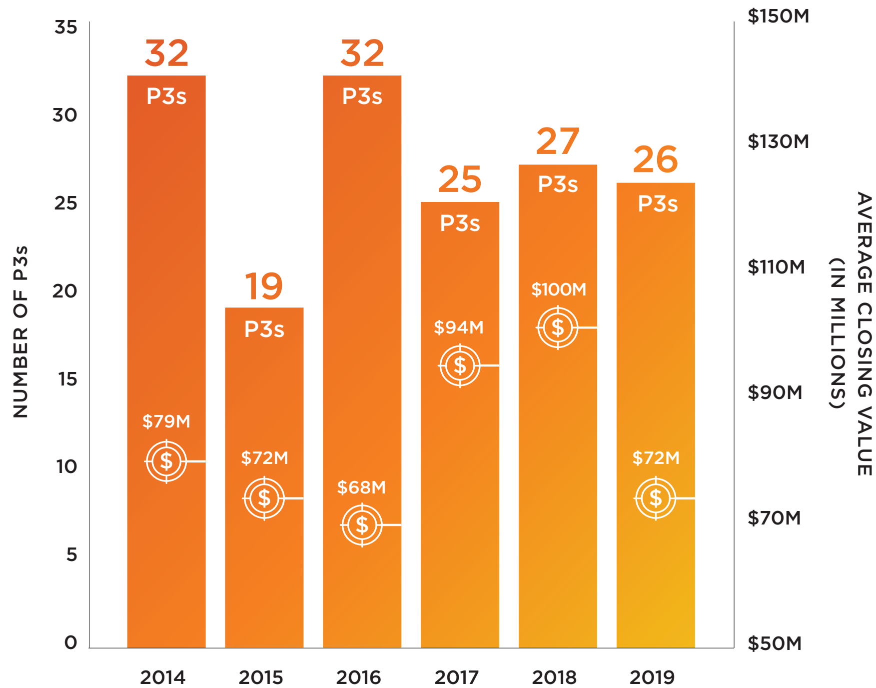
Number of Deals & Closing Value

The average number of deals closed per year has remained relatively steady in the last few years, hovering in the mid-to-high 20s[1].

Last year, we noted that the average deal size appeared to be trending larger—a suggestion, when taken in the context of a steady number of deals per year, that more schools might be bundling (wherein a single project covers multiple asset classes). **In 2019, however, the average deal size *dropped* significantly—to a level not seen for years.** While we've seen a continued interest in bundling due to its many benefits, it seems a stretch to suggest a trend at this point. More than anything, the average closing value by year has simply been dynamic, going down then up and then back down. The *trendline* is still inclined, but the see-sawing nature of this figure is the predominant takeaway from the data.

The average closing value of P3s has a slightly inclined trendline, but the year-by-year data is highly dynamic.

Number of Housing P3s and Average Closing Value, by Year



[1]*Throughout the report, you will see modest changes to the numbers stated in last year's report. These changes are due to additional findings collected since. We make every effort to collect as complete a dataset as possible, but inevitably a number of closed projects slip through the cracks each year.*

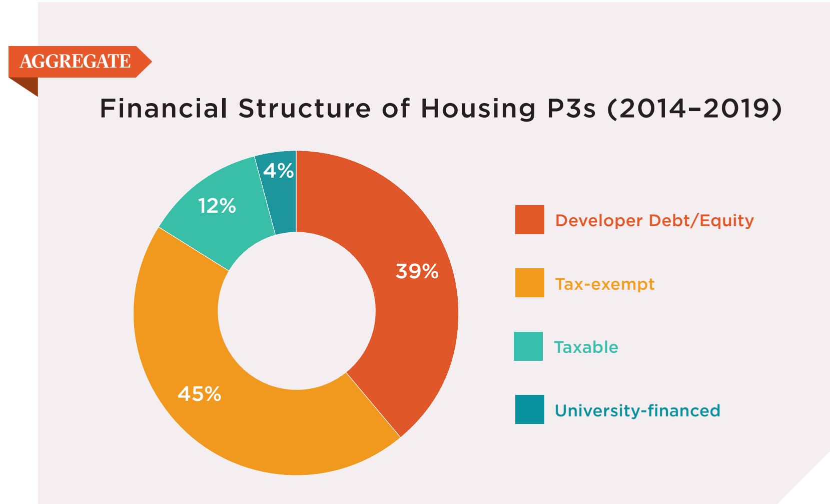
THE DATA

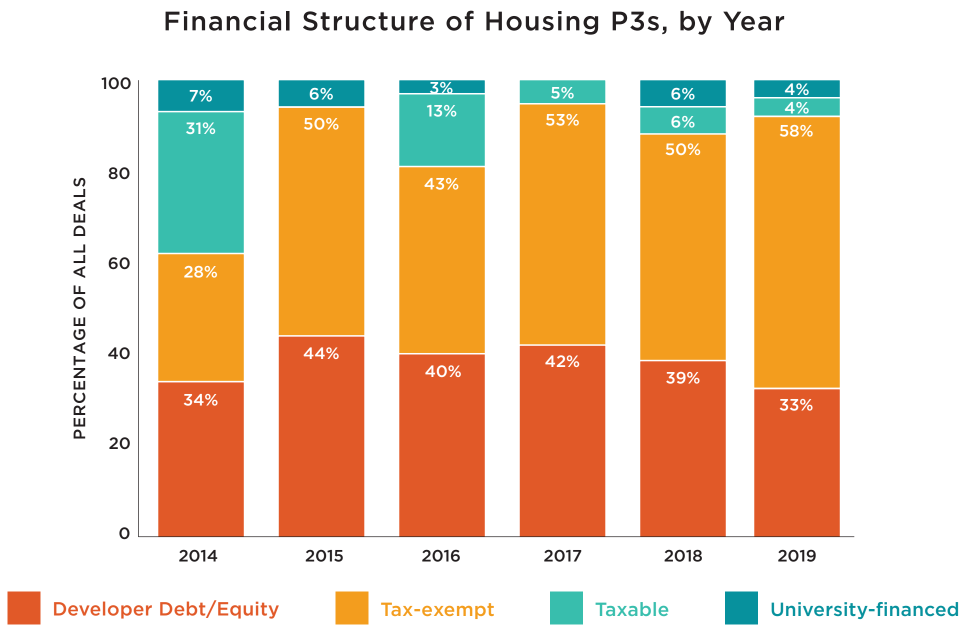
Financial Structure

When looking at the last six years of data in aggregate, we can see that some financial structures are more popular than others for housing and housing-anchored mixed-use P3s. The majority of deals in our database (84%) are **tax-exempt** or **developer debt/equity** (45% and 39%, respectively), with just 16% of deals recorded as **taxable** or **university-financed** deal structures (12% and 4%, respectively).

Looking at year-over-year data paints a more nuanced picture. As was true in last year's reporting, the vast majority of housing deals closed continue to be **tax-exempt** or **equity**. In 2019, these two financial structures comprised 91% of deals. And the two remaining studied structures, **taxable debt** and **university-financed**, remained relatively steady from last year.

Last year, we'd noted **university-financed** deals' re-emergence on the scene after years of decline, suggesting that schools might be considering retaining the finance piece while otherwise retaining an interest in transferring operations and maintenance risk. The 2019 data aligns with that concept, but as with many of these things, only time will tell.



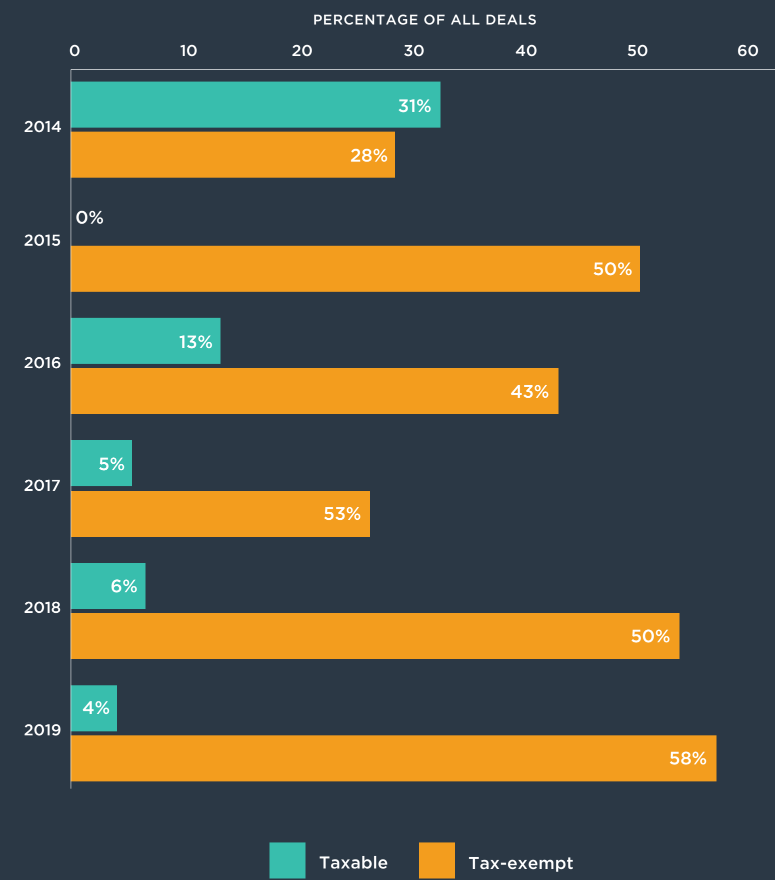


BY FINANCIAL STRUCTURE

As One Goes Up, The Other Goes Down...

The percentage of projects employing each of the four financial structures in our database varies from year to year, sometimes significantly. Focusing on *just* taxable and tax-exempt deals over the years reveals an apparent inverse relationship. We are *not* suggesting that all projects that previously would have been taxable are now tax-exempt, we are simply noting the trend away from taxable deals over time, and the trend toward tax-exempt.

Financial Structure of Housing P3s, by Year (Taxable and Tax-exempt)



THE DATA

Ground Lease Duration

Looking again at the aggregate data, we can see that most partnerships for housing or housing-anchored mixed-use P3s favored shorter to medium-length leases, with 73% of deals lasting under 60[2] years. The *average* lease length of all deals analyzed is **49 years**.

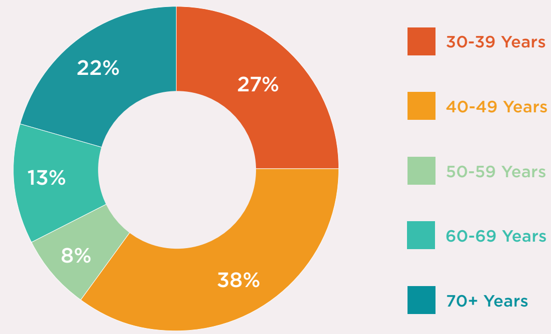
Looking at year-over-year data paints a more nuanced picture. Shorter leases—specifically those **40-49 years** in length—seem to have become popular in recent years, and have remained popular. Meanwhile the longest leases—specifically those **70 years** or longer—were popular in earlier years but have dropped off almost entirely recently.

38%

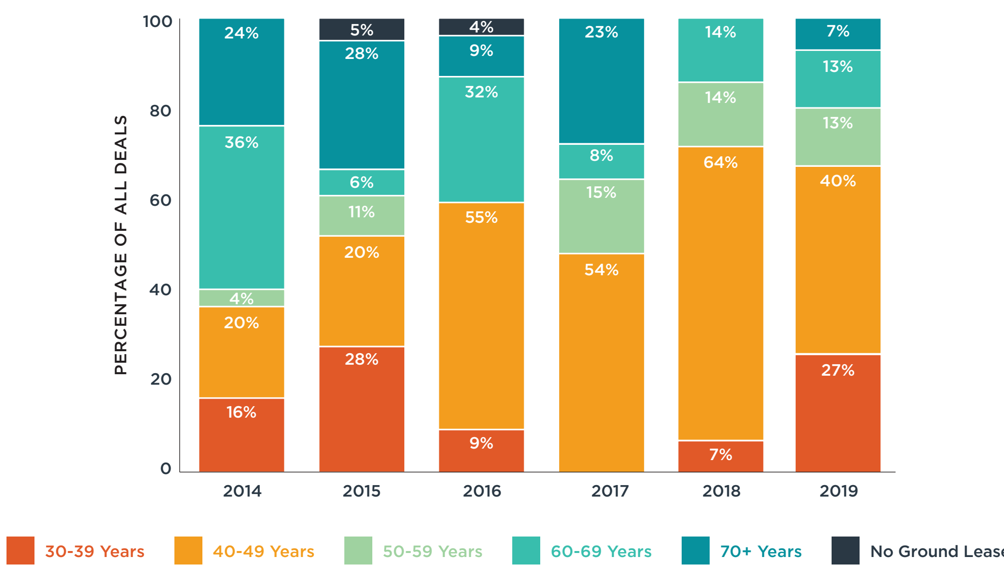
OF GROUND LEASES IN THE LAST SIX YEARS HAVE BEEN 40–49 YEARS IN LENGTH

AGGREGATE

Ground Lease Duration of Housing P3s (2014–2019)



Ground Lease Duration of Housing P3s, by Year

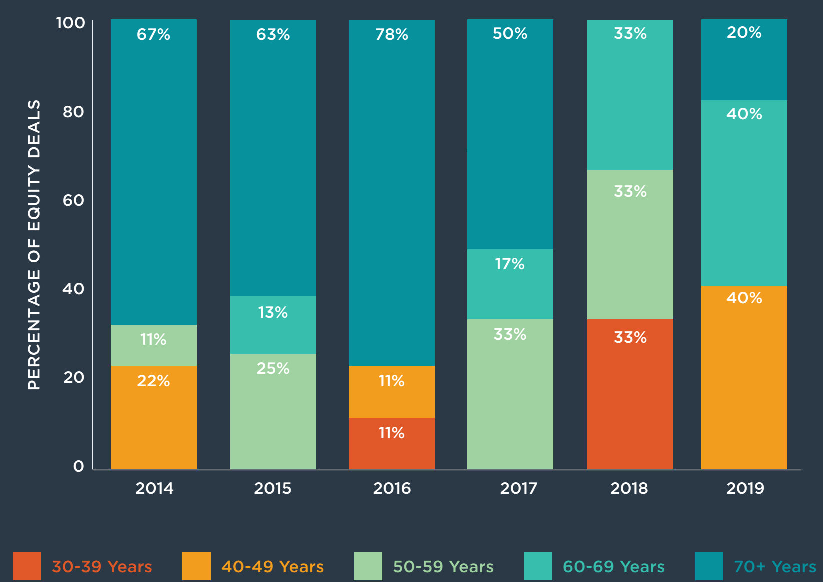


[2]For readers who closely follow our reports, please note that we have changed reporting methodologies for ground lease duration. Previously, optional extensions were not included in the ground lease reported; now, all optional extensions are added to the base number.

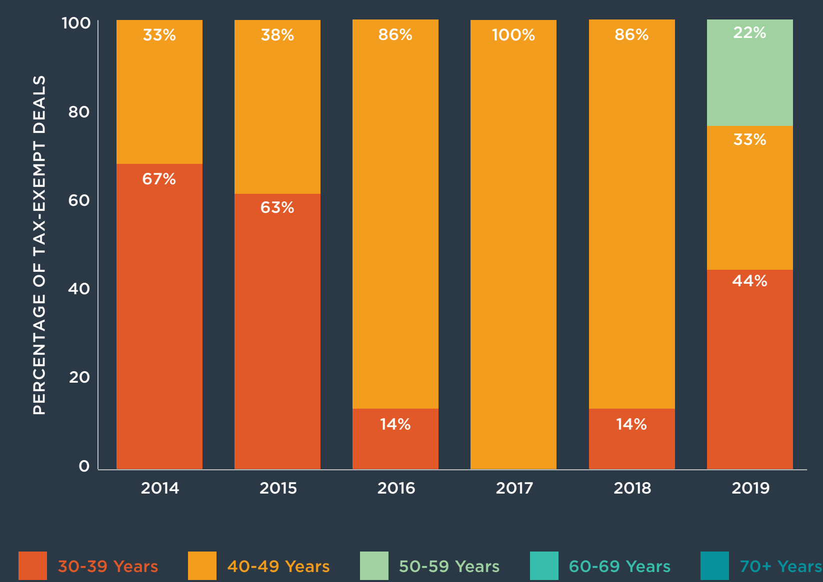
BY DEAL STRUCTURE

Another way to look at the data is to see the ground leases used for various financial structures. The ground lease durations we have seen from 2014–2019 for developer debt/equity and tax-exempt deals suggests a shifting marketplace, with 2019 recording some pretty counter-trend happenings. For example, tax-exempt deals have clearly been trending away from the shortest ground leases (those **30-39 years** in length), while trending toward leases **40-49 years** in length. In 2019, however, the shortest leases saw a big resurgence, while leases **40-49 years** in length dropped off significantly, and those **50-59 years** in length emerged on the scene for the very first time in the survey period.

Ground Lease Duration of Housing P3s With Equity Deal Structure, by Year



Ground Lease Duration of Housing P3s With Tax-exempt Deal Structure, by Year



THE DATA

Institution Type

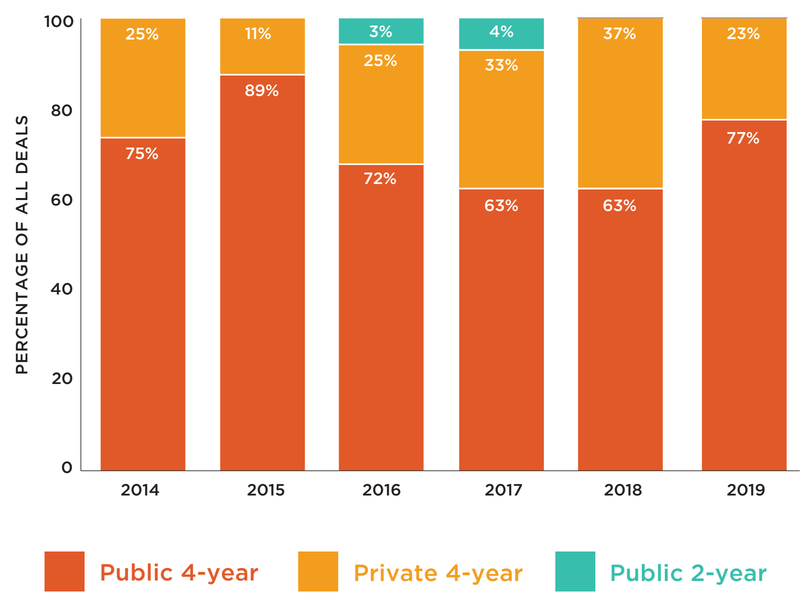
Most housing and housing-anchored mixed-use P3s we've tracked have taken place at **public four-year institutions**. This was true in 2019, and it's been true every year we've tracked.

In 2019, we did see a trend reversal at **private four-year institutions**. Previously, there was a strong trendline of a larger and larger percentage of P3 projects analyzed taking place at **private four-years**. In 2018, for example, more than one-third of projects analyzed took place at **private four-years** (36%); but in 2019, under one-quarter did (23%).

Meanwhile **public two-years** have seen almost no housing or housing-anchored mixed-use P3 engagement during the survey period. 2019 marked two years in a row of no projects. Still, we continue to believe that we will see an increase here in the foreseeable future; this was true before Covid-19 struck, and feels even more true now. *See Part Two: The impact of Covid-19, for a deeper exploration.*

2019 saw a trend-reversal when it comes to housing P3s by institution type. We had seen an increase in P3s taking place at private institutions in previous years, but 2019 showed a contraction.

Housing P3s by Institution Type, by Year



THE DATA

Regional Focus

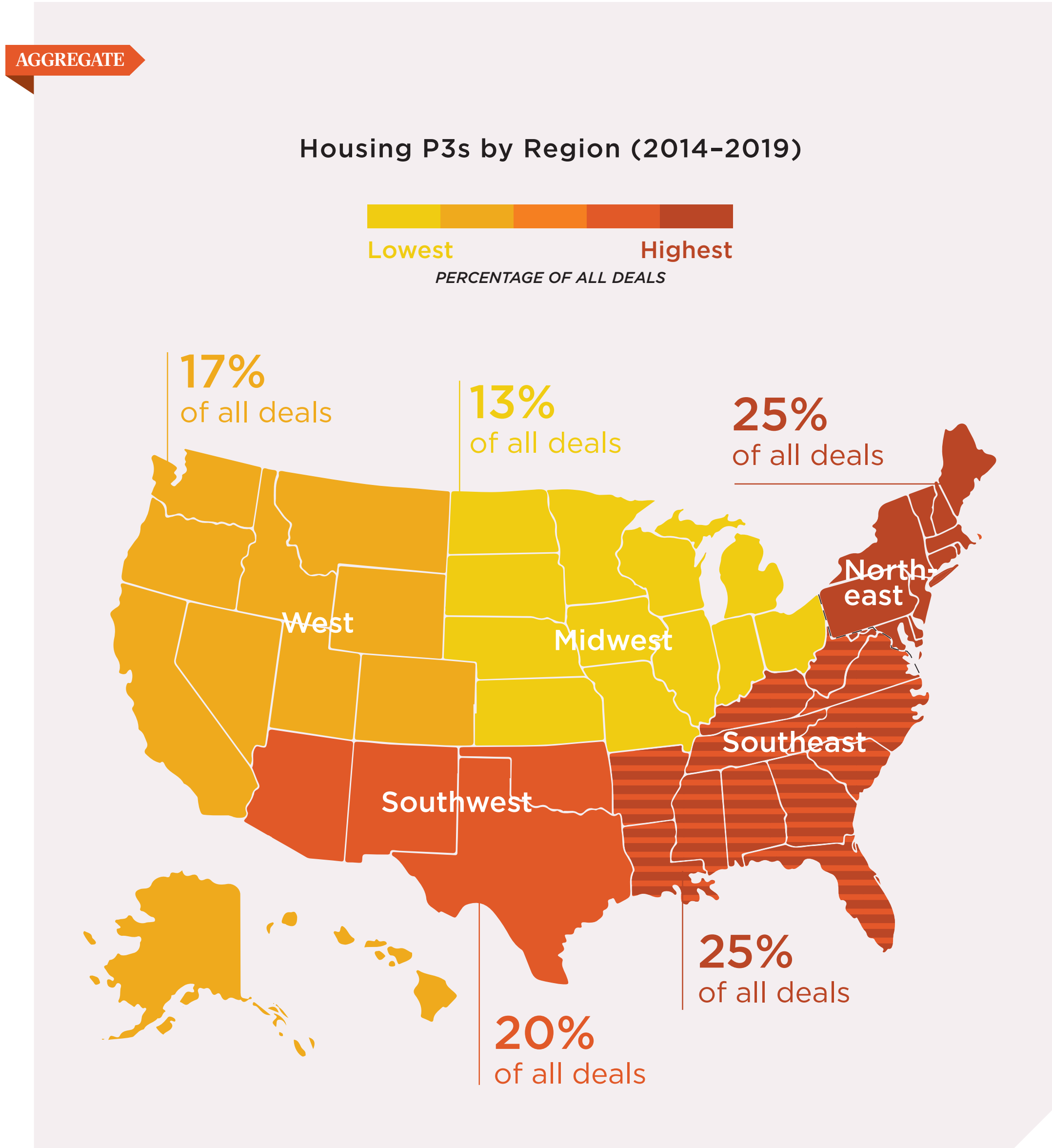
Housing and housing-anchored mixed-use P3 deals continue to happen across the entire country, with shifting concentrations each year. In our previous report, we noted that pipeline data[3] suggests increasing deals in the **West**, and indeed the **West** saw more deals in 2019 than in any previous year tracked and analyzed.

The **Southeast** also had a busy year, newly tying the **Northeast** for largest percentage of projects in the database. Together, the **Northeast** and **Southeast's** projects now comprise 50% of the projects in our database. The scene in the **Northeast** may be shifting, though. The percentage of deals taking place in the **Northeast** was high from 2014-2018, but then dropped dramatically this past year—from 33% of all deals in 2018 to only 15% in 2019.

17%

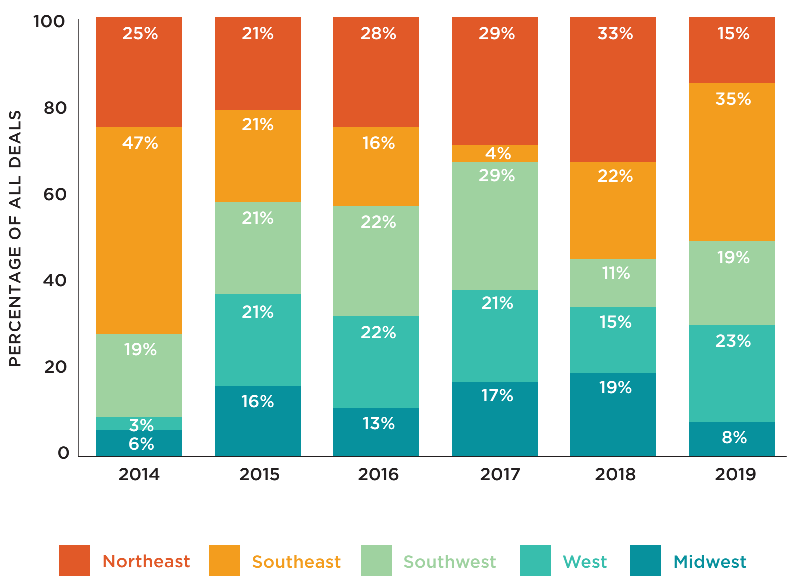
OF ALL DEALS DURING THE STUDY PERIOD HAVE BEEN IN THE WEST

[3] *To be included in our database as a pipeline deal, the project must have been conceptualized within a Request For Information/Qualifications/Proposals and put out for bids by advisors and/or developers.*



Although the Northeast and Southeast regions comprise 50% of our database, the Northeast region saw a dramatic drop in P3 deals closed in 2019.

Housing P3s by Region, by Year



BY INSTITUTION TYPE

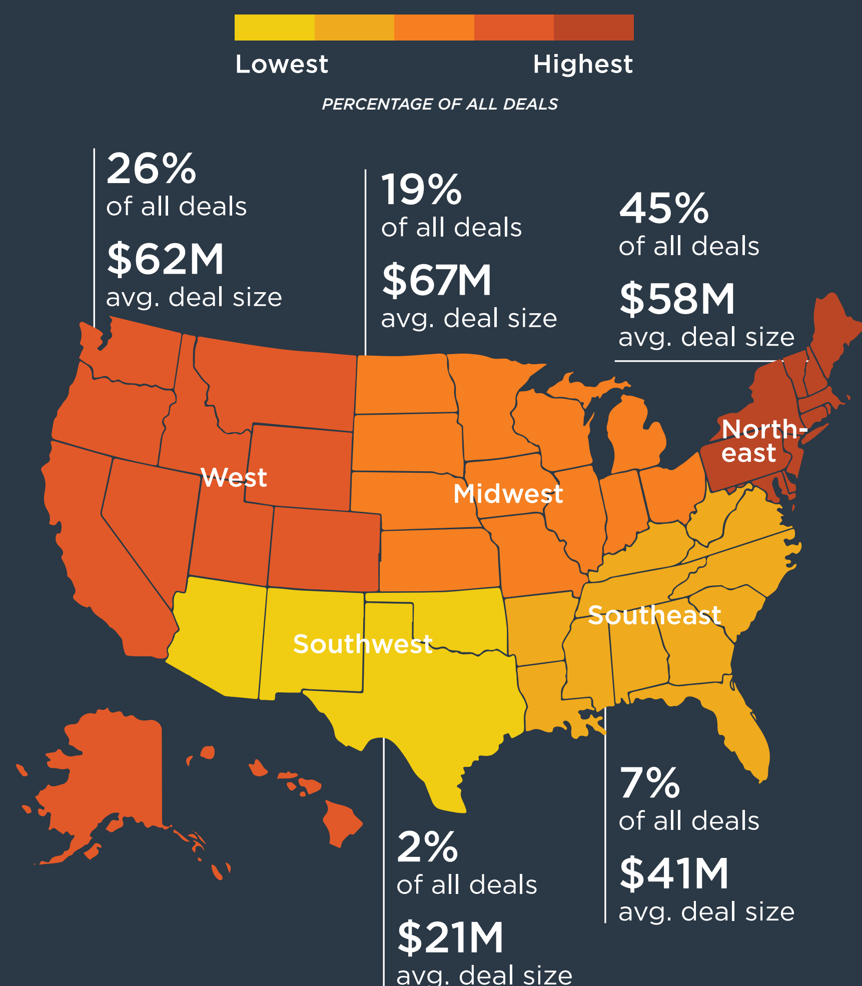
The average deal size of *all* projects from 2014-2019 was $81M. However, it's no surprise deal sizes at private institutions are *much* smaller on average than those at publics; compare $50M (private) to $96M (public). Breaking the data down by region further reveals the stark contrast; the smallest average deals by region took place at private institutions ($21M, in the **Southwest**), the largest at public institutions ($126M, in the **West**)—making the largest average deals by region a whopping 6x larger than the smallest. Another observation: Private institutions' largest average deals by region ($67M, in the **Midwest**) are still smaller than the *smallest* average deals at public institutions ($77M, in the **Southwest**).

Private Four-year

The region with the most private institutions doing P3s during the study period remains the **Northeast**, hosting 45% of the closed projects (down from 47% last year). This is not terribly surprising given the density of schools**;** 32% of all private schools are in this region.

Meanwhile the **Midwest**—a region that saw about one-fifth of all housing P3s at private institutions during the 6 years analyzed—had projects with the largest deal size, averaging $67M. Note, though, that the **Midwest's** average deal size throughout the six years analyzed dropped $5M from last year, whereas other regions' changed by +/- $1M.

Housing P3s at Private 4-years, by Region (2014–2019)



BY INSTITUTION TYPE

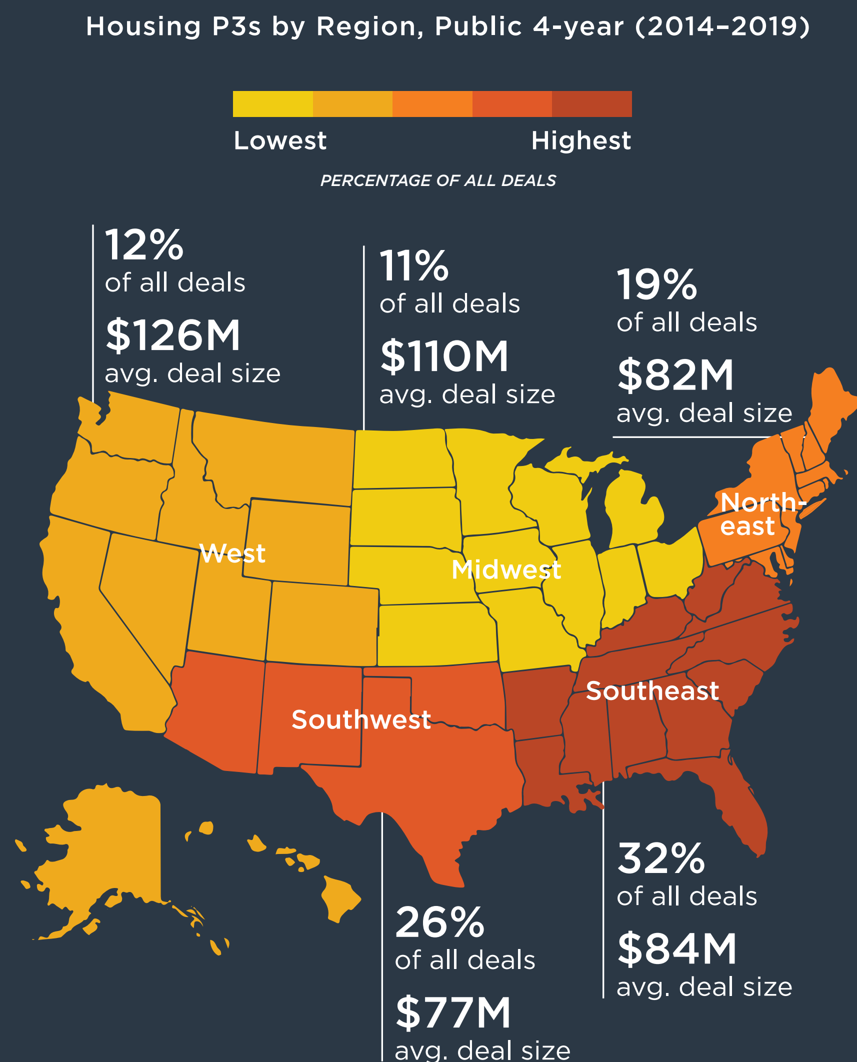
Public Four-year

The region with the most public institutions doing housing or housing-anchored mixed-use P3s during the study period was the **Southeast**—with almost one-third (32%) of closed projects taking place here.

The publics with the largest average deal size ($126M) were located in the **West**. Note that the largest average deal size for publics was almost twice the size than that at privates.

32%

OF DEALS AT PUBLIC INSTITUTIONS ARE IN THE SOUTHEAST, THE REGION WITH THE MOST DEALS



PART TWO

MOVING FORWARD

The Impact of COVID

While the year is not over, 2020 will likely end with the fewest P3 project closings in our database. Due to the pandemic, most schools were forced to close their housing and campus operations in the spring semester. This put considerable stress on P3s since a large percentage of projects are financed with revenue bonds. With many schools not fully opening in Fall 2020, and many already announcing the same for Spring 2021, many projects did not meet their key covenants.

What we can offer, then, is five key observations from across the country, and from most every type of school—public and private, small and large, new to P3s or well-versed, etc. These observations don't take the form of charts, but we hope they can be of use to higher education P3 stakeholders in understanding what the industry is experiencing at this very moment, and what the implications for the future might be.

OBSERVATION 1

On the familiar negative outlook cast over higher education

For years now, a negative outlook has been cast over higher education as a whole. There is endless chatter about higher ed's decreasing pool of applicants, always-increasing tuition figures, mounting deferred maintenance, and that clichéd but indicative phrase—the unsustainable business model.

Covid-19 is not what higher ed needed, and unsurprisingly, the pandemic and its long-reaching arms have only accelerated the negative outlook for higher education. With many schools online-only in Fall 2020 and/or Spring 2021, the difficult reality is that many smaller institutions will struggle to survive.

Out of that struggle, partnerships will be born. For schools whose survival is tenuous but whose closure is still distant enough, capital projects will continue—only, differently. P3s may become increasingly favored, as a way to get the project completed without footing the bill and/or without taking on the associated risks. And partnerships more broadly will grow, particularly in the form of mergers and acquisitions.

Covid-19 is not what higher ed needed. But out of that struggle, partnerships will be born.

OBSERVATION 2

On the fight to quality

While more and more schools may look to partner in the coming years, it increasingly seems possible that not every school looking to participate in a P3 will be able to. The private sector still sees big P3 opportunities in the future, as evidenced by continued interest in projects currently in the market. But increasingly the private sector's focus will be on large, "Power Five Conference" schools and other well-rated institutions with big endowments.

Smaller schools, and especially those with lower credit ratings, may struggle to find a quality partner—or any partner at all. And so the very schools that may most *need* a partnership may be unable to engage in one.

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OBSERVATION 3

On the continuing challenges for many 501(c)3 tax-exempt deals

Many schools are dealing with financial and reputational risks as part of their P3 projects. In a 501(c)3 P3 project, a not-for-profit foundation is the owner of the asset and pays investors back through student rents. That market has struggled through the pandemic, as credit spreads have widened during 2020, making it difficult for projects to hit their targeted debt service coverage ratio of 1.2x. Some projects are even now requiring a 1.25 debt service coverage ratio. For example, a P3 project with university support that closed in September 2020 had a 300–400 basis point spread from the MMD.

Currently, any 501(c)3 project with hope of achieving an investment rating will need university support in a variety of ways (i.e., master lease, contingent lease, first-fill agreement, subordinated expenses, etc.), and that support will bring the project closer to the school's balance sheet and debt obligations—something many schools might not want to take on.

Any 501(c)3 project with hope of achieving an investment rating will need university support.

OBSERVATION 4

On the still-hungry market

501(c)3s might face a uncertain future, but P3s as a whole are still happening. In the spring, as we all opened our eyes to our new world and wondered what impact Covid-19 might have on the market, there was so much talk of a dampened industry appetite in the face of so much uncertainty.

So far, at least, that hasn't been the case. At all. At least as far as the private sector's appetite is concerned. Schools have in some cases hit the pause button, with many procurements and projects pushed from mid-to-late 2020 to early 2021. But equity developers and the capital markets have remained hungry, pursuing sound campus-related development projects with gusto. Across sectors, equity P3s are not experiencing significant declines. In some cases, the number of projects is *increasing* due to the reduction in construction costs and the historically low cost of debt in the credit markets. For equity investors, the lowering of the cost of debt translates into lower equity hurdle rates for project investment analyses.

Here's an example of how this manifests. Among the procurements that have continued, we have seen sustained, strong interest from the private sector. Five recent procurements, for example, have yielded an average of nine responses.

Another manifestation might be the market's *shifting* focus, rather than a decreased one. Our database's pipeline suggests an increased interest in asset types like **graduate student housing** and **innovation districts**. Likewise, **utility-related assets and energy systems** will likely continue to grow as schools look to monetize existing energy assets. As with so much else in 2020, this has been the trend for a while now, but Covid-19 certainly seems to be speeding it up and exaggerating it. This increased interest is not terribly surprising; these asset types draw private partners in for different reasons than undergraduate housing—allowing the private industry to diversify and better ensure long-term financial viability—and likewise can be wise areas for schools to partner on. We are particularly curious to track innovation district and energy developments. Regarding innovation districts, their ability to draw talent may become crucial for schools existing in this even more competitive, financially challenged landscape.

OBSERVATION 5

On the importance of having a partner in more than name, especially during extraordinary times

We have all seen the news articles calling attention—fairly or not—to partnerships going sour during the pandemic. And indeed, some schools have chosen to absorb significant financial losses, whether legally required or not in their P3 agreement. Meanwhile other schools have had to navigate private partners holding students and their families to their leases. For the most part, though, the private sector has truly stepped up to the plate to help host institutions deal with these difficult times. Many private-sector partners are bringing their experience from other campuses to help aid schools with thoughtful and safe reopenings and operations.

As detailed in a September 2020 article from *The Chronicle of Higher Education*[1], the difference this year between a school making the news in a negative article because of its P3 and a school having a *positive* experience because of its P3 has largely seemed related to whether the partnership was set up to handle rare, unexpected events. Various clauses in legal documents like the ones governing P3 relationships help entities navigate extraordinary events outside of the parties' reasonable control—like a war, riot, strike, natural disaster, or pandemic. In many cases this year, when such a clause was included in the original agreement, the parties have successfully worked together—often in good faith that they'd be able to work it out in the longer term.

For example, at one school this year, two parties renegotiated a P3 agreement during the pandemic. The project's insurance was not enough to cover the shortfall, so the private partner gave money to the university so it could refund its students their housing costs. Then, the university and private partner restructured the payment plan so the private partner would, over time, recoup the loss.

Moving forward, we expect schools and private partners to continue working together; the benefits of P3s remain as viable as ever, and schools have just as many infrastructure and deferred maintenance needs as ever. While the risks associated with these partnerships can never be fully removed, they *can* be identified and mitigated. And agreements can be structured to better serve both parties, even if they can't realistically be structured to cover all unforeseen events. This just means that parties engaging in P3s will need to be extremely disciplined, strategic, and intentional. This has always been the case, and many parties are already doing this. The pandemic has simply laid bare the importance of this reality, forcing *everyone* to pay close attention.

[1] *Carlson, Scott, "How Covid-19 Exposed the Cracks in a Public-Private Housing Deal," The Chronicle of Higher Education, September 3, 2020, www.chronicle.com/article/how-covid-19-exposed-the-cracks-in-a-public-private-housing-deal.*

BRAILSFORD & DUNLAVEY

Founded in 1993, Brailsford & Dunlavey is a leader in implementing creative solutions for higher education clients to maximize the value of their buildings and resources. We are at the forefront of higher education P3 advising—shaping the deal structures of today. B&D is listed among *Engineering News-Record*'s "Top 30 Program Management Firms" and has been a finalist for the P3 Bulletin's Technical Advisor of the Year award in both 2017, 2018, and 2019.

BDCONNECT.COM

Higher Ed P3 Resource Center

B&D launched the Higher Ed P3 Resource Center as an educational forum for the sector—college and university leaders, developers, and other stakeholders. Serving as a central, go-to place for answers—or even the right questions to ask—the resource center offers articles from industry experts, a P3 101 guide, infographics, presentations, and more. The Higher Ed P3 Resource Center serves as a library, housing information from throughout the industry.

P3RESOURCECENTER.COM

Cover image courtesy of Greystar
Inside cover image courtesy of CSRS

For more information or to have your projects represented in next year's report, please contact:

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