WHEN IS INFRASTRUCTURE REAL ESTATE?

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Universities looking to enter into P3 transactions with private partners to monetize existing facilities or as part of a strategy to finance capital improvement plans may be surprised to learn, on occasion, that their proposals don't qualify as infrastructure from their investors' perspectives.

Typical university P3 proposals seek to "unlock" private capital and relevant expertise to build or improve essential but non-core facilities on their campuses, including utility or power systems, energy efficiency refurbishments, dormitories, lab and office space. However, the difference between attracting a real estate or infrastructure private partner depends on the essentiality of the asset, term of a concession agreement, level of market risk allocated to the private partner and alignment of financial incentives and responsibilities between the university and the private partner.

As they evaluate their financing requirements, universities may be able to use infrastructure investors as an effective partner for their capital planning and strategic goals with an acceptable partnership structure in place.

For certain projects, infrastructure funds look to have a long-term lease or concession (over 30 years) with flexibility in ownership over time as the project continues to de-risk. Additionally, infrastructure investors prefer projects that have limited market risk and a creditworthy counterparty or off-taker that can provide a level of certainty of payment over the entirety of the lease or concession. For an infrastructure investor, the contemplated project should be essential to the university and its strategic plan, which in turn creates further financial alignment between the university and the private partners.

When a university project has a shorter-term agreement, outsized market risk placed on private partner and less economic alignment between the university and the private partner, the deal becomes much more similar to a real estate investment where there is more inherent risk to the private partner in exchange for a much higher return in a shorter time frame.

Some university projects, such as management of administrative services, student residences or retail in a commercial area that are non-core services to the university, may not meet an infrastructure investor's investment criteria given relevant market risk. As an example, a project to build a new campus laboratory building, half of which is leased long-term to the university and half of which is leased to private companies needing lab space on shorter term leases, presents two very different risk profiles for the investor, and the market risk associated with leasing up the private half of the building could make the project out-of-scope for typical infrastructure funds.

Structuring a project to satisfy an infrastructure fund's criteria can have tangible benefits to the university. P3s have resulted in a sizable upfront cash payment, a possibility that is increasingly attractive to cash-strapped institutions, to fund critical initiatives, affinity education programs, and near-term core capital plan priorities, while allowing for a level of budget certainty in future years. CapEx risk can be transferred to the P3 partner and university resources can be devoted more to educational mission. Additionally, the private partner may bring valuable technology and innovation to its partnership with a university, creating intrinsic value to all parties involved.

For example, the Ohio State University (OSU) entered into a 50-year comprehensive energy management concession agreement and lease with Ohio State Energy Partners (OSEP), a consortium led by Engie North America and Axium Infrastructure. The partnership was structured such that OSU obtained about $1bn in upfront proceeds to fund its initiatives, an additional $150m for direct spending on university priorities and an estimated $250m in sustainability improvements to reduce OSU's energy use by 25% in 10 years, while OSEP received fixed and variable revenue streams from OSU. This partnership allowed OSU to receive significant proceeds towards priorities as laid out in its strategic plan without drawing any additional capital. Additionally, the partnership improved the university's sustainability efforts and academic environment.

Other universities seek private capital to address significant deferred major maintenance or solve energy efficiency goals as evidenced by Fresno State central utility plant project and Purdue University student housing project.

What these types of successful transactions for infrastructure funds and universities have in common are incentive structures and risk allocation alignments between all parties including any third-party service providers or construction contractors. For this reason, infrastructure funds can consider transactions with private institutions which, while not public infrastructure, can offer a risk allocation and deal term that resembles a government-sponsored project.

With public universities' projects, the relevant municipality's credit rating and associated appropriation risk plays a large part in the evaluation of the risk profile and stability of a project for an infrastructure fund. For a private university, the risk profile would be more idiosyncratic to the university itself. Thus, an infrastructure investor would seek to work with a private university that is likely to continue to be a leading institution with a strong standalone financial profile. Private universities also may be restricted by their endowment fund investment criteria.

Depending on the project and associated risk profile and economics, universities may be able to partner with real estate or infrastructure investors. An infrastructure investor approach may be a better fit for a project especially as a university seeks to be a stakeholder in long-term partnership. To tap into the infrastructure investor market specifically, universities should focus on projects that are essential to the university and structure a long-term agreement with acceptable market risk dispersion and financial alignment between the university and the private partner. P3

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