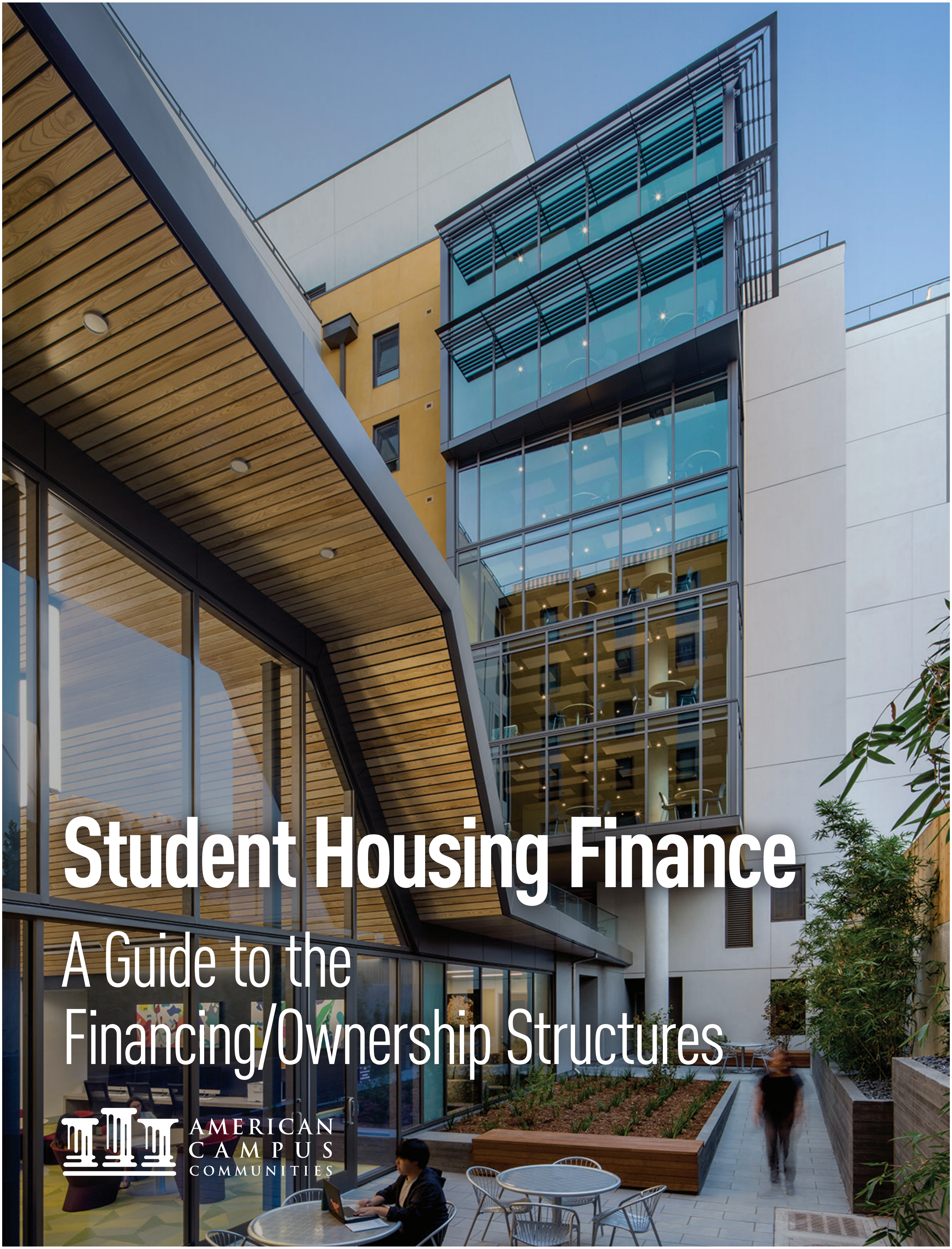


Student Housing Finance

A Guide to the Financing/Ownership Structures

AMERICAN CAMPUS COMMUNITIES

Gladding Residence Center | Virginia Commonwealth University

INTRODUCTION

Doing More with Less

Colleges and universities in the United States are facing increased competition for students. In some regions this is due to a decrease or plateau in the population of traditional college-aged residents, and in others an increased population of young adults is driving this competition[1]. Modern student housing communities can help attract and retain students, provided they are affordable and purpose-built to foster academic success and physical and mental well-being.

Like any development, a student housing community must be built on a strong foundation, and that starts with funding. Schools' cost of providing education is increasing while funds from the government and private endowments remain stagnant[2]. Finding the money to build, update and repair communities — without sacrificing the core functions of academics and research — can be a challenge. That's one reason why higher education institutions are increasingly using public-private partnerships (P3s) to fund, develop and operate their student housing communities.

Contents

The P3 Advantage

By partnering with a private sector entity, a higher education institution can deliver housing more quickly and efficiently, with less risk and more debt capacity reserved for other campus projects. There are many types of ownership and financial structures for student housing P3s. They vary in their funding sources, term lengths, amount of risk transferred to the private partner, level of control retained by the university and overall cost of capital. P3s are long-term engagements, so it is critical that schools choose the structure that best fits their objectives.

This white paper provides an overview and analysis of the four most common types of P3 ownership and financial structures to help university leaders make an informed comparison and ask the right questions as they select a development partner:

- Public developer equity
- Private third-party equity/debt
- Tax-exempt bond financing
- Taxable bond financing

1 Current Term Enrollment – Spring 2019. National Student Clearinghouse Research Center.
2 Lapovsky, Lucie. "The Changing Business Model For Colleges and Universities". Forbes. 6 February 2018

GUIDE TO EVALUATING PARTNERS AND TRANSACTION STRUCTURES

How a P3 Development Partner Can Help

Private development partners bring expertise, operational efficiencies and capital that universities either lack or don't have the bandwidth to leverage. As P3s have gained popularity, student housing has become an attractive investment and respected global asset class, making it easier to get funding from high-quality investors. A good P3 partner will not pressure a university to choose a certain type of ownership and financial structure, but will instead provide objective information and help the school make an informed, data-driven decision.

The partner should work closely with the university's bond counsel, underwriter, auditor and financial adviser to determine how each of the potential financial structures may affect:

- The university's balance sheet
- The university's outstanding debt rating
- The institution's ability to borrow funds for future campus capital projects (i.e., debt capacity)
- The university's credit profile
- Any existing financial covenants

What to Look for in a P3 Partner

Whether the university engages in a formal request for proposal process or solicits bids directly from one or more partners, it should look for a partner that has:

- Strong experience with similar projects
- Outstanding references (be sure to do due diligence here)
- Extensive on-campus construction and development experience. Building on campus isn't like other projects and requires coordination with campus master planning, facility managers and university architects.
- Knowledge of how to operate and maintain a student housing community, particularly on campus in partnership with a university. This is an operations-intensive business.
- Extensive understanding of university physical and mechanical systems
- Ample access to working capital, construction funds and money to own, operate and reinvest in the property as it ages
- Strong track record of sustainability and understanding of how to achieve energy and operational efficiencies

Questions to ask a P3 Partner About Financing

- What construction and permanent financing do you intend to use for this P3?
- What types of financing are you able to do?
- How do you anticipate funding the long-term capital reinvestment or long-term repair and replacement of the facility as it ages?
- What covenants and commitments are you expecting from the university to make the plan successful? Are you going to require minimal expectations and guarantees and take most of the risk, or are you going to require the university to provide a guarantee of revenue, occupancy, etc.?

OWNERSHIP AND FINANCIAL STRUCTURES

This section gives an overview of each of the primary ownership and financial structures utilized by American Campus Communities (ACC) to execute a P3 in today's marketplace. Two of the biggest differences among these structures are the level of risk transferred to the P3 partner and the level of responsibility and control retained by the university.

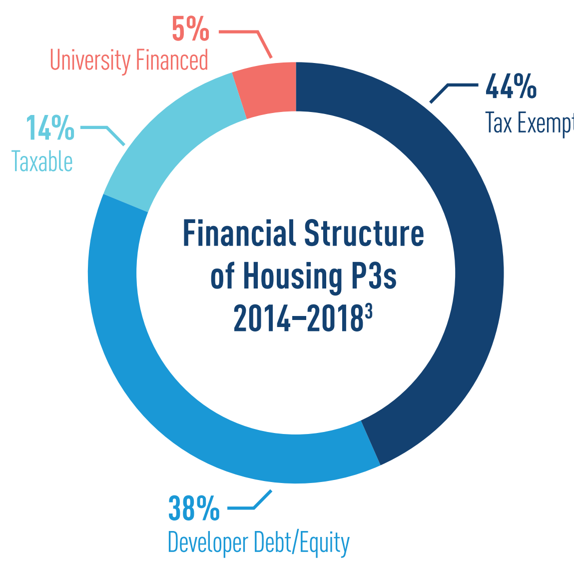
Transfer of Risk/ Responsibility	American Campus Equity (ACE)[1]	Third-Party Equity[1]	Project-Based, Taxable Bonds[1]	Project-Based, Tax-Exempt Bonds
Conceptual Development Cost	ACC	Bankruptcy remote special purpose entity (SPE)	SPE	SPE
Predevelopment Cost Risk Sharing[2]	Shared 50/50 with ACC and University	Shared 50/50 with SPE and University	Shared 50/50 with SPE and University	Shared 50/50 with SPE and University
Construction (Cost and Delivery Date)	ACC	SPE - limited to fee	SPE - limited to fee	SPE - limited to fee
Initial Lease-up	ACC	University or SPE	University or SPE	University or SPE
Residence Life and Student Development	University or ACC	University or SPE	University or SPE	University or SPE
Property Operations and Maintenance	ACC	University or SPE, Project-based funding	University or SPE, Project-based funding	University or SPE, Project-based funding
Property Long-term Capital Investment	ACC	Project-based funding	Project-based funding	Project-based funding

1 If structure is undertaken via long-term concession agreement, ownership resides with the university and thus property taxes may be avoided.
2 50/50 risk sharing only upon termination. ACC funds all predevelopment expenses.

Risk Transfer: Public Developer Equity vs. Project-based Financing

Third-party private equity, tax-exempt bond financing and taxable bond financing are considered "project-based," which means that the transfer of risk to the P3 development partner is limited to the revenues generated by the project.

Project-based financing structures create an independent student housing enterprise that will be managed in partnership between the university and the private sector partner. The operations of the housing enterprise (most likely without a corporate counter-party guaranty) will be responsible for generating sufficient revenues to pay all debt service, marketing and leasing costs and operating and maintenance expenses, as well as any residence life and student development payments to the university. Likewise, the long-term capital reinvestment commitments under the agreement will be funded by accumulating annual repair and replacement reserves generated by the project.



With public equity financing under the American Campus Equity (ACE®) program, there is a full transfer of risk to the P3 partner, American Campus Communities. Long-term repair and replacement funding is fully guaranteed by ACC and not dependent on project performance.

3 Brailsford & Dunlavey. Higher Education Public-Private Partnerships: 2019 State of the Industry Report. Data based on 130 housing deals closed at U.S. colleges and universities (public and private), 2014-2018.

Public Developer Equity: American Campus Equity (ACE®)

The American Campus Equity program is unique to American Campus Communities. ACC is the student housing industry's only publicly traded real estate company, which gives it access to the public capital markets and low cost of borrowing. Under the ACE structure, ACC funds 100 percent of a project's development costs using its own internal balance sheet. No property-level debt is placed on the project at closing. ACC retains control of financial decisions relative to return requirements and transaction terms. Because ACE is a single-source transaction structure, ACC does not charge third-party fees but rather earns returns based on the project's long-term success.

Under ACE, ACC becomes the university's exclusive long-term partner from every aspect, including development, finance, management and operations, residence life and long-term capital reinvestment. ACC enters into a long-term ground lease or service concession agreement (65–85 years) with the university for the project site. The lease provides for the facility's design, development, construction, operation and management. During the lease term, ACC is 100 percent responsible for maintaining the facility to an agreed-upon standard of care, regardless of cost and timing. In exchange for the right to own and operate the project on campus, ACC pays the university ground rent. Minimum annual ground rent is guaranteed by ACC, regardless of project performance or ability to meet investment return thresholds. Ground rent may include an upfront payment as well as annual payments calculated as a percentage of total gross revenues. When the ground lease ends, the university owns the project free and clear.

Advantages

- Single-source partnership
- Direct investment by investment-grade partner
- Quick decision-making with no third-party approvals needed
- Full alignment of interests between the university and public development partner
- Full transfer of risk to development partner
- No developer fees
- Less leverage than project-based debt alternatives
- Optimal balance sheet and credit outcomes
- Ground rent and long-term capital reinvestment are guaranteed

Disadvantages

- Longer agreement term (50–85 years)
- Public company ownership may trigger local property taxes
- Less economic, operational and management control for the university (excludes residence life and student conduct)
- Higher cost of capital may reduce ground rent to the university
- Limitation on future competing developments (third-party demand study requirement)

ACC Case Study | Arizona State University

Since 2008, ASU has chosen the ACE program to finance $544.2 million in on-campus projects: three new residence halls, including two honors colleges; a redevelopment; plus an apartment community and Greek village. Two are LEED-certified. ACC is the owner through long-term ground leases and is thus 100 percent financially responsible, and also serves as developer, construction manager and operations manager for all phases.

Private or Third-Party Equity Investment

Under a third-party equity model, a private entity separate from the developer funds 100 percent of the project development costs. This funding comes from private equity and/or corporate-level debt. The funds are given to a bankruptcy remote special purpose entity (SPE), who then enters into a long-term ground lease or service concession agreement (65–85 years) with the university. The SPE will also enter into agreements with the developer and other entities for the housing facility's design, development, construction and management. The developer serves as a third-party fee developer and initial manager of the project.

For the term of the ground lease, the SPE will retain a qualified management company to operate the facility in partnership with the university. The SPE will also pay annual ground rent to the university. However, private equity investors usually do not provide a guaranty for project operations and long-term capital reinvestment. These are paid from repair and replacement fund reserves generated by project cash flows. Annual ground rent is also not guaranteed and is payable only from excess project revenues, meaning rent payments may be at risk if the project doesn't deliver the expected equity returns. When the ground lease ends, the university owns the project free and clear.

Advantages

- Private equity investors may require lower returns and have more flexible terms
- Less leverage than project-based debt alternatives
- Arm's length equity approach can result in advantageous balance sheet and credit outcomes
- Increased operations and management control for the university

Disadvantages

- Not a single-source partnership
- Private sector development partner does not control capital
- Potential misalignment of interests between the university and private sector development partner
- Development fees are charged
- Longer agreement term (50–85 years)
- Ground rent may be subordinate to developer or equity investor returns
- No full transfer of risk to development partner, and capital reinvestment is limited to funded reserves
- Private company ownership may trigger local property taxes
- Limitation on future competing developments (third-party demand study requirement)

> *"When universities are contemplating these kinds of public-private partnerships, they don't have to be these sort of anonymous things...they can be profoundly singular relationships where you really have a trusting relationship with your partner, and I've really found that at ACC."*
>
> *—John Fry, President, Drexel University*

Tax-exempt, Project-based Bonds

Under this structure, the university leases land to (or enters a service concession agreement with) an independent, bankruptcy remote SPE. The SPE must be a qualified 501(c)(3) nonprofit organization that supports the university's mission to provide affordable student housing. The nonprofit contracts a fee developer to design and build the project. The facility's ongoing operation, management, maintenance, repairs, and residence life programming are handled by a private management company, the university, or both depending on the school's preferences.

The nonprofit uses the annual project budget to pay annual fees to the management company and/or to pay the university for any operational services performed. The project budget also covers annual replacement reserves and payment of all debt service obligations while meeting the annual rate covenant. The university receives 100 percent of the project's net cash flow in the form of ground rent, as long as the project is in compliance with the covenant. Under this structure, the term of the underlying agreement is approximately 40–50 years with a bond amortization of between 30–40 years. The ground lease expires upon full debt repayment, and the university owns the property free and clear.

Advantages

- Shorter transaction term (30–40 years)
- Increased ground rent, as the university receives all net cash flows
- Exempt from federal, state and local income tax
- No property taxes
- Greatest level of economic, operational and management control for the university
- Lowest cost of capital
- No transfer, sales and excise taxes and/or fees

Disadvantages

- High leverage (+/-120% loan to cost) due to costs of issuance, capitalized interest and reserve funds
- Developer, manager, issuer and borrower fees are charged
- No full transfer of risk, and capital reinvestment is limited to funded reserves
- Feasibility and ground rent are subject to achieving 1.20x annual rate covenant
- Federal tax limitations on bond term, use of proceeds, costs of issuance, TEFRA and project use

ACC Case Study | University of California, Irvine

Since 2004, ACC has master planned and developed $585 million in apartment and townhome communities for UCI – including LEED-certified and net-zero energy communities – to transform it from a commuter school into a destination residential campus. The projects were financed using project-based, tax-exempt bonds, and each met the original pro forma, were completed on time and on budget, and achieved required debt coverage.

Taxable, Project-based Bonds

With this arrangement, the university leases land to (or enters into a service concession agreement with) an SPE that is either a qualified nonprofit or a new taxable entity created specifically for the proposed P3. The SPE issues taxable bonds to fund the project. From there, the project follows the same model as with a tax-exempt structure, although taxable bonds have some unique costs and variables to consider (see sidebar: Tax-exempt vs. Taxable Financing).

Advantages

- Shorter transaction term (30–40 years)
- No federal tax limitations on bond term, use of proceeds, costs of issuance, TEFRA and project use
- No issuer and qualified not-for-profit owner and related issuer and borrower fees
- Increased ground rent, as the university receives all net cash flows
- Potential for elimination of property taxes under concession agreement
- Greatest level of economic, operational and management control for the university

Disadvantages

- Higher cost of capital
- Private placement market fluctuates on market conditions
- Elimination of optional redemption features limiting refinancing optionality
- High leverage (+/-120% loan to cost) due to costs of issuance, capitalized interest and reserve funds
- Developer, management and borrower fees
- No full transfer of risk, and capital reinvestment is limited to funded reserves
- Feasibility and ground rent are subject to achieving 1.20x annual rate covenant

Tax-exempt vs. Taxable Financing

Tax-exempt financing has been the most common P3 structure over the past 15–20 years because investment-grade public offerings provide the most cost-effective form of capital and eliminate most taxes. Tax-exempt debt typically maximizes annual cash flows (ground rents or concession payments) and has the shortest possible final terms. Tax-exempt bond programs are more complicated than taxable financing because they involve more participants and must comply with federal tax laws.

Taxable bonds have a higher overall cost of capital than tax-exempt bonds, and that cost increase with the expansion and contraction of the market. However, current taxable-to-tax-exempt yield spreads are historically narrow, thereby reducing the cost impact. Because taxable bonds don't have to comply with the same tax laws as tax-exempt bonds, this can eliminate the 2 percent cost of issuance rule, 10 percent bad debt provisions and limitations on final maturity. In some cases, the taxable bond market does not provide traditional optional redemption features (i.e. optional call dates), potentially eliminating future flexibility to refinance. And unless structured properly, the use of for-profit taxable counterparties may also trigger local property taxes.

ACC Case Study | Prairie View A&M University

Over 23 years of partnership, ACC has revitalized PVAMU's campus through nine phases of development with nearly 5,000 beds. Some of its University College projects were financed through taxable bonds, and the community is managed by a joint ACC/PVAMU team.

BY-THE-NUMBERS COMPARISON

Transfer of Risk/ Responsibility	American Campus Equity[1]	Third-Party Equity[1]	Project-Based, Taxable Bonds[1]	Project-Based, Tax-Exempt Bonds
Subordination of Land	No	No	No	No
Ownership Entity of Improvements[1]	ACC-owned entity (SPE)	Equity Investor (SPE)	Third Party Entity (SPE)	Qualified 501(c)(3) (SPE)
Vested Parties/Decision Makers	ACC and University	Developer, equity provider/ lender (if any) and University	Developer, Lender and University	Developer, Lender and University
Transaction Character	100% owned, financed by ACC, sole source of return is the successful operation of asset	100% owned, financed by third party, ground rent may be subordinate to investor return	100% owned, financed by third party (taxable or T/E entity), project-based debt, private placement, no equity investment	100% owned, financed by third party (T/E entity), project-based debt, publicly offered, no equity investment
Ground Lease Term	45-year base term plus extensions (typically 3 to 4 10-year extensions)	50-85 years	30–40 years, terminates automatically upon full repayment of debt	30–40 years, terminates automatically upon full repayment of debt
Construction Loan	No	No	No	No
Permanent Loan Term	ACC does not place debt on project initially	Up to 30 years	30-40 years	30-40 years
Ground Rent/Cash Flow	FMV, set as a % of total gross revenues, base rent + % rent + outperform	FMV, set as a % of total gross revenues, minimum return to investor prior to rent	Ground Rent = % of net cash between Owner and University	G. Rent = 100% of net cash flow
Loan-to-Cost	As a publicly traded REIT, ACC does not utilize project-level debt, must retain ability to leverage leasehold, maximum LTV < 70%	100% initial equity investment, must retain ability to leverage leasehold, maximum LTV < 75%	+100%	+100%
Finance Costs	No DSRF, construction period interest, 0.5% COI	No DSRF, construction period interest, 1% COI	100% MADS DSR, CAPI for construction period plus 6 months, 1.5% COI	100% MADS DSR, CAPI for construction period plus 6 months, 2% COI
Developer Fees	None	Yes	Yes	Yes
Management Fees	2.5% of revenue	3-4% of total revenue market management fee	3-4% of total revenue market management fee	3-4% of total revenue market management fee
University Commitment	· Marketing assistance at no cost to University (to be negotiated) · Commitment not to overbuild the student housing market	· Marketing assistance at no cost to University (to be negotiated) · Request for ROFR on future projects · Commitment not to overbuild the student housing market	· Obligation to operate the project as part of its on-campus housing stock, on par with its other student housing facilities · Marketing assistance · Commitment not to overbuild the student housing market	· Obligation to operate the project as part of its on-campus housing stock, on par with other student housing facilities · Marketing assistance · Commitment not to overbuild the student housing market

Continued on next page.

Transfer of Risk/ Responsibility	American Campus Equity[1]	Third-Party Equity[1]	Project-Based, Taxable Bonds[1]	Project-Based, Tax-Exempt Bonds
Feasibility Test	Targeted going-in yield of 6.5-7.0% on final development cost (IRR 9-plus percent)	7-8.0% as set by Third-Party Equity Investor	1.20x debt coverage ratio	1.20x debt service coverage
Replacement Reserves	Owner required to maintain building to certain standard regardless of cost	$175/bed/year, escalating at 3 percent annually	$175/bed/year, escalating at 3 percent annually	$175/bed/year, escalating at 3 percent annually
University Purchase Option	At any time after two years through a negotiated formula taking into account current FMV and owner's required minimum return	TBD by Third-Party Equity Investor, plus full payoff of all debt including any prepayment penalties	At any time for the full payoff of all debt including any prepayment penalties	At any time for the full payoff of all debt including any prepayment penalties
Permanent Financing	Yes	Yes	Yes	Yes
Property Taxes[1]	Yes	Yes	Yes, if SPE is taxable entity/ No, if SPE is nonprofit	No
Prevailing Wage	No	No	No	No
Mixed-use Retail Ability	Yes	Yes	Limited	Limited
Option for Subordinated Utilities	N/A	N/A	Yes	Yes
University Balance Sheet Treatment	Off balance sheet	Off balance sheet	Off balance sheet	Off balance sheet
Impact to Debt Capacity	None (based on periodic review)	Limited (based on periodic review)	Limited (based on periodic review)	Limited (based on periodic review)
University Credit Impact	None (no outstanding debt), positive upon stabilization at proforma	Initially neutral, positive upon stabilization at pro forma	Initially neutral, positive upon stabilization at pro forma	Initially neutral, positive upon stabilization at pro forma

1 If structure is undertaken via long-term concession agreement, ownership resides with the university and thus property taxes may be avoided.

Greek Leadership Village | Arizona State University

Greek Leadership Village | Arizona State University

LONG-TERM GROUND LEASES VS. SERVICE CONCESSION AGREEMENTS

The majority of student housing P3 projects employ long-term ground leases, which involve the university leasing land to a private entity and then collecting rent. Ground lease-based transactions are well-received by both equity and bond investors. However, in areas where state and local laws governing ground leases and/or local property and transfer taxes have proven difficult to navigate, some universities opt for service concession agreements (SCA) instead.

SCAs are not a new legal concept, as they have been used for decades in other P3 sectors such as food service, beverage agreements, surface transportation and other public infrastructure projects. Under a student housing SCA, the university grants an SPE (the "concessionaire") the exclusive right to operate all of its housing for a specified period of time (usually 40–50 years). This means the concessionaire will design and construct new housing; renovate and repair existing facilities; and manage, operate and maintain the facilities over the lifetime of the agreement. The concessionaire invests equity or raises outside capital to fund these activities.

The third-party capital investment is used to pay off any debt on existing facilities, build and/or renovate projects, and establish a reserve fund. The agreement gives the concessionaire the right to receive and own all gross revenues generated by the project. These pay for operations, repair and maintenance; capital reserves; and debt service and fees. Once those costs are covered, remaining revenues will go into a facility reinvestment fund and back to the university in the form of an annual concession payment.

64%

OF GROUND LEASES ARE AT LEAST 40 YEARS IN LENGTH[4]

Because an SCA is a transfer of operational control rather than a transfer of real estate, the university will own the land and project improvements for the full term of the agreement. This means the structure may avoid property taxes, transfer taxes and sales/excise taxes. And in some cases, the elimination of a ground lease entirely negates state provisions with regard to agreement term (i.e. certain restrictions with respect to ground lease term [40 years] may be eliminated in favor of a longer-term SCA [+50 years].

ABOUT AMERICAN CAMPUS COMMUNITIES

American Campus Communities is the largest owner, manager and developer of high-quality student housing communities in the United States. The company is a real estate investment trust (REIT) with expertise in the design, finance, development, construction management and operational management of student housing properties.

ACC owns 171 student housing properties containing approximately 109,400 beds. Including its owned and third-party managed properties, ACC's total managed portfolio consists of 205 properties with approximately 133,700 beds.

A Partner for Any Transaction Type

ACC has closed $5 billion in on-campus financing structures of virtually all types, including its American Campus Equity program, project-based taxable and tax-exempt (senior and subordinate) bonds, equity-based partnerships, conventional construction borrowing and long-term permanent commercial lending via conventional leasehold mortgages, and university general obligation or general receipts revenue bonds. The company is uniquely qualified to help colleges and universities objectively evaluate their financing options using current market information and choose the right solution for their needs.

For More Information

To learn more about ACC's financing solutions and experience, visit **AmericanCampus.com/for-universities/financing**.
To speak with an expert, contact **P3@AmericanCampus.com**.

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