BRAILSFORD & DUNLAVEY

HIGHER EDUCATION PUBLIC PRIVATE PARTNERSHIPS

State of the Industry Report

2022

INTRODUCTION

In the winter of 2018, with the first hints of a global pandemic still nearly two years away, Canadian Prime Minister Justin Trudeau was a featured speaker at the World Economic Forum in Davos, Switzerland when he uttered the following:

"Think about it, the pace of change has never been this fast, yet it will never be this slow again."

In speaking to fellow world leaders and the titans of business in attendance, he followed up that line with "if you're anxious, imagine how the folks who aren't in this room are feeling."

While he wasn't explicitly referencing the higher education sector, of course, there's no doubt that such anxiety has been coursing through the veins of college and university leaders. And with good reason.

Forces of disruption have hit higher education with a thunderous boom—including online learning, shifting student demographics, and changing cultural norms. Throw on top of those the Covid-19 shutdown, along with rising interest rates and construction costs, and what we have is an inflection point of accelerated change.

"Most universities are like elephants. They're big, they're slow, they're bureaucratic, and they don't want to change," West Virginia University President Gordon Gee said a few years ago. "We're going to have to be [quick and agile] like ballerinas, or we're going to end up like the dinosaurs."

Ten years ago colleges and universities faced many of the same acute challenges they face today. But a school's ability to act quickly has never been more mission critical than it is right now, and this is where public-private partnerships (P3s) continue to serve a role for higher education.

By design, P3s can allow schools to move larger and more complex initiatives forward quickly. Add to that the fact that P3s often bring private sector nimbleness and ingenuity. For these reasons, as higher education author and thought leader Jeff Selingo wrote recently, "colleges will need all the outside help they can get (via these partnerships) to survive and thrive." The sentiment appears to be the same on campus, with a recent survey from The Chronicle of Higher Education and the education conference P3 EDU finding that 71% of the 350 higher ed leaders surveyed see P3s growing on their campuses.

BRAILSFORD & DUNLAVEY'S 5TH ANNUAL
P3 STATE OF THE INDUSTRY REPORT

A Bounce-back Year Showcases a Resilient Sector

An accelerated pace of change, along with an obvious backlog of projects from the Covid pause, are the prime catalysts of the bounce-back year for higher education public-private partnerships in 2021—as highlighted in this report.

Brailsford & Dunlavey's 5th annual Higher Education P3 State of the Industry Report reveals a big jump in projects reaching financial close in 2021—while also looking forward to a future that promises to be quite active as well. The goal of the report remains the same as in past years. As the many critical stakeholders (e.g., higher education leadership, developers, financiers, not-for-profit 501c3 owners, architects, builders, and advisors) explore development projects, Brailsford & Dunlavey seeks to support and empower the industry with a "snapshot" of the market's key metrics.

Also like in recent years, this report not only focuses on housing-anchored and other mixed-use projects, but since we have engaged in a full range of P3 projects in higher education, we will also discuss how these markets, such as energy deals, continue to evolve (and grow). To be included in this database, though, a project must be tied to a higher education institution, meaning the projects were—or will be—built on a school's or foundation-owned land, and be a housing-anchored and/or other mixed-use project featuring related revenue-generating asset classes.

TODAY'S MARKETPLACE

College and university leaders no doubt faced many of the same challenges ten years ago that they face today. The difference, however, was that the context then was not such that it drove these leaders to respond with such immediacy. Today, however, with both education and real estate conditions caught in a hyper-acceleration vortex, the resulting volatility across the range of successes and setbacks (big and small, public and private, four-year and two-year) is driving a speed of response where P3s have come to be the solution at a much greater rate than they used to be.

Take for example Lynn University, a private four-year college with approximately 3,500 students in Boca Raton, Florida. Lynn was growing before Covid, and its popularity (and population) reflected steady growth even during the pandemic where they continued to offer courses, academic support and other services 100% virtually. Lynn had an immediate need to replace and acquire new upper division beds. School leaders actively planned for sustained growth as well as new construction, and strategically sought a partner to support development to meet the exponential demand. Lynn moved swiftly to find the right private development partner to keep the first phase of the Housing Master Plan moving forward even during the volatility of Covid. Utilizing a P3, school leaders quickly took measured risks that they may not have taken 10 years ago. In the end they recognized that a P3 delivery was the best option to expedite new beds on campus, and after achieving financial close in 2021, the needed first phase opened in the fall of 2022. Similar to other schools that marched forward with their projects during Covid, including the New Jersey Institute of Technology (NJIT) in Newark, Lynn also realized significant cost savings and delivery certainty by avoiding rising inflation that kicked in as the country began emerging from the pandemic.

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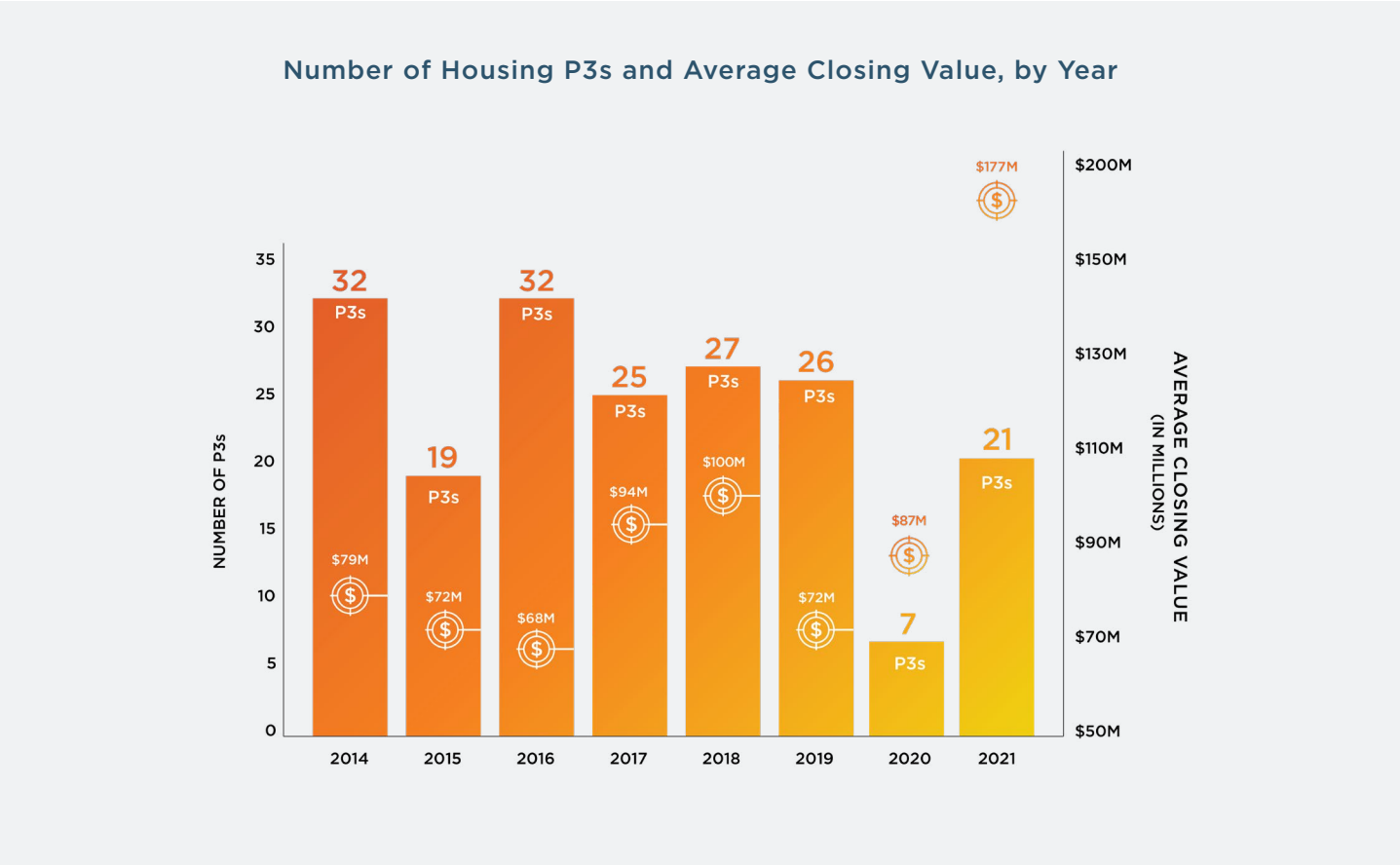
Another example is from the University of Maine's flagship campus in Orono. Their objective is less about speed-to-market and more about creative solutions brought through a P3 structure—the skills and capabilities that a comprehensive private development team brings—to address a wide context of campus challenges including, but not limited to, deferred maintenance. Two of the oldest buildings within the campus historic district, Coburn Hall and Holmes Hall, were built in 1888 and have been non-operational for the past 15 years. The partnership was publicly procured in 2021 and looks to close in 2022. The halls will be converted into a boutique on-campus hotel with 95 rooms and suites and a bistro café—with a planned opening in 2024. As state assets on the historic register that could not be torn down, the complexity of this project necessitated identifying a team with the creativity to redevelop the halls with a solution that works in the private market and utilizes historic tax credits. It also required the combined strengths of national firm leadership and financing with a significant Maine presence (architect, contractor and operator).

THE DATA

Number of Deals & Closing Value

So with this accelerated pace of change, along with the hope and fulfillment of 2021 being a bounce-back year showcasing the resiliency of the sector, it's time to dive into the numbers.

The total number of deals the achieved financial close in 2021 was 21, a considerable jump from seven in 2020. You can find a full list of schools in this report on the following page. While not getting the market all the way back to pre-Covid levels (26 in 2019 and 27 in 2018), it provides confirmation that the market is alive and well. As expected, average deal size was also significantly higher—coming in at $177M in 2021 compared to $87M in 2020.



As dissected earlier in this report, the confluence of a rapidly increased speed of change coming out of Covid along with the pent-up demand for projects that were paused because of Covid, were the major drivers of this significant increase. While Covid is still a threat, the market has certainty responded in a more "business-as-usual" manner compared to the first year of the outbreak and before the arrival of vaccines.

Another trend of note in the year-to-year figures, looking out over a wider time horizon: The scale and complexity of higher education P3 deals continues to grow. While 2014 and 2016 saw the highest number of deals at 32 each, the average size of those deals were only $79M and $68M in 2014 and 2016, respectfully. Despite the uncertainty in the market in 2020 and the small number of total deals that closed, the average deal size still eclipsed those earlier years at $87M – before the true bounce-back year of 2021 with an average deal size of $177M.

Average deal size was significantly larger—$177M in 2021 compared to $87M in 2020.

In early 2022, the higher education P3 market also got further confirmation of its business model—as Wall Street weighed in with the global investment firm Blackstone's agreement to purchase Texas-based ACC (formerly American Campus Communities), the largest developer, owner, and manager of student housing in the country. Nearly a quarter of ACC's 160 properties in 71 campus markets are P3s located on campus-owned land.

When the deal with Blackstone was announced, ACC's CEO Bill Bayless said: "18 years ago, we began our pioneering quest to transform the student housing sector into a mainstream, institutional asset class within the commercial real estate sector....and we have certainly accomplished that mission."

21 COLLEGES & UNIVERSITIES THAT HAD A P3 DEAL REACH FINANCIAL CLOSE IN 2021

Appalachian State University
Blinn College
Cal Poly Pomona
Concordia University Texas
Drexel University
Eastern Michigan University
Lynn University
Morgan State University
New Jersey Institute of Technology
Princeton University
Santa Rosa Junior College
Texas A&M University
University of California, Davis
University of California, Irvine
University of Evansville
University of Maryland
University of North Dakota
University of South Carolina
University of Southern Maine
University of Washington Bothell
Vanderbilt University

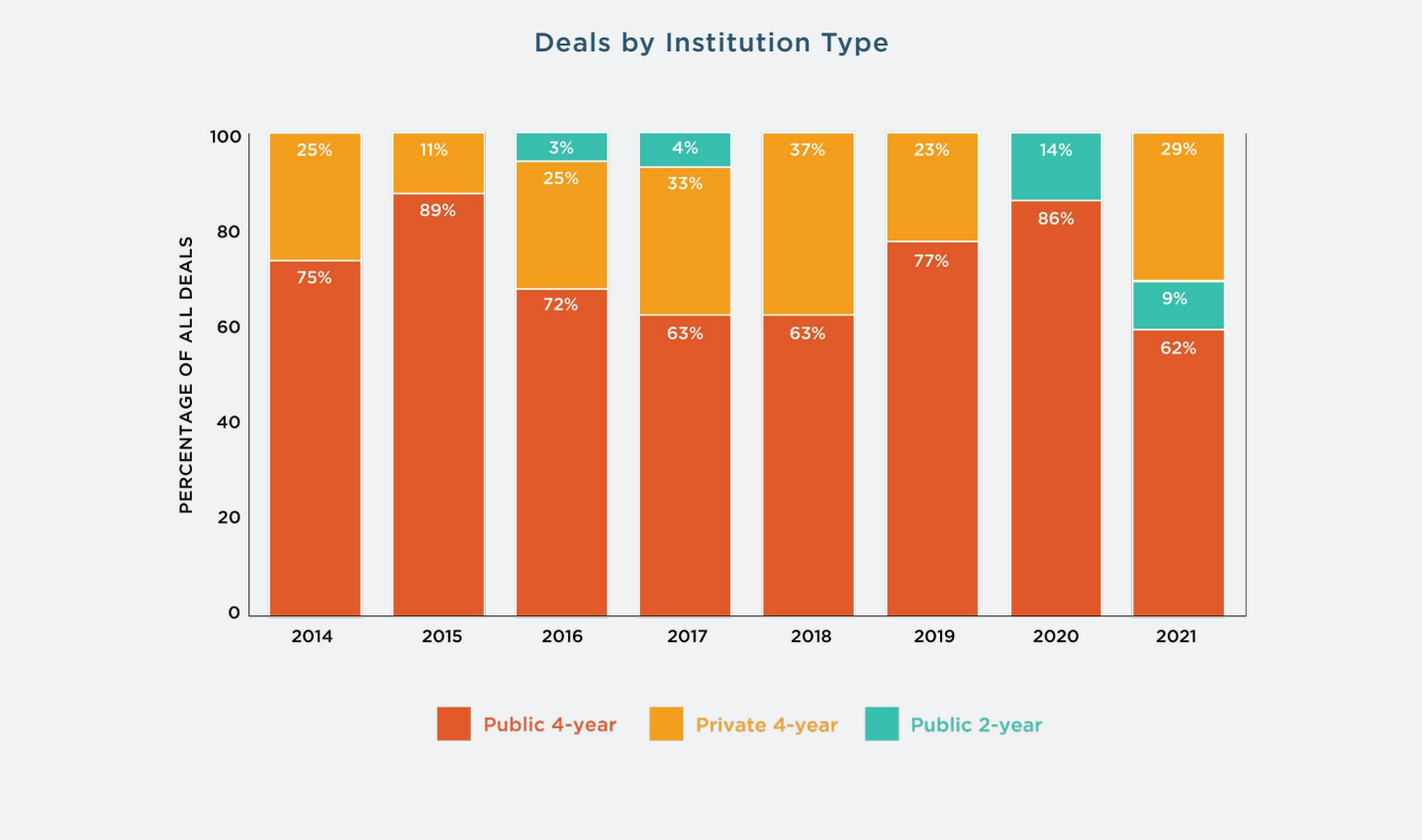
THE DATA

Deals by Institution Type

Public four-year universities have always dominated the State of the Industry report, and 2021 was no exception—with 62% taking place on these campuses. While 2020 was likely an exception at 86% due to the small number of deals, this figure for 2021 is consistent with prior years (2014-2019) where four-year public schools were generally in the 60-70% range.

Private four-year schools made up 29% of the deals closed in 2021, the strongest showing for this class since 2018 (37%). As these percentages for four-year private schools have tended to bounce around quite a bit year-to-year in this report, it will be interesting to see if the 2022 numbers will begin to point to any notable trendlines.

Two of the deals in 2021 were on two-year campuses, and while it is anecdotal thus far, indications are that this class of community colleges is poised to see ongoing P3 activity, particularly in high-cost real estate markets, into the future due to several factors. First, California's new law signed in September 2021 (CA - SB 169), which provides state grants for community college affordable housing and has already led to a considerable number of P3s that will be realized in the next few years, could be a model for other states to follow. Second, many of these schools have excess land, and often in desirable locations, and P3s provide them the opportunity to utilize this land to generate additional revenue.

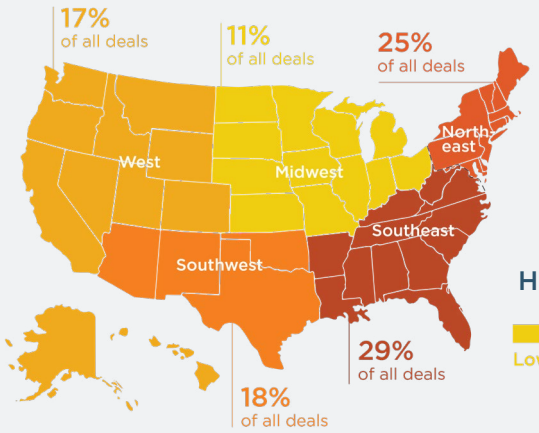


THE DATA

Regional Breakdown

If you take out 2020 as an outlier with only seven total deals, the regional breakdown of deals has remained remarkably consistent through the years. In 2021 the northeast region saw the most deals (29%), followed by the west and southeast at 24% and 19%, respectively. It was the first time since 2018 that the northeast topped the list, but the fourth time in the eight years of the data being collected. The southeast region typically performs well too, and often finds itself in the top spot in the years when the northeast deals tail off.

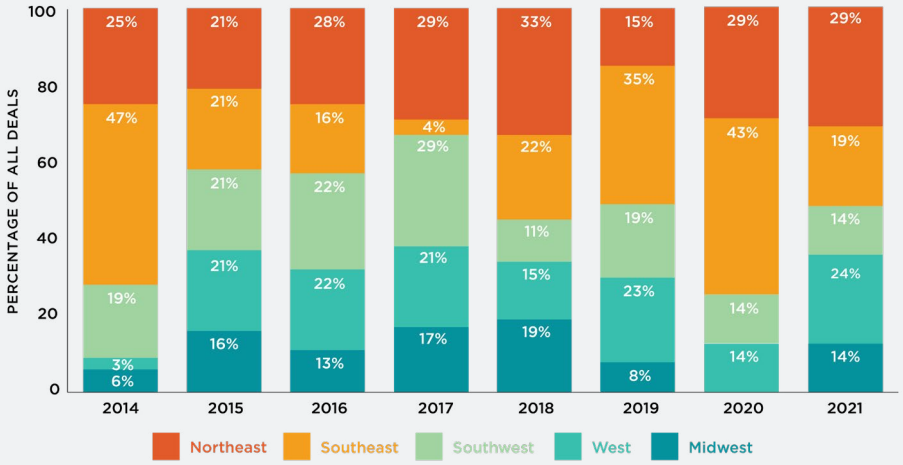
Of course the sheer number of colleges in the northeast makes it a likely candidate to feature the most deals in any given year. Additionally, the competition in recruiting from a smaller overall pool of students with the enrollment cliff coming, along with the fact that northeast schools generally speaking have some of the largest deferred maintenance backlogs, should keep this region focused on P3 development—particularly for non-student housing projects that can leverage underutilized land and help off-set tuition revenue losses.



Housing P3s by Region, 2014-2021

Lowest — Highest

Housing P3s by Region by Year, 2014-2021



THE DATA

Financial Structures

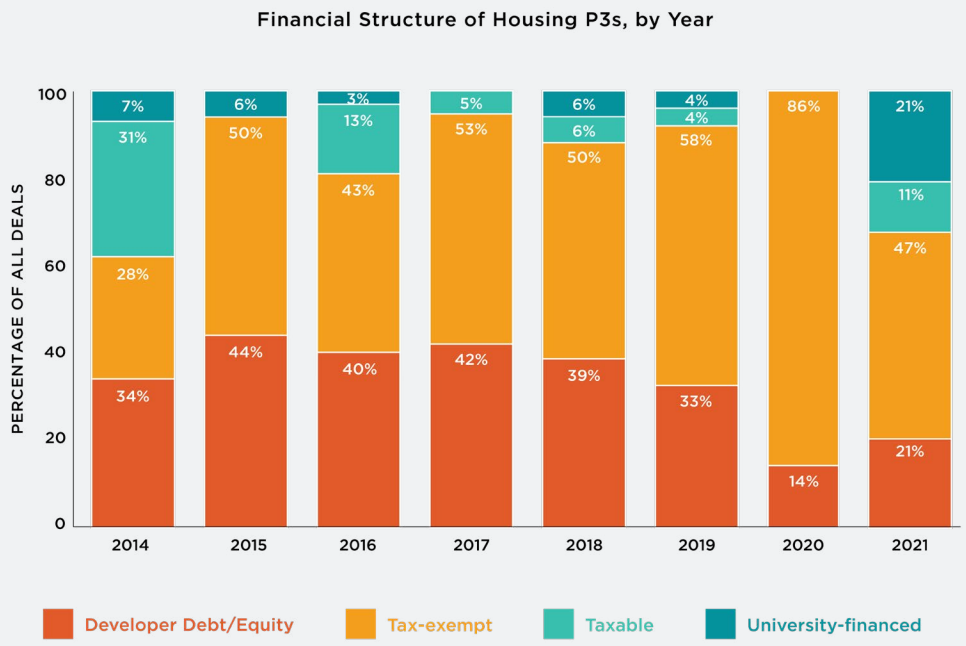
The financial structuring of these deals is another data point that has remained predictably consistent. It's no surprise that 501(c)3 and other tax-exempt structures remain the most preferred P3 delivery method in higher education.

But what's interesting to note is that 2021 saw a big increase in the number of university-financed deals (the "F" in DBFOM). Typically in single digits, as a percentage of total deals in a given year, this structure represented 21% of the deals in 2021 likely due to several factors. First, there is increasing pressure to keep college affordable, and a lower cost of capital means lower rents. Also, with increasing construction costs and rising interest rates, projects were having more trouble penciling—and so schools stepped in to take on the financing and keep the projects moving forward.

Since our reporting began in 2014, developer debt/equity has predictably been the second most common deal structure behind tax exempt. That was also the case in 2021, but the percentage was down to only 21% of the total deals from a high in the lower 40s in 2015-17. One rational for this was that with interest rates at historic lows in 2021, 501c3 deals were able to secure a cheaper cost of capital and universities were willing to provide additional support to make projects pencil. Equity investors were cautious after some of the losses due to pandemic-related closures impacted their returns, but with renewed investor confidence and campuses at full capacity, we expect to see an increase in next year's report.

Please note that this chart is based on our ability to determine the financial structures of 19 of the deals that closed this year, rather than the full 21 indicated elsewhere in this report.

Deals by Financial Structure



BEYOND HOUSING/MIXED-USE

Energy & Utilities

Two and a half years after the COVID lockdown, energy and utility systems are experiencing even faster rates of change than higher ed overall. Campuses have been retooling HVAC systems to ensure safety in campus buildings just as hybrid return-to-work trends have upended "normal" building-use patterns. The great resignation has already impacted thinly-staffed facilities teams. Pandemic-driven supply chain issues have complicated projects in buildings, utility systems, and renewable energy projects alike. Just as things were returning to the semblance of the "before times," the war in Ukraine ended an almost decade of low natural gas prices. Energy costs have doubled almost overnight in many parts of the country.

Despite these headwinds, higher ed is not done reinventing itself. Many campuses balanced their books for the first time in a long time through the massive influx of pandemic relief funds. There has been a new wave of campus commitments to renew their district energy systems, electrify systems and slash their greenhouse gas emissions. Historic federal legislation, like the infrastructure bill and the Inflation Reduction Act ("IRA"), will provide new tailwinds through significant direct and indirect financial support for the energy transition already underway. The amount of public and private capital ready for deployment may be at the highest level of our generation.

In the context of all this change, public-private partnerships are also evolving. The past year saw renewable energy projects' continued deployment through various purchase agreement structures. While some projects were slowed or canceled due to pandemic-driven supply chain disruptions and high-profile trade cases, renewable energy deployment continues to grow. According to the US Energy Information Administration, the largest increases in electricity generation will come from renewables like wind and solar, growing from 20% of total generation in 2021 to 24% by 2023. Higher ed continues to follow this macro trend. According to the owner's advisory firm, CustomerFirst Renewables, renewable energy purchases grew from just over 4 TWh in 2018 to 6 TWh in 2021. Much of this growth came from power purchase agreements, a P3 structure where non-profit entities use a tax-equity partner to take advantage of solar and wind tax credits. The IRA not only extends these lucrative credits but will also make it easier for public institutions to capture these tax credits. These changes may prompt some institutions to become direct investors rather than just credit-worthy counterparties, however given the rapidly changing landscape power purchase agreements will remain the bedrock of the higher ed energy P3 marketplace.

There has been a seismic shift in the ambition of institutional environmental goals. Many institutions have been moving beyond "carbon neutrality" and are now pursuing full "decarbonization." Unlike the first wave of neutrality goals which institutions often met through accounting instruments like carbon offsets, decarbonization requires campuses to completely phase out the use of fossil fuels in their operations. Pressured by students, faculty, and state mandates, this transition requires significant capital investments to transform 20th-century fossil-fuel-based infrastructure into modern, flexible systems powered by renewable energy. P3 structures are rapidly changing in response to this trend. Beyond relatively simple agreements to purchase renewable electricity, many higher-ed institutions are now seeking holistic options from the market to provide heating, cooling, and resilience services. Here again, the IRA will likely super-charge this trend since it dramatically expands incentives for renewables, batteries, EV charging, heat pumps, ground-source heating, hydrogen, and other emerging technologies.

The largest increases in electricity generation will come from renewables like wind and solar, growing from 20% of total generation in 2021 to 24% by 2023.

LOOKING TO THE FUTURE

With tighter margins expected at state universities due to slower revenue growth, we can expect that P3s will continue to be a preferred development structure in this sub-class going forward (and dominate future State of the Industry reports).

We also expect to see more pre-development risk, which has already started, as inflationary construction costs increase and interest rate pressures are putting deals at risk. There are several recent examples of deals not making it to the finish line due to rapidly changing market conditions.

On the positive side of things, the pipeline of deals remains strong—with 89 potential projects in the pipeline. Almost 80% of these pipeline deals are in the northeast, southeast, and west regions. Currently, the San Diego State University Mission Valley Campus is the largest P3 in the higher education sector (mixed-use, revenue-generating asset classes), with multiple RFPs on the street at the time of publication. Some of these deals hitting the market soon are expected to be extremely large too, in excess of $1B in project cost.

While the number of deals is expected to climb, developers are becoming more strategic—by limited their number of pursuits. Schools are getting fewer submissions to their RFPs, but the submissions they do get are generally of a very high quality—and the development teams are responding to the schools' needs to be creative.

More schools are also pushing for DEI (Diversity, Equity & Inclusion) and climate action goals, with many P3s solicitations now including an energy piece and pushing toward better sustainable outcomes. It would have been unthinkable ten years ago that many of the new P3 projects today—including apartments and restaurants, for example—are not going to include natural gas as part of their development.

Other trends to continue to watch include more non-student housing asset types, more outsourcing of management functions within the university, a growing number of P4s that would include another public entity such as a city or county government, and an increase in state and federal funding to help support P3 projects. Just as this report was going to press the state of Hawaii, for example, significantly scaled back a long-planned P3 featuring the redevelopment of Aloha Stadium on Oahu due to an increase in state funds for the project, according to the governor.

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, operations, 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 2017, 2018, and 2019.

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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

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

Jeffrey Turner, Executive Vice President
jturner@bdconnect.com

Brad Noyes, Executive Vice President
bnoyes@bdconnect.com

Mekenzie Hord, Senior Manager, Business Development & Marketing
mhord@bdconnect.com