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2006 SERIES: "CREATING COMPETITIVE ADVANTAGE"

– ESSAY 5 –

Leveraging Facilities for Competitive Advantage

ARAMARK EDUCATION

Leveraging Facilities for Competitive Advantage

ESSAY 5

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"Facilities and creative financing have become inextricably intertwined as colleges seek competitive advantage."

Increasingly, facilities on today's campuses have become a barometer of an institution's success. They are no longer simply structures to house teaching and learning. Today's facilities, in many cases, are central to the campus experience, inextricably bound to an institution's ability to attract and retain students and faculty. In extreme cases, institutions start facilities "arms races" as they race to build the best and most attractive facilities and services. Each institution in the "arms race" attempts to clearly differentiate itself from its peers. The "arms race" has forced institutions to become more creative in financing new buildings and services so that they can survive the competitive pressures in today's heated markets. This essay will show how facilities and creative financing have become inextricably intertwined as colleges seek competitive advantage. The essay will also include examples of how institutions have leveraged athletic complexes, performing art centers, science buildings, senior centers, and residence halls to strengthen their competitive edge.

Casus Belli

The recent arms race or building binge has three causes: competition for students, competition for prestige, and replacement of outdated baby boomer buildings. In certain instances, several causes are combined. For example, baby boomer buildings designed in the drab concrete brutal modernist style of the 1960s are replaced with cathedrals of student services designed with flash and grandiosity to attract students who want more than a cot and three square meals. Many students today have never shared a bedroom at home and have technology and amenity expectations that far exceed that of when their parents may have attended college.

Competition for Students: It is not without justification that institutions of higher education construct edifices and facilities that they believe will appeal to new students. *The Facilities Manager,* the journal for the Association of Higher Education Facilities Officers, reported that "62% of students surveyed said the factor that most influenced them during a campus visit was the appearance of the college's grounds and buildings."[1] Students are mainly interested in the residence halls, library, classrooms, technological facilities, and student unions.[2] Poorly maintained facilities, in particular their housing, seemed to weigh on the minds of students.

Woe to those institutions that ignore the preference of new students for well maintained buildings and services. High tuition rates coupled with personal experiences—comfy bedrooms stuffed with computers, iPods, televisions, game players, DVDs, a nearby bathroom, and other personal luxuries—have fostered a sentiment in parents and their children that they are entitled to this level of luxury when they go to college.[3 4] Just a few decades ago, college residence halls were little more than cells with a bed, wardrobe, and small desk; and a single bathroom with gang showers served a whole floor. Forget about air conditioning, televisions, refrigerators, microwaves, and other amenities. Student Unions were small snack bars with walls covered by pictures of sports heroes of old. Athletic facilities were for varsity sports and did not include places for non-athletes to workout, hangout, watch television, and whittle away the hours playing with gadgets and moaning about the lack of anything to do. Life at a college was spartan and was not meant to invoke pleasure or comfort. It was supposed to be the first step into the real world where luxuries were earned and not granted.

Since enrollment demand remains high, student and family expectations persist, and competition is steep, presidents and/or boards are not inclined to cut back on facility luxuries. The high cost of new and better facilities and services are easily offset by ever-higher tuition and fee rates. Students and parents, though they complain of college costs, seem willing to foot the expense of ensconcing the college with all the wonderments of a Trump Casino and Hotel.

Competition for Prestige and Donor Dollars: The Bilbao effect—a celebrated "metal clad Surrealistic swirl" Basque museum in Bilbao, Spain—describes the desire of presidents and donors to locate a similarly famous architectural bauble on their campus.[5] They want this edifice to stamp their institution as worthy of rank in the corridors that dole out dollars based on prestige and buildings. World-renowned glitterati architects like Saarinen, Philip Johnson, or Frank Gehry design these extravaganzas. While they burnish the prestige of the institution, these gems are appealing to high-class fashion magazines like *Architectural Digest* or *Vanity Fair* and donors who make statements by giving their dollars only to the best of the best. For donors, a Bilbao structure means the institution is worthy of their hard-earned dollars. It is also nice to have their name attached to the historic structure.

This is not a new phenomenon; it has existed since the late 19th century when major institutions began building their Greek and Latin paeans to the gods of learning. Only now the need for "big-dollar magnet buildings" is more pressing for presidents at prestigious institutions as they cope with the cost to maintain instructional and research reputations and draw the best and brightest students. However, the downside of a failed Bilbao—failed if the designer does not pull off a stunning creation or if the building costs a fortune to maintain or if someone thinks it is ugly—is a diminution of prestige, a potential loss of donor dollars, and a hazard to student recruitment.

Legacy of Baby Boomer Buildings: Baby boomers entering higher education in the 1960s and '70s forced the quick construction of masses of anti-Bilbao structures—huge concrete swabbed dormitories and instructional halls designed with all the charm of the Stalinist school of architectural design. This design mode could be called "modernist brutalism." Anyone who lived in one of these dorms or had classes in a boomer building knows all too well what "modernist brutalism" means.

These buildings not only lack charm, but they have reached the end of their highly detested life. These maintenance sinkholes lack the basic amenities and technology to support today's classrooms and research labs. Essentially, they are concrete boxes that hinder flexibility and are monstrously expensive to maintain or to renovate.

No firm numbers are available on the number of boomer buildings that are being replaced, but the huge building explosion begun in the sixties to accommodate the boomers is now nearing its fifth decade with building to accommodate generations X and Y. Replacement buildings carry costs much higher than simply substitution of an equivalent new building. Building costs have sky-rocketed. Additionally, campus administration must now account for advances in technology plus the elementary essentials expected by today's students. The result is that normal rebuilding cycles have become intertwined with the provision of small-scale palaces as colleges compete for new students.

It is a paradox that students, who expect fine living quarters and instructional environments, must also pay the piper through higher tuition and fee rates to fill their heart's desires.

Leveraging the Arms Race

Joining the arms race calls for presidents to find ways to leverage the costs of providing suitable facilities for students, instruction, and research. In many instances, the old reliables—bonds, loans, gifts, and higher tuition—though they are still used, often are not enough to offset either the costs or the risks of the investment.

Cost and Risk: The cost of new construction can shock a president planning a new project. Costs of a new building quickly mount as land acquisition, government approvals, architectural and engineering design, environmental and zoning regulations, amenities, technology, and design flexibility are taken into account. Cost of construction plus furnishings can quickly turn even a simple project into expensive square footage comparable to the price of new office buildings in the center of our largest cities. Obviously, cost must be managed, which can mean that timing is everything. Projects started in the middle of a building boom or after an international disaster such as "Katrina" or the 2005 tsunami are going to be higher. Additions to land-locked institutions are always more pricey than additions to a rural campus. Depending on town/gown relations, costs may include higher legal, engineering, and/or public relations fees. High costs mean that the Board, the president, and the planning group must be careful about what they include in the plan. They must keep a sensible financial strategy focusing resources on the main goal to be achieved by the project.

Risk refers to the chance that some or even all of the planning assumptions will prove false. Bradford College, which closed after a major residence hall project failed, is too sad of an example of planning assumptions gone wrong. Risk management means cutting the probability of failure while finding ways to reduce the risk. For building projects, especially at financially-stressed institutions, risk means finding ways to offset debt or to reuse the project in some other way to reduce capital and operating costs.

Financial Tools: Presidents can turn to time-honored financial tools—gifts, bonds, loans, and tuition hikes; or innovative tools—student referenda, leaseback, business partnerships, educational partnerships, dual use, downtime rentals, and entrepreneurial ventures; or a mix of these tools to fund new construction. The innovative tools are being used more frequently to raise capital while mitigating risk by either spreading risk or reducing risk. Here is how some of these new tools are applied:

- *Student Referenda*—University of Cincinnati, Louisiana State University, and the University of California are several examples of institutions working with student governments to conduct referenda to use higher student fees to cover part of the full cost of a new student center.

- *Leasebacks*—In this scenario, institutions work with private investors to establish a separate entity to purchase land, construct the building, and in some cases manage the new facility. The institution provides the final drawings for building design and engineering, and they are on the team to oversee construction. The building is then leased back to the institution, which offers these benefits: a) institutions have access to new fund sources beyond the typical constraints imposed by government bonding regulations, b) the leasebacks are usually net of depreciation, and c) the leasing company may gain certain tax advantages that reduce lease costs, which accrue to the college.

- *Business Partnerships*—Many large institutions have formed partnerships with companies to build research labs, retail business centers, and other facilities that benefit both the institution and the business partner. The University of

Pennsylvania provides a good example of how this tool is used. They have built research labs and a large retail center, where capital, operational costs, and net revenues may be shared. The College of the Holy Cross in Worcester, Massachusetts, partnered with the Worcester Tornadoes, a Can-Am Semi-Pro baseball team, to renovate the Holy Cross field and provide some ongoing operational resources.

- *Educational Partnerships*—Wilmington College in Delaware rents space at a local community college where full degree programs are offered. Wilmington gains the advantage of a site in a new geographic market and access to the community college's students.

- *Dual Use*—Wesley College in Delaware recently built a new student athletic center, which they share with the local Boys and Girls Club. Sharing the building reduces the cost of operation, plus they gain access to a new market.

- *Downtime Rentals*—Curry College in Massachusetts rents its space during downtimes in their schedule to another local institution that does not compete with them. The other institution gains space at a reasonable cost, while Curry is able to offset a portion of its capital and operational costs. Nichols College, also in Massachusetts, rents its athletic fields during the summer to companies offering specialized summer athletic camps—their largest venture has been with the Joe Namath football camp.

- *Entrepreneurial Ventures*—Some schools have expanded their education base to include senior citizens, who are housed in residential senior housing from independent living to long-term care facilities. In many cases, seniors take classes (this is required of residents at LaSalle College's Senior Center in Massachusetts), attend college lectures or events, or provide an educational or internship opportunity for undergraduate or graduate students. Some schools enter the senior living ventures solely and others seek companies to partner with. However, colleges entering senior residential operations must consider how the venture fits with the institution's mission and the financial risk and impact on the overall financial health of the college.[6]

Caveat Emptor

Whenever an institution seeks creative methods to leverage or finance a major capital project, its full costs and risks must be taken into account. This can be done by:

- Using a financial model to test the project. The financial model should produce a full set of financial statements that mimic the audit.

- Testing the financial plan against debt covenants and standard financial ratios for institutions of higher education.

- Testing the risks; for example, what happens if certain assumptions are not met.

- Preparing a comprehensive plan for project management that includes these sections—finance, market strategy, operations, contingency plans, approvals, performance goals, and timelines.

The institution must be unforgiving in its analysis so that it does not place itself in a high risk situation that threatens its financial integrity. Several of the innovative financial tools carry caveats that need to be understood before they are used. First, student referenda can be voted down multiple times, which could have an adverse impact on the institution's market strategy or on how new students view the college because important services are not available or student service buildings look unsightly. Additionally, current students could vote for a hugely expensive project, which leads to very high fees for future students. Second, leasebacks have unique accounting requirements that need to be understood. In particular, the institution should include the full-lease costs in its debt covenant ratios and other standard financial measures to assure that it is not placing itself at risk. Third, business partnerships can fail. So the college needs to have a contingency plan ready in case the partnership turns sour. Fourth, educational partnerships can also fail or the institution that controls the space may suddenly change the rules of operation or cost. This risk is present whenever a private institution is partnered with a public institution, because government regulations, which can not be negotiated, may change. Fifth, downtime rentals, if they provide a significant contribution toward debt service and operational costs, are very risky. The risk is that the lessee may pull out leaving the college with no alternatives except substantial increases in tuition to cover the lost contribution to debt and operations. Lastly, business ventures, while they can be exciting and may offer substantial returns, may pose risks that are poorly understood by the uninitiated. It is probably wise to have someone from the field analyze the project to assess its viability; otherwise, the institution could place its endowment and liquid assets in jeopardy. There are cases where presidents have seen millions of dollars of their endowments disappear overnight when a business venture goes belly-up. Simple prudence should guide presidents when they select an innovative financial tool, be it one mentioned here or a new and untested concept.

Summary

Presidents have many tools that never existed before to leverage new capital projects. These tools offer the opportunity of keeping a step ahead of the arms race that is pushed by their student and/or donor markets. Each president should keep in mind that any large financial decision carries risks and should be carefully tested. Presidents have not had this opportunity to redefine their campuses in four decades. This is a wonderful time for strategy and the chance to build new and exciting buildings that strengthen the position of an institution in its market.

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Endnotes

[1] David Cain and Gary L. Reynolds, "The Impact on Recruitment and Retention of Students"; http://www.appa.org/FacilitiesManager/article.cfm?ItemNumber=2567&parentid=2542.

[2] Audrey Williams June; "Facilities Can Play Key Role in Students Enrollment Decisions, Study Finds"; May 30, 2006; http:/chronicle.com/daily/2006/05/2006…5/31/2006; pages 1 and 2.

[3] "Necessary Infrastructure—or Mission Inflation?"; January 27, 2006; http:/chronicle.com /weekly/v52/i21/21b…5/15/2006; page 2.

[4] Adam Weinberg; "An Alternative to the Campus as Club Med"; September 2, 2005; http:/chronicle.com/weekly/v52/i02/02b…5/15/2006; page 1.

[5] M. David Samson; "What the 'Bilbao Effect' Can Do to, and for, a Campus"; April 28, 2006; http:/chronicle.com/weekly/v52/i34/34b…5/15/2006.

[6] Audrey Williams June; "Getting Smarter With Age"; July 14, 2005; **The Chronicle of Higher Education**; pp. 25-27.

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