PRESIDENTIAL PERSPECTIVES

2010/2011 Series: Economic Prosperity in the Next Decade

chapter two:

Mixed-Use Developments

Public-Private Partnerships

ARAMARK
HIGHER EDUCATION
Helping Campuses Thrive

a higher education presidential thought leadership series

Mixed-Use Developments

Public-Private Partnerships

Dr. Joseph C. Rallo: President of Angelo State University

Doing more with less, identifying efficiencies, and shaping human resources (including personnel cuts) are some of the imperatives emerging to address the economic turmoil now faced by American universities. Public and private institutions all share loss of endowment revenue, a fast-approaching ceiling on tuition and fee increases, and perceptible public disenchantment with the value proposition of a university degree. While there is no substitute for a robust development office or the essential role for external research funding, many small- to medium-sized universities possess an underused and nonproducing asset—land. Not all vacant land is valuable, but many institutions own tracts with unrealized potential. This article focuses on strategies that turn these nonperforming assets (NPAs) into revenue.

The Emergence of Mixed-Use Development

Although the concept of mixed use has a long history in the United States, this construction style initially gained popularity in the planned residential developments of the mid-1970s. By the early 1980s, urban redevelopment, with a strong emphasis on historic preservation, reinvigorated the concept of a mix of uses dependent on each other. Urban malls began to resemble small villages with pathways connecting retail and residential spaces. A pedestrian-oriented, small-town feel comingled with high-end retail outlets to create a sense of place for residents and visitors. Increased-use density was more than offset by the creation of public and civic spaces that invited people to visit, shop, and live.

> Given the uncertainties of future university funding, a mixed-use project can be an attractive entrepreneurial approach for others to explore.

For a variety of reasons, universities have recently begun to embrace this construction concept. Students from urban areas expect an edgier look to their residential and retail choices. Institutions seek to recapture students lured to private, off-campus residential developments. Gateway construction around a campus is seen as integral to the recruitment of new students and retention of existing ones. Emerging economic challenges now provide an additional reason to pursue this type of initiative and turn an NPA into unrestricted revenue. The solution is not for everyone, but this article will provide a step-by-step approach for those who would like to try.

Angelo State University (ASU)

ASU's Centennial Master Plan, completed in 2005, identified for future commercial development nearly 40 acres of land on the southern edge of a 268-acre campus. A request for proposal (RFP) was issued in spring 2006, resulting in two responses for private development, one of which was for a used car lot. The University then decided to partner with a private firm to develop a master plan for the acreage along mixed-use residential-retail lines.

The initial challenge was to demonstrate to the Board of Regents that the 40 acres would not be needed for future expansion of the campus. Here, the Master Plan was invaluable, indicating that the area had been identified for commercial development. The second challenge was to show that the land provided revenue opportunity. A traffic study was commissioned, indicating that with 22,500 cars per day, the road bordering the property was the second-most heavily travelled in a city of nearly 100,000 people. Third, we needed to expand the scope of the project to include 250–300 apartment-style residences for married and graduate students. Fourth, the University broadened its plan to outsource the student health clinic to one built and operated by a local-area hospital on the mixed-use property. Most importantly, the project's centerpiece remained a mix of retail outlets to attract students, community members, and visitors.

Sequencing Concept Components

A 2008 urban development conference sponsored by Georgia State University provides the following summary:

> 'Live here, work here, play here,' according to developers promoting urban mixed-use projects. But in reality, putting these projects together presents new legal, land use, financing, and environmental challenges...

Those challenges are equally present in university mixed-use proposals.

Exclusive Negotiating Agreement

An exclusive negotiating agreement takes the land off the market for a price and period of time to allow both parties to craft a detailed letter of intent if the project moves forward. Normally, a fee of $30,000 goes to the university, with half of that amount returning to the developer if the project materializes. During this contractual period of exclusivity, the developer identifies a list of predevelopment tasks to be performed, as well as a detailed outline of expenses that will be reimbursed. Less tangible, but equally important, is a sense of whether the potentially 40-year relationship between developer and university "feels right."

Master Development Agreement

A critical decision for the university is how to handle the contractual aspects of the master development agreement. Most university counsel lack the specialized real estate expertise needed to oversee the project, and so an outside attorney should be hired. For public universities, state law often requires attorney general permission to prepare the RFP, as well as approval of the actual firm to be hired. Ample consideration should be given to a balance between expertise and knowledge of the local real estate market. Equally important, the expectations set for this individual should include serving as the project contact point for local interactions at city and county levels. Critical work involving zoning ordinances, environmental permits, and similar preconstruction negotiations are part of the contractual responsibilities of this individual. Naturally, these conversations will be informed by the design of the project and its footprint on the land. While a mundane point, if the hired external counsel must commute to the campus site for these meetings, the cost and availability of air or rail connections must be a financial consideration.

Lease Terms

The actual agreement defines the scope, timetable, and assumption of risk between the parties. The delineation of responsibility by both parties for the project is the initial step. Universities are best served by terms that allocate control of the project to the developer, subject to restrictive covenants on the types of businesses that may participate. This will include transfer of the land to the developer under the terms of a sale or lease. A sale terminates the university interest in the land, which strongly supports the use of a long-term land lease. Normally, these leases have three distinct components over the period of the project. First is the ground lease itself, which is usually structured for an initial 20-year term with two renewals of 10 years each, subject to performance measures being met by the developer. Annual payments to the university for the ground lease should be adjusted up to 2.5 percent per year based on changes in the Consumer Price Index (CPI). Second is the initial rate of return to the developer, usually 60 percent of net profits, until the preferred equity has been paid back to its investors. Finally, terms for the remainder of the lease are set with a 50 percent (developer) and 50 percent (university) split of net profits. Revenue to the university is then based on payments for the ground lease and from net profits of the project.

Since the developer's investment is first to be paid off, care must be taken to ensure that the asset—the development—is well maintained so that its return to the university after the termination of the lease remains a valuable asset. Thus, the agreement must contain provisions for maintenance and upkeep by the developer during the lease term and also a reserve for the university to access once the project returns to it. Terms to create the maintenance and reserve funds are of critical importance, since the development will become the responsibility of the university at a defined time in the future.

Default by the Developer

A sensitive but essential part of the agreement is the inclusion of remedies in case of default by the developer. While legal recourse is always present, a half-finished hulk on the edge of campus defeats the purpose of the project. Thus, it is imperative to conduct extreme due diligence when researching the developer at the project's outset. Further, it is essential that there are clear limits on transfer of its contractual obligations to another corporation. The agreement also must identify remedies in case of default in order to allow the university to retain value in its initial asset—land—and account for project improvements.

ASU's Current Phase

Angelo State University is currently in the predevelopment phase of the project, which is expected to last 12 to 18 months. The developer is actively engaged in soliciting commitments from retail stores, as well as identifying site locations for a possible medical clinic and other commercial ventures. The University's primary involvement is to review project design of the buildings and approve, within reason, tenants for the development. Although the residential portion of the development will be to house married and graduate students, the University is not involved except to incorporate this option in its marketing material.

The initiation of construction will be determined when the developer meets its contractually specified leasing milestones. At that point, it is expected that construction will take an additional 12 to 24 months. The initial revenue estimate for the University is approximately $200,000 in each of the first two years of development operation, jumping to more than $600,000 annually thereafter. Ultimately, the development will revert to University ownership upon completion of the 40-year lease period. At that time, the University will have a stable revenue-producing asset and will have benefitted from 40 years of generated income.

Summary Checklist

- Developer will pay a deposit to show good faith and create an option in the land.
- The university agrees not to market the property during this period of developer due diligence.
- The university will provide a 40-year ground lease to the developer.
- Ground lease payments will be adjusted by the CPI by up to 2.5 percent per year.
- Distribution of net profits is 60 percent (developer)/40 percent (university) until preferred equity has been paid in full, with a 50 percent/50 percent split thereafter.
- Construction does not begin until the property has met certain pre-leasing milestones.
- The developer maintains appropriate reserves for project improvements and maintenance.
- The university has the right, within reason, to review and approve project design and tenants.

Dr. Joseph C. Rallo was appointed President of Angelo State University, a component campus of the Texas Tech University System, in San Angelo, Texas, on June 1, 2007. Previously, he served as Provost and Academic Vice President at Western Illinois University. Dr. Rallo has published extensively on global business topics, with an emphasis on the European Union and Japan. He has been named a Fulbright Scholar and NATO Fellow, and from 1991–99 chaired the Executive Committee of the Japan Center for Michigan Universities, a consortium of the 15 public institutions in Michigan.

Dr. Rallo holds senior leadership positions on several boards, serving as the Secretary/Treasurer of the Texas Council of Public University Presidents and Chancellors, President's Committee on International Education-AASCU, and as a member of the Board of Trustees of the Southern Association of Colleges and Schools (SACS).

Dr. Rallo received a B.A. in Russian History (1971) from Lafayette College, a J.D. (1976) from Western New England College, as well as the M.A. (1978) and Ph.D. (1980) in International Relations from the Maxwell School of Citizenship and Public Affairs at Syracuse University. After 27 years of active and reserve service, he retired from the Air Force on July 2, 2008, with the rank of Colonel.

PRESIDENTIAL PERSPECTIVES

a higher education presidential thought leadership series

ARAMARK HIGHER EDUCATION

Helping Campuses Thrive™