Privatization of Student Housing, a Financing Alternative

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Introduction

Residence halls were developed by Oxford and Cambridge during the 13th century (SchoolFacilities.com, 2002). They were built on the model of an academic environment where students live and learn; the environment influences behavior and learning is a total process (Palmer, Broido & Campbell, 2008). “The professors served as the house masters, common living areas and libraries provided social and study space, students slept in private or shared rooms, and meals were provided in a central dining room shared by faculty and students” (SchoolFacilities.com, 2002, p. 1). The academic environment model of student housing did not change until the 1950s and modifications continued through the 1970s. The new model of student housing and the current model for many universities, consisted of high rise facilities clustered around a central elevator, usually two persons per room with as many as forty students sharing bathroom facilities, study and dining room spaces were in separate buildings (SchoolFacilities.com, 2002).

Today many campuses have student housing facilities that require costly renovations, regulatory upgrades or the facilities may be at the end of their life cycle. The student housing on many campuses was built in the 1960s and 1970s for the Baby Boom generation to enter college (Stoner & Cavins, 2003). The older, ‘dormitory style’ residence halls may provide a negative first impression for both students and parents, thus it may negatively impact the recruiting and admissions process (SchoolFacilities.com, 2002). Reductions in federal and state funding, increases in deferred maintenance, and the requirements for building, safety code and Americans with Disability Act have impacted the ability for universities to establish reserve funds for replenishment of the student housing facilities.
In order to attract prospective students and maintain existing students, universities have a need to build new contemporary student housing. The students of the Echo Boom generation, born 1977 to 1997, those born to the Baby Boom generation (Rosen, Patel & Chitharanjan, 2004) are a generation that is technological. They communicate via multiple methods and access data instantaneously through the internet. The Echo Boom generation desires to have all the amenities they have grown up with provided in student housing.

Development of external relationships, also known as “outsourcing,” has been part of higher education for much of its history (Palm, 2001). The scope of higher education’s contracting with external agencies includes food service, vending, laundry and bookstores. (The terms contracting, privatizing and outsourcing are often used interchangeably). Palm (2001, p. 5) stated that “privatizing is a new term for an old idea.” Privatizing refers to a private entity that provides a public service; for example an outside company that builds, finances and manages college campus housing. Whether it is contracting, outsourcing or privatization, higher education is looking for ways to meet the needs of students and focus on their central mission (Palm, 2001). Privatization is a way for universities to contract for processes and programs that are supplemental to teaching, research and service roles (Palm, 2001).

This paper will provide an understanding of privatization of student housing including what has motivated higher education to privatization, the trends, the benefits to privatization, and a brief look at the history and statistics related to privatization of student housing. In this paper, the use of the word university is defined as any institution of higher education, including two year, four year, junior college, public or private, or profit or nonprofit.
Rationale

Each year thousands of prospective college freshmen and their parents visit college campuses throughout the U.S. The visit to a campus includes the residence hall. Today’s prospective students do not desire to live in the same facilities and amenities that their Baby Boom generation parents lived in. Block towers with minimalist wooden furniture and communal bathrooms do not appeal to the Echo Boom generation (Wotapka, 2011). The student housing is outdated and unappealing to a generation of students who grew up pampered with their own bedrooms wired with the latest technology and their own bathrooms (Wotapka, 2011).

“There are nearly 60 million children enrolled in grades 1 through 12 who will enter college between 2004 and 2020 and more of these children will attend college than ever before in U.S. history” (Johnson, 2003, p. 20). Rosen Consulting Group reported that the bigger states with the largest population of young adults will continue to have the largest populations of college age adults; the states are California, Texas, New York and Florida (Rosen et al., 2004). Rosen et al. (2004) reported these states are major immigration states which will bolster college enrollment growth. The continued increase in college enrollments will demand an increase in student housing needs.

Public and private universities have felt the recent economic crisis, of 2007-2008, and have been limited by the increased costs that can be collected through tuition increases. Inflationdata.com (2012) states that since 1986 overall inflation has increased by 115.06% as compared to the 498.31% increase in tuition costs. In order to meet the financial challenges faced by higher education, it has become necessary for universities to seek alternative solutions for financing and revenue streams. Privatization of student housing is an alternative financing solution that can provide universities with the ability to meet the increased demand for new and
additional student housing and provide a new revenue stream to support the financial operations of the university. The alternate method of financing can provide relief for capital capacity constraints for university balance sheets. Privatized housing is a financing alternative that will permit universities to be innovative with housing plans while retaining commitment to students’ needs.

Stakeholders

Several stakeholders maintain a vested interest in the privatization of student housing. Privatization of student housing can be influenced by several different stakeholders: universities and administrators, students, state government, parents of students, donors and the community. Each stakeholder maintains a unique perspective. Universities and administrators are interested in providing student housing that can be financially supported within the operating budget of the university to attract and retain students. Students are a major stakeholder as the consumers and will become the residents of the student housing; it is necessary to attract the students to the university while providing the appropriate amenities, security and community. With the shifting of the costs of education to the consumers resulting from lower financial support to public and private universities, state government maintains an interest in the development of human capital, the students, and their universities in maintaining adequate facilities to support the students. Parents and donors contribute directly by paying the bill for the students and student housing. The community is a stakeholder in the development of the human capital, the student, and for the revitalization of the community resulting from the student housing project.

Literature Review
Models of Privatization

With unhappy students, outdated residence halls, and a lack of traditional funding, progressive university administrators are working toward resolution of these problems (SchoolFacilities.com, 2002). Administrators are developing business plans and due diligence studies to formulate support for growth in student housing. The business plan would include the most appropriate financing option (s) for funding the construction of the student housing.

Several models exist that permit universities an opportunity to finance the student housing project. The models include: traditional development, university affiliated foundation, unaffiliated nonprofit corporation and fully privatized development. Sansevior (2010) defines the traditional development model of student housing as a student service or auxiliary enterprise of the institution or some combination. This model is financed by the direct credit of the university and will not require a partnership. In the university-affiliated foundation model, a non-profit entity such as university foundation, develops the project and leases it to the institution with the institution maintaining the ultimate decision-making responsibility for how the facility will be managed once it is leased by the institution (Sansevior, 2010). A nonprofit corporation that is not affiliated with the institution, the unaffiliated corporation, either leases land from the university or purchases nearby land to build the housing (Sansevior, 2010). The university may lease the housing and choose to fully operate it or choose an alternate operational arrangement with the unaffiliated nonprofit corporation. In the fully privatized development model, the private developer may lease land from the university or may acquire private land and fully own, develop, finance and operate the housing; the developer may require exclusive marketing and referrals or overflow housing guarantees (Sansevior, 2010).
The fully privatized development model requires further explanation. The private developer is a third-party, typically a charitable nonprofit organization, or a for-profit developer. The private developer may also be referred to as a third party. The housing may be constructed or acquired for the students on or off campus. The student housing is typically financed using student housing revenue bonds. The student housing revenue bonds are repaid by the revenues generated by the student housing project. Investment bankers, George K. Baum and Company (n. d.) states the bonds are typically nonrecourse to the university with no responsibility for the debt service and the university’s land is not subordinated to the project financing. (The Internal Revenue Service (n.d.) definition of nonrecourse is the borrower is not liable.) Specifically, if the student housing project is on campus, the bondholders have no rights to foreclosure remedies on the title to the land. The project will be financed by tax exempt bonds if it is a nonprofit developer or taxable bonds if the developer is for profit (George K. Baum and Company, n. d.). Although the for-profit developer will pay a higher interest rate, the bonds are typically backed with credit enhancement which lowers the capital costs (George K. Baum and Company, n. d.). State Housing Finance Agencies (HFAs) are an alternative to lower the cost of capital. HFAs may issue the bonds to provide construction and permanent financing, then pool the loans to ensure credit characteristics prior to issues tax exempt or taxable bonds to finance the projects (Moody’s, 2003). In many privatized housing projects, the university will participate in surplus revenues and maintain an option for future ownership interest in the project (Moody’s, 2003).

In the late 1990s, universities were focused on limiting risk on their balance sheets and credit capacity resulting from new housing projects. Capstone, one of the big three developers of privatized student housing projects, stepped up to assist with setting up nonprofit charitable foundations to own on campus housing developments; they pioneered the use of nonrecourse
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debt to fund the on campus student projects (Shaver, 2012). The current trend in higher education was born, the privatized development model. Carlson (2012) references the “big three” third party housing companies working in higher education: Education Realty Trust, Capstone and American Campus Communities. One example of privatized housing is at University of Kentucky (UK). UK turned over all of their student housing facilities to Education Realty Trust Inc. in exchange for ground-lease payments and Education Realty’s $500 million investment in upgrades and construction while UK collects rent payments from students (Wotapka, 2011). UK has requested further assistance from the developer; specifically UK would like the developer to hire their existing housing staff while they maintain control over the residential life programs (Wotapka, 2011).

Higher education has never been without a need to identify financing alternatives for various projects. Stoner and Cavins (2003) noted higher education has traditionally opted to increase room rent, reduce the cost of housing and residence life programs, or both, in order to finance renovations and new construction for student housing. Alternative funding for higher education has existed for more than one hundred years. The State of Texas is one example, the Permanent University Fund (PUF), a permanent capital endowment of two million acres where oil was discovered in 1923 and the Available University Fund (AUF) the portion of the PUF distributed annually (Stoner & Cavins, 2003). The AUF is restricted to instructional facilities including all furnishings acquired, constructed or improved (Stoner and Cavins, 2003). Another example from the State of Florida is the Capital Improvements Trust Fee (CITF); the initiative generated $2.25 per credit hour per student enrolled in higher education in Florida for the purpose of facility needs on campus. Another example of alternative financing in Florida is the Public Education Capital Outlay (PECO) funds which accrue from the tax on gross sales of
utilities within the State and can be utilized for construction or renovation of academic living and learning projects (Stoner & Cavins, 2003). Over the years, universities have demonstrated creativity in identifying alternatives for financing their needs.

**Reasons for Privatization**

Higher education has many reasons to support a partnership in the student housing project. The literature review offers several reasons to support privatization of student housing projects.

The privatized developer is an expert in developing and building housing facilities. The developer is an expert in design, development and construction of student housing. “Universities are typically bogged down in the process which becomes time consuming and delays the project” (Carlson, 2012, p. 1). The focus for universities is usually on the core academic buildings which distracts from the student housing project. There is efficiency in the expertise of the private developer. Bekurs (2007) stated that the private developer can provide the site selection, building design, financing and construction in one process, greatly reducing the time necessary to realize a new building. The developers are adept at erecting buildings quickly at a relatively low cost (Gose, 2005). For a university, time efficiency is an important key to completing the student housing project to meet the student demands and needs.

The privatized developer is able to build residences that accommodate student desires. The students do not want bathrooms down the hall; the students desire amenities they have grown up with (Gose, 2005). Today’s student want single rooms with bathrooms shared by no more than four people, air conditioning, kitchenettes, microwaves, high-speed internet connections, cable TV, fitness centers, Starbucks kiosk, washer and dryers, and on and on (El
Nasser, 2004). Many of the student housing facilities are built in a live and learn environment. The live and learn student housing includes living and academic spaces typically related to majors, such as arts, wellness and the environment. Syracuse University provides 29 live and learn communities since 2003, fostering academic pursuits and enhancement to the undergraduate learning experience (Angelo & Rivard, 2006).

The Echo Boom students also desire to have sustainable facilities. Sustainablecampus.org (n.d.) defines sustainable to include the following components: “improving economic efficiency, protecting and restoring ecological systems and enhancing the well-being of all people.” Many student housing facilities are being built as sustainable learning centers. Duke University has a 6,000 square foot LEED Platinum student housing facility that serves as a live-in laboratory (Fabris, 2011). In addition to a sustainable design, students have a mindset toward conserving energy and caring for the earth (Angelo & Rivard, 2006). Universities are interested in sustainable environments to respond to changing laws and the shifting student consciousness about the environment (Angelo & Rivard, 2006).

Often times, the privatized developer will provide ongoing management services in the student housing facility; another reason in support of privatized housing. The university will contract the developer to provide 12 month service onsite for management of the facility to include continuing operations and maintenance (Carlson, 2012). Some student housing facilities include an online work order system that permits the student residents to submit work orders online to maintenance supervisors, who dispatch 24 hours a day to resolve the problem in the facility (Gilroy, Davis, Anzia & Segal, 2007).
The core mission of higher education is not to deliver housing; it is to deliver educational services to their students, a reason to support privatization. Shaver (2012) stated according to the National Center for Education Statistics, total enrollment in higher education is expected to increase 13 percent between fall 2009 and fall 2020. These statistics support that student housing is something many universities will need more of. Bill Bayless, CEO of American Campus Communities stated in MultifamilyExecutive.com that institutions are saying they should be taking their limited capital dollars and devote them to core mission of the university (Shaver, 2012). The process by which universities prepare for new housing can be delayed by the focus on projects related to the core mission and constrained by state regulations. Motivation for privatization is created as a result of these delays that will distract the university from the much needed student housing project. In Virginia, the traditional bond programs are reserved for building 50 to 100 year structures and the typical apartment-style student housing will not meet the criteria of the state’s financing programs (LaRoche, Flanigan & Copeland, 2010). Most public universities use student housing revenue bonds to avoid time consuming and expensive state approval processes for new housing facilities (George K. Baum & Company, n.d.).

The age of the existing student housing is a motivator for privatized student housing. Universities have figured out that the 100-year structure of student housing does not make sense and is now obsolete (Gose, 2005). Many traditional student housing facilities were built in the 1950s and 1960s after Congress passed Title IV of the Housing Act of 1950 (Ryan, 2003). As the housing facilities turn forty years old, fifty years old or even older, a significant portion of the housing budget will be utilized for repair, maintenance and preventive maintenance costs (Ryan, 2003). Changing federal and state laws and codes may also require significant upgrades to
existing facilities. These costs to improve existing housing can be significant and support the need for privatized housing solution.

The benefit of preserving the use of capital for the privatized student housing project exists for the university, another motivation for privatization. Depending of the financing structure of the housing project, the university’s use of capital capacity may not be utilized directly in a privatized housing venture. This leaves credit capacity for borrowing available for other projects that are core to the university. While Moody’s Investors Service (2010) views student housing as a strategic core business of higher education, they have reaffirmed privatized student housing projects as contingent liabilities. The contingent liabilities will impact the credit of the university; the credit impact may not be static and will vary dependent upon the project’s specifics (Moody’s, 2010). The “specifics will include the project’s strategic importance to the university and the university’s involvement with the project” (Moody’s, 2010, p. 1). Moody’s (2010) will utilize the privatized student housing transaction in the calculations of the debt ratios for the affiliated university. There will be no impact on the use of capital in privatized housing project with an unaffiliated university. This could change according to Moody’s (2010) if there is probability that the university would support the privatized student housing project in times of financial stress. Moody’s (2010) will continue to review the terms of agreements including the benefits and the risks of the projects to the university. Thus the credit impact of the project will vary based on the complex legal arrangements and the strategic motivations of the affiliated or unaffiliated university (Moody’s, 2010).

Reduced balance sheet exposure is another benefit of the privatized student housing alternative. The financing incurred by the privatized developer is not reflected on the balance sheet of the university. The balance sheet is not restricted for future borrowing capability of the
university. Gose (2005) supports that privatized housing is secured on its own credit with the only assurance the bondholders will be paid comes from student rentals and a small reserve fund, not the university’ finances.

Public universities have incurred reduced state subsidization, a motivation toward privatization of student housing. Rosen et al. (2004) reported that universities were budgeted to receive $60.3 billion from state budgets in fiscal year 2004, down from $61.6 billion in 2003 and $62.8 billion in 2002. The reduction in state appropriations is faulted by health care budgets from an aging population and restoration of funding to primary and secondary education (Rosen et al., 2004). The recent economic crisis of 2007-2008 has been faulted for limiting the amount of funds that states can provide to public and private universities (LaRoche et al., 2010). Some states do not permit state funds to be utilized for non-academic facilities, supporting the pursuit of privatization (Sanseviro, 2010). Many states are using performance funding that creates pressure to meet enrollment and retention objectives (Bekurs, 2007). In order to meet the enrollment and retention objectives, new facilities with nicer amenities aid in accomplishing the objectives of student housing needs (Bekurs, 2007).

**Negatives for Privatization**

The privatization funding model is not without a few negatives. It can be noted from the literature that there are fewer negatives than positives identified in the literature review.

Reduced or lack of university involvement throughout the life cycle of the privatized development project may negatively impact the privatized student housing project. When a privatized developer manages the student housing facility, the university may not be a participant in the ongoing operations of the facility. Sanseviro (2010) stated that the safeguards put into
place by the privatized developer and the university to protect the tenants/students either prove insufficient or are forgotten over time. To minimize the result of this impact on the students, Carlson (2012) stated universities might maintain a residential life staff in the facilities to protect and guide the students, especially in the event of an emergency. Another potential negative of the arrangement between the university and the privatized developer is the inclusion of the debt obligation in the ratio calculation by Moody’s (2010). Moody’s stated in their Special Comment in 2010 that regardless of the direct legal obligations by the affiliated university, the privatized student housing transaction still has an impact on the credit of the university. An unaffiliated university arrangement would require Moody’s to make a final determination after a careful review of the direct legal obligations.

Higher rents are perceived as a negative. New student housing facilities that include the students’ desired amenities and more space per student may result in the perception of higher rents or student housing costs to the students. Despite the perception of higher room rates, universities claim the newest student housing facilities are the first booked, demonstrating that privatized developers are meeting a need for higher education (Mantra, Inc., 2011, Franey, 2004). Many universities continue to provide new or renovated traditional housing for freshman and sophomore students at the usual cost to the students to reduce the perception of higher residential costs.

A lack of land connection to the university can be a negative in privatization of student housing. Carlson (2012) stated that housing built near University of North Texas around 2003 sold in 2011 for $3 million less than was owed on it because the university did not maintain a connection to the privatized developer. The lack of university land connection to the student
housing may affect the ability of the housing developer to achieve full student occupancy increasing the risk to the financial operations.

While the university has the need to build new student housing in an expedient manner and provide new student desired amenities, the privatization model may eliminate an important revenue stream. Carlson (2012) stated, in *The Chronicle of Higher Education*, a developer can be a trade off especially for private universities who may lose money on an educational offering and subsidize it by collecting housing fees; a developer will likely not offer the opportunity for the university to receive the profit. John Nelson, a director of higher education at Moody’s, stated that a developer relationship will result in sharing a lot of profit, perhaps all of it which is a reason why many private universities do not pursue privatized student housing (Carlson, 2012).

Community relations must be considered in the housing development in order to avoid negative impact to the success of the privatized housing solution. Sanseviro (2010) stated it is often difficult to achieve an effective balance between the university’s desire for student and community development with the developer’s rigid corporate policies and procedures. “Sometimes universities do not adequately detail the scope of the project or their expectations for performance” resulting in inadequate communication (Bekurs, 2007). It is a key aspect for the values and expectations of both parties to be aligned.

The negatives of privatized student housing can be avoided by approaching the developer relationship as a strategic investment, not a purchasing decision. Bekurs (2007) stated the relationship should align the interests of both parties, establish objectives and measurable goals in advance, define the process for recognizing problems in advance, put experience staff in place to manage the relationship.
Privatization Statistics

The literature presents few sources of information relating to the statistics on privatization of student housing projects: Moody’s Investors Service (Moody’s) and George K. Baum & Company, (Baum), an investment bank, provide statistics. Moody’s statistics reflect only the projects they provide a bond rating. Moody’s (2012) reports they maintain 43 public ratings for 37 privatized student housing projects with $2.3 billion outstanding. Baum maintains a database of privatized student housing non-recourse rated and unrated finance projects. The following statistics were provided by Baum (2012):

- Number of privatized student housing projects 312
- Number of public privatized student housing projects 267
- Number of units 51,177
- Number of beds 182,866
- Total issue size 9,826,965,348
- Oldest issue date January 1995-University of Central Arkansas
- Most recent issue date November 2012-University of TX at Arlington

Support for Privatization

A parallel of support for privatization of student housing can be observed between universities and the military for privatization of housing. In the mid-1990s, the Department of Defense (DoD) recognized that 60% of the military housing units were in disrepair and would require nearly 30 years to refurbish (Gilroy et al., 2007). “The Privatization Initiative (MHPI) was established by Congress in 1996 to improve the quality of housing and reduce the total housing costs to the DoD” (Gilroy et al, 2007). “Under MHPI, the different branches of the Armed Forces use a competitive bidding process to select private developers that will own, operate, and maintain military housing” (Gilroy et al., 2007, p. 12). The benefits of military
privatization compare to university student housing privatization—cost savings, speed in addressing housing shortage, better housing quality, property management, and higher service member morale (Gilroy et al., 2007).

The credit markets of the 21st century have supported privatization of student housing. The dissolution of the auction rate security market occurred in 2007. This was the beginning of a volatile period for the capital markets including the inability for borrowers to attain any capital funds. Highly rated bond insurers became inaccessible in 2007 and it was difficult to attain credit from financial institutions, in particular letters of credit to support bond financings. The privatization of student housing was the alternative for universities to attain the much needed new student housing facilities and not have to absorb the capital on their balance sheets.

Conclusion

“Privatization increases the pressure on traditional higher education institutions to operate more efficiently, to pursue goals set by outside interests, and to market more aggressively” (NEA Higher Education, 2004, p. 2). Further, the NEA Higher Education (2004) stated that universities seek privatization for cost savings and revenue generation, quality improvement, technological expertise, human resource solutions and safety measures. These factors are associated with the trend toward privatization and are supported by the shift in the population now served by higher education; higher education is no longer for the elite but for the masses (NEA Higher Education, 2004).

Since September 11, 2001, the fiscal situation of universities has deteriorated as a result of increases in security, labor and construction expenses, all of which have outpaced revenue growth (Rosen et al., 2004). It is of paramount importance to higher education to achieve effective results or greater efficiency, an objective of privatization of student housing as a
financing alternative. Bekurs (2007) stated that the privatization takes the form of strategic partnerships where organizations contract out major functions to specialized and efficient service providers to gain the necessary efficiency. Bookstores, dining and laundry are a few examples of privatized solutions that have been successful for higher education.

Privatization as a means of financing is not without implications. A partnership arrangement of privatization has the ability to diminish decision making control by the institution, an implication for the privatized student housing. Decisions may not be aligned between the institution and the developer. Decision making may be impeded by reduced communication or filtered communication through the developer. The profit motive of privatization partners is another implication for privatized student housing. The profit motive of the privatized partners is often not aligned with the university’s goal to care for its student residents. Another implication is the possible impact on the delivery of educational services to students which may be impacted by more centralized decision making, declining acceptance of academic norms, loss of faculty autonomy, and development of private funding sources (NEA Higher Education, 2004).

Privatization of student housing as a financing alternative may be open to further research to gain greater understanding on the impact to the university’s balance sheet and the university’s core mission. Further research into the impact of privatization on student recruitment and retention is appropriate.

In summary, privatization of student housing can enable the university to remain focused on their core mission--delivery of educational services. Privatization as a financing alternative is a viable option for universities to finance new student housing projects. The need for financing
of student housing, specifically privatization, will continue to be driven by the age of existing student housing, the universities need and desire to preserve capital capacity and to focus on their core mission. Bekurs (2007) stated administrators will be driven to continue considering privatization as a means to achieve quality housing facilities in an effort to retain students, central to a university mission. Privatization can provide higher education with an alternative solution for financing the necessary student housing facilities and upgrades. The financing alternative offers several varying models dependent upon the university’s desire for involvement and the tolerance for balance sheet impact and capital capacity.
References


