Academic Housing Partners

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Current Topics in Student Housing

OPTIMIZING STUDENT HOUSING DECISIONS

Residential life in colleges and universities in the United States is older than the country itself; the country's first college, Harvard University, had residences for students starting in 1636. Since then, issues of how much housing to provide for students, how it should be configured, and how it should be financed, have been rattling around the academic corridors. In this report, we submit that student housing enhances the mission of colleges and universities; further, if properly structured and particularly if owned, student housing can also enhance the institution's credit standing.

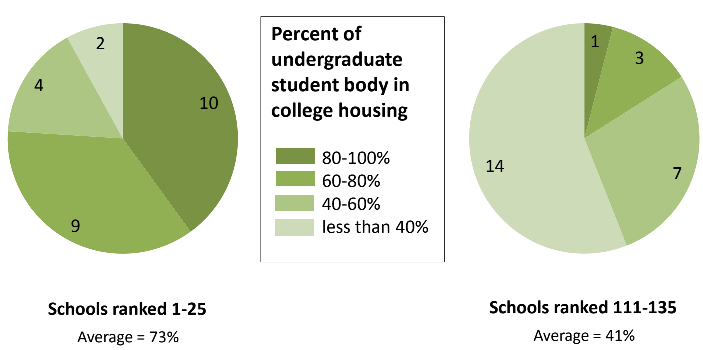
Housing is important for school rankings and ratings

Much has been written about the residential component of college life being an integral part of the educational experience. Many colleges believe that having desirable and affordable student housing is important strategically to attract and retain top students and faculty, maintain competitive rankings and support alumni development. In fact, nearly all competitive, non-commuter schools require freshman to live on campus to take part in the residential portion of the educational experience. Beyond freshman year, some upperclassmen choose to live to off-campus; this is of concern to those schools whose leaders believe that the educational experience is enhanced by a combination of intellectual exchange, social relationships and emotional growth fostered by a multi-cohort student living arrangement.

Housing is provided and deemed important in the most competitive colleges and universities. Schools with a higher rankings and larger endowments offer housing at a much higher rate than their lower rated and less endowed peers. We compared a sampling of 50 geographically diverse colleges and universities including both the more highly ranked schools and the less competitive schools on the criterion of housing provided as a percent of the undergraduate student body. **Exhibit 1** compares these metrics for the top 25 schools according to the *US News and World Report* against schools ranked 111-135. The first tier schools accommodate 73% of college students on-campus, while the second group houses only 41% of students on average. For the top 10 schools, the on-campus housing accommodation approaches 90% of the student body on average.

Exhibit 1:

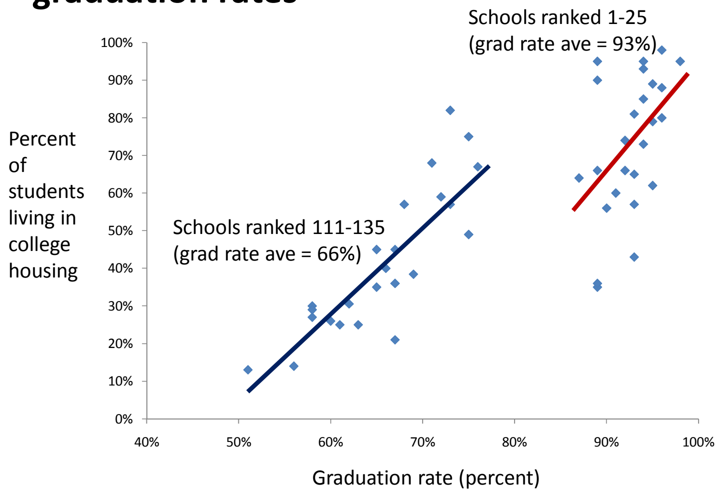
Percent of students in college housing by rankings
(number of schools)



In **Exhibit 2**, we found that there was a strong correlation between on-campus housing and graduation rates. The top ranked colleges, which house nearly three-quarters of students on campus, have a 93% graduation rate on average. This compares to a 66% graduation rate for the institutions ranked 111-135, which house only 41% on-campus.

Exhibit 2:

Students living in college housing and graduation rates



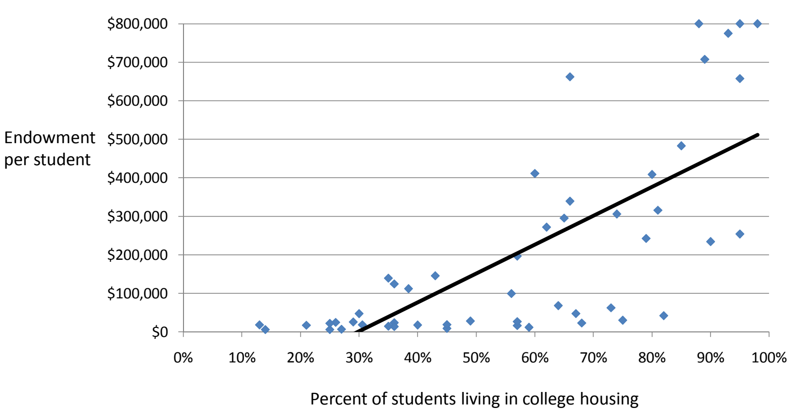
We then studied the relationship between university endowment size per student and on-campus housing statistics and found again that there is a clear relationship between the higher endowed schools and those offering a greater percent of student housing. **Exhibit 3** shows the trend.

The trend holds for graduate schools as well. Of the top 10 programs for law, business, medicine and engineering, according to *U.S. News and World Report*, our survey shows that 36 of these 40 (90%) of programs offer graduate students on-campus housing. In fact, 100% of the top 10 business and law schools provide some student housing. Conversely, of the graduate schools ranked 81-90 in law, business, medicine and engineering, only 63% on average provide housing for students as shown in **Exhibit 4**.

Exhibit 3:

Students living in college housing and endowment per student

(institutions rated 1 – 25 and 111 – 135)

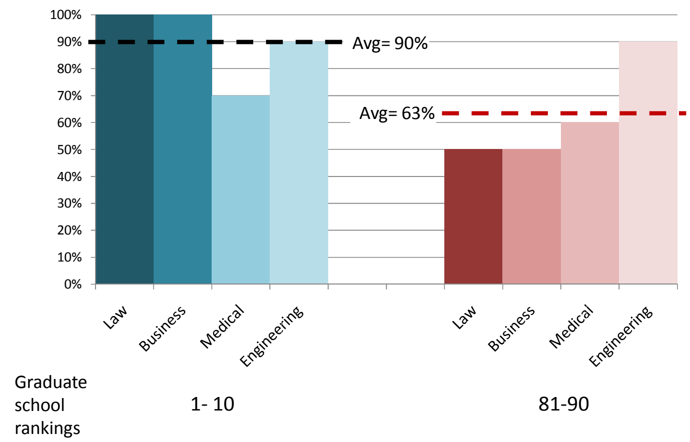


These analyses suggest that while on-campus housing may not be a cause of high rankings, high graduation rates or large endowments, schools that enjoy the highest academic and financial success provide housing as part of their competitive value proposition to students. The institutions with the highest academic rankings are also accorded high regard when applying for financial ratings. Of the four core areas Standard & Poor's uses to evaluate colleges and universities, "demand" is listed first and pertains to enrollment, selectivity, applications, acceptances, student quality, yield and retention ("Private

College and University Credit Ratings", June 19, 2007, *Standard & Poor's*). In addition, the "financial" criterion of Standards and Poor's includes endowment as an important category of evaluation. Thus, the higher ranked schools tend to also be more highly rated by the rating agencies.

Exhibit 4:

Percent of graduate schools offering student housing



While most universities favor a traditional dense dorm-style environment for first-year college students, the more senior students want private or semi-private bathrooms, state of the art technology, single bedrooms rather than shared, apartments or suite arrangements, and special purpose social spaces such as work-out rooms, coffee bars and retail. Without accommodating at least some of these living preferences, student housing may not be successful. However, once addressed, well-designed housing can be an enormous bonus to schools in attracting robust demand for on-campus housing.

Well-structured financing will optimize economics, maintain control and limit risk

There are many creative options to structure housing transactions, especially in response to recent legislation in various states establishing the framework for public/private partnerships for student housing, e.g., New Jersey Economic Stimulus Act of 2009, as amended. These transaction structures range from owning and financing the housing property by the school itself to arranging for students to lease in a privately owned property. Other structures have elements of both, including private financing, master leasing, financing through private nonprofit-foundations and public/private partnerships. In our view, three criteria should be applied by colleges in selecting the most optimal structure:

- Control, flexibility and risk
- True economics of the alternative options
- Financial statement impact

Full ownership affords the most control because a dorm can be constructed, operated and modified to meet the changing needs, of the school and unified with the residential life program; however, ownership often offers the least flexibility for disposition. In addition, by constructing the housing itself, the school takes on both timing and cost risk. Moreover, funding with bonds creates concomitant concerns for the institution as well, such as the time to issuance, one-time costs related to issuance, interest rate risk from delays, prepayment restrictions and bond capacity diminution.

At the other end of the spectrum, colleges can arrange for students to lease year to year from a third party. While this approach offers maximum flexibility respecting annual cost and eliminates entirely the construction risk, the school loses the right to operational control, branding and cohesion with the rest of the academic community.

The second evaluation criterion is true economics. This should be measured on a comparative basis among housing options under consideration and in terms of annual all-in carrying cost, including financing, operating charges, terminal value, leasing and the opportunity cost of the equity employed.

The third criterion is the effect of a housing project on a college or university's financial statements and financial ratios, specifically, whether the financing is on or off-balance sheet and how the rating agencies will evaluate the effect of a new student housing project on ratings and debt capacity. This criterion will, in our view, have less significance going forward because the rating agencies already consider operating leases like debt for many purposes, whether or not the institution has direct responsibility for debt service. In addition, a recent FASB proposal to net present value and amortize operating lease payments like debt will further remove the potential benefits of off-balance sheet operating lease financing.

Direct ownership of student housing can be beneficial to a college, especially one located in an urban area, when the rating agencies evaluate the school and its debt. Historically, the rating agencies have not taken campus real estate into account as a financial asset based on going concern and illiquidity issues. But for universities with real estate in an urban area, which may be separable from the core campus for alternative uses, the rating agencies attribute positive value to the school's rating ("Special Comment: Public-Private Partnerships in U.S. Higher Education", June 2008, *Moody's Investor Service*).

The use of public/private partnerships gives universities an additional choice in their student housing structure decisions. Public/private partnerships are financing, development and sometimes operating arrangements between private or public nonprofit colleges or universities together with third parties to provide economic benefits not otherwise available to each entity individually. Public/private partnerships are helpful for schools if they provide the needed student housing in a cost-effect manner, minimize risk, reduce time for delivery of the housing and permit management rights for the school. Nearly all approaches will have some effect on debt capacity.

In conclusion, university-run student housing with desirable design enhances the mission of a university and is generally found to be consistent with more highly rated and highly ranked institutions. While housing projects may be structured in various manners, an assessment of control/flexibility/risk factors and true economics are the most important evaluation considerations. Colleges and universities should investigate the variety of customized options available to secure housing to optimize and even enhance the financial impact.

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