Financing Considerations Associated with the Monetization of Higher Education Assets – An Alternative Capital Source

Higher Education Sector Trends: The credit profile of the higher education sector has stabilized after several challenging years that left participants in weaker financial positions but a number of issues still exist and will continue to impact institutions:

- Balance sheets have weakened as a result of swings in the equity market – investment and fund raising income down
- More pressure today on tuition revenue increases
- Inconsistent growth in student demand, state subsidies and market pricing power
- Operating margins have declined due to inability to improve "top line" and contain certain expenses
- Rapid inflation of employee benefits and other costs
- Continued pressure to invest in and expand facilities

Credit Rating Trends: After a record high proportion of downgrades in 2003, the sector recovered in 2004 – particularly among public institutions.

- Capital needs, combined with low interest rates and relative credit stability, have driven significant debt issuance

Capital Implications: The only certainty – capital needs will continue to outpace increases in operating profits.

- Debt issuance is outpacing growth in debt capacity
- The degree to which higher educational institutions have access to capital will separate further the "haves" from the "have nots"
- Weaker institutions will be unable to:
    - Replace aging facilities and equipment
    - Fund IT and technology upgrades
    - Retain market share
    - Generate sufficient operating income
    - Improve balance sheets and capital access

Debt Market Trends: The need for capital has driven the volume of higher education bond issuance to all time highs, despite weaker financial positions among many participants. In 2004 700+ issues were offered for a total of $25 billion in new bond debt in the market. Approximately 90% of these issues have been insured.

Implications for Future Capital Access: As the need to invest continues to grow, it becomes imperative to consider creative financing strategies and alternative sources of capital.

- Current trends are leading more institutions to focus on strategic capital planning processes that coincide with:
    - More careful articulation of "business" and market strategy
    - More vigilant management of operations and balance sheets
    - Prioritization of capital requirements and more disciplined approach to investment decisions
    - Comparison of asset deployment versus financial performance
    - Evaluation of re-allocation and monetization opportunities

Asset Monetization Opportunities: Monetization of facilities is proceeding at an increasing rate due to:

- The presence of equally motivated buyers and sellers, and the perceived stability of the education sector
- Real estate monetization has been the focus in areas listed as follows:
    - Student housing
    - Hotels
    - Senior and alumni housing
    - Office space
    - Raw land
    - Central utility plants
    - Parking facilities
    - Arenas, conference centers, and student activity centers
    - Health facilities

Reasons to Monetize Higher Education Real Estate Assets: Organizations pursue real estate monetization to satisfy a variety of – and often – multiple objectives:

- Redeploy capital
- Reduce debt and improve liquidity
- Reduce depreciation/increase profitability
- Improve financial ratios and credit position
- Eliminate real estate risk
- Enable management to focus on core operations
- Comply with regulatory issues (Boiler Mact)
- Gain expert management and development
- Address deferred maintenance, modernization, and sustainability issues

Reasons for Interest on Behalf of Buyers: Education properties are particularly attractive as they are viewed as relatively stable properties;

- Depending on the purchase price and interest rates, buyers can lock in returns on certain portions of their portfolios with the upside potential of appreciation in their real estate holdings
- Education properties offer diversification to investor portfolios
- The opportunity exists to establish a working alliance for future development opportunities around campus perimeters

The Buyers: Competition will increase among the variety of investors listed as follows:

- Public and private REITS
- Private property owners and developers
- Local and regional investors
- “Net lease” buyers
- Parking garage owners
- Pension funds and insurance companies

Transaction Structures: Innovative transaction structures enable higher educational institutions to retain strategic control of the assets;

- Outright sale
- Sale with ground lease
- Sale/leaseback

- Sale/partial leaseback with ground lease
- Sale with master leaseback with ground lease
- Joint venture

Transaction Considerations: Objectives among the parties should include the following:

- Maximize the cash purchase price
- Maintain significant control over the monetized asset
    - Approve occupants and uses
    - Retain the right to lease space, replace management, and repurchase the assets
    - Develop cooperate relationship with the new owner

New Facility Development: Developers are eager, in conjunction with higher educational institutions to participant in the design/build/finance process to ensure that new facilities are the core to their continued success. These projects, similar to transactions involving existing facilities, can be structured to provide significant ongoing control to the institution and may be off-balance sheet.

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