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The outlook for P3s in higher education

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WASHINGTON -- Demand for public-private partnerships in higher education is on the rise, particularly for student housing and parking, according to a report issued Monday by Fitch Ratings.

“Public-private partnership (P3s) financings are a potentially suitable option for student housing, parking, energy, and other auxiliary assets,” Fitch said, adding, P3s “provide a more efficient procurement and delivery process, transfer of risk, and preserve balance sheet debt capacity.”

On the cautionary side, Fitch said the number of high school graduates is expected to plateau over the next decade and has already begun to decline in the Midwest and Northeast.

“As a proxy, revenue risk associated with a university project is likely to fall between established transportation assets, such as airports or toll roads with a proven history and with lower revenue risk, and greenfield transportation assets, such as toll roads with higher revenue risk,” Fitch said.

“However, the benefit of a captive market, such as students, and framework agreements with inherent protections are comparable in some respects to an airport with an established customer base and airline agreements,’’ the report said.

Justin Cooper, co-chair of the public finance department at Orrick Herrington & Sutcliffe, said in an interview Monday that higher education P3s are “among a relatively small number of growth areas right now in our practice.”

“Anything that is revenue producing is going to be a candidate for alternate procurement or financing,” Cooper said.

He listed student housing, health care buildings, continuing education facilities, parking and student union buildings that might include a bookstore, café or any other student hangout.

Moody’s Investors Service issued a report in August 2016 highlighting how P3s are being used as alternative capital financing and procurement strategies for universities globally.

A more recent Moody's report on privatized college student housing issued in May said the rating agency expects the sector to hold steady because of solid real estate fundamentals and marginally improving financial performance.

Dennis Gephardt, vice president and senior credit analyst at Moody’s, said in an interview Monday that his credit agency’s general assessment of higher education P3s hasn’t changed.

“It is slow moving news, but is news,” Gephardt said. “There is an evolving interest in the sector in part because the capital needs are so great. There’s aging infrastructure and sometimes a need to improve the assets that are there. So I think our base case is that it will increase.”

A year ago a P3 bond-financed student housing project at Texas A&M University's flagship campus in College Station received widespread publicity because the 3,306-bed apartment complex opened with low occupancy rates under 60%.

Moody’s Investors Service lowered its rating of the bonds below investment grade in October to Ba1 from Baa3.

The complex, known as Park West, was financed with bonds issued in 2015 through New Hope Cultural Education Facilities Finance Corp.

This semester the occupancy rates at the Park West student housing complex at Texas A&M has occupancy rate in the 95% range, but Moody’s analysts say the project is still struggling financially.

“While it looks like occupancy has rebounded, it’s at much lower rents than what the project was underwritten to,” Susan Fitzgerald, associate managing director at Moody’s said Monday.

Fitch has not rated the Texas A&M student housing project, but cited it in its new report as a cautionary tale.

“Reasons for the low leasing rates and poor initial occupancies, per an investor call in late 2017, were identified as location challenges, excess supply in the local student housing market, premium pricing and limited marketing cooperation with the university," Fitch said. "All these circumstances demonstrate the clear risks present in the development of private student housing projects, even those at universities with very strong demand profiles."

On an upbeat note, the Fitch report cited an early 2000s student housing project at the University of Tennessee at Chattanooga that it rates as BBB with a stable rating outlook. The student housing revenue bonds were issued and loaned to Campus Development Foundation Inc. to build both housing units and associated parking.

Fitch said CDFI "has the ability to withstand relatively severe stresses to bed occupancies to meet all cash flow requirements."