MAKING THE GRADE

While many P3 sectors in North America continue to face ups and downs, student housing is flourishing. **Dan Colombini** reports on how the model has established itself in public sector hearts and minds

For years now, universities and colleges across the US and Canada have suffered from aging facilities and crumbling infrastructure, despite maintaining reputations as esteemed seats of learning. So while the young minds inside these facilities continued to grow and expand, the buildings that house this vital development have continued to fall into disrepair.

Traditionally, the challenge began with the simple fact that – much like many other public sector organizations – there was just not enough money being generated to foot the bill for the necessary work to drag establishments into the 21st century.

“Higher education institutions are facing increasing pressure on their mission to provide high quality, affordable education to students and perform world-class research,” said a report from consultancy EY in 2017.

“Reductions in public funding support and concerns about overall affordability present substantial near-term and longer-term budget challenges for many institutions.”

As a result, universities across the country have been willing to embrace the P3 model as a way of bringing in much-needed finance to get projects off the ground. And what is encouraging for the market is the sheer volume of these deals that now make up a significant portion of the P3 industry across the US.

According to the EY report, over the past few years the value of P3s between higher education institutions and the private sector—primarily devoted to student housing — has risen from $1.2bn in 2014 to $3.1bn in 2016, with this figure

now looking set to rise further as 2019 gets underway.

In January 2019 alone, we have already seen progress on four schemes in the US and Canada, including the awarding of a contract in Indiana, the launch of two new deals in Ontario and an advisory contract secured in Maine.

This is to add to a flurry of activity at the end of last year. There is now demonstrable proof of just how exciting the market really is.

"My view is that the assessable market for student housing is sizable," says Michael Likosky. "It shares characteristics with water and airport markets in its balkanization.

"At the same time, it possesses a sheer capacity to deliver, as each single university sits on its own distinct pipeline. Right now, the task for investors and corporates is to unlock these pipelines. This means appreciating the objectives, challenges and mechanics of specific universities, and developing a uniquely tailored solution accordingly."

"Universities are doing this in part to realize value from their housing portfolios and to transfer development (renovation and new construction) and operations risks to the private sector," adds Tad Guleserien, executive vice president at Hunt Companies.

"Additionally, schools are seeking to include non-revenue assets (academic and other space) into P3 student housing solicitations, seeking to have the student housing revenues support the construction and/or operating costs of these other university spaces."

What appears to be the most obvious conclusion as the market seeks to move to the next step is that the public sector has seriously embraced just what opportunities P3s can give them.

This has not always been the case in the US, something which has stymied growth significantly as suspicion and a lack of understanding in the model has resulted in numerous deals stalling and being scrapped at various points of a project. But with a track record of impressive student housing deals now in place and more on the horizon, the notion that the model will work for the right deal is firmly acknowledged in this space.

"P3s for higher education are a fairly light lift, compared to other types of assets for the first P3, as they are often self-supporting in terms of the revenue streams," explains Lisa Buglione, executive director at the Association for the Improvement of American Infrastructure (AIAI). "Additionally from a public perspective, universities, both private and public, are somewhat autonomous and have a bit more flexibility when considering and moving forward with procurement options."

The key here is the removal of the political risk from the deal, which is not present at the forefront of the decision-making process. Without this staple nemesis of many a project across the world, these projects continue to be better placed to succeed.

"It typically [comes down to] a question of what procurement option is the best solution for the infrastructure needs they have and how it fits in the overall plan," explains Buglione. "P3 for student housing is an accepted business and financing model as colleges and universities across the country have successfully employed projects. This has led to other colleges and universities following suit.

"As a result, the development and operations & maintenance communities are familiar with the business model. Equally important, the finance, investment and rating agency communities have embraced P3 student housing, which has allowed it to progress."

"P3 delivery for student housing is quickly following a similar path as military housing by using this revenue generating asset to leverage private capital and expertise to build and operate housing more efficiently and cost-effectively on a full lifecycle cost basis," adds Jay Brown, managing director of real estate firm Alvarez and Marsal.

"For many institutions, the capital cost of bringing their housing to a standard that is expected by today's students is beyond their debt capacity and poor quality housing is affecting recruitment and enrolment."

Like the military, universities recognize that owning and operating housing is not their core competency and over the long-run, this has resulted in under-investment in and deferred maintenance of its housing assets.

Many developers in the space had recognized that the military was experiencing the same problem when it privatized military family housing starting in the mid-1990s.

In many cases, the transaction structures and risk transfer are very similar, utilizing long-term (40-50 years) ground leases and/or concession agreements, demand-risk revenue models, developing and constructing within an active campus, and the need for on-campus operations and maintenance.

This has meant that there are plenty of private partners who are comfortable with the model from their previous experience with the military to take advantage of the opportunities that have arisen in higher education.

"Vertically integrated firms that can bring many or all of the major disciplines (development, construction, financing, operations and maintenance) under a single corporate entity provide additional value to universities and colleges," says Guleserien.

"The additional value comes both from the fact that there is a long-established history of working together which creates familiarity and experience, and from the point of view of accountability and responsibility if an issue which must be resolved should arise."

The question now for developers and institutions alike, is how can they build on this impressive progress?

One roadblock facing the market is to tackle issues related to the financial dependence that many institutions have on student housing revenue, which is often needed to finance wider programs at the university and not just repayments for the site development itself.

"Redirecting that revenue back into the housing facility, through a P3, can be a challenge," says Guleserien. "The established players have an earlier mover advantage over newer entrants in that they can point to a longer track record. However, the earlier mover advantage is not an absolute advantage.

"Financially sound and creative firms with the ability to innovate both with respect to design and transaction structure and financial structure often are able to be more nimble and leading edge and provide more value to the universities and colleges through their innovative structures.

"Players that are not beholden to a few transaction and financing structures and which can implement a program that is collaborative and responsive to the needs and constraints of the university or college can return tremendous value to the institution both upfront and over the long term."