Current Issues for Higher Education Real Estate Lawyers

BY PAUL C. BAUER • NOVEMBER 9, 2017

The 15th Annual Higher Education Real Estate Lawyers conference was held in San Francisco, where attendees listened to and learned from both in-house and outside counsel at colleges and universities on the following topics.

Real Estate Tax Exemption – The Princeton Case.

(Hannah Ross General Counsel [Middlebury College], formerly University Attorney at Princeton University).

Princeton University recently settled litigation in which residents of the Town of Princeton, New Jersey challenged the University's property tax exemption for its campus alleging that notwithstanding Princeton's 501(c)(3) status, it was not a qualified tax exempt entity because it engaged in commercial and/or profit seeking and profit driven conduct and distribution of profits. This claim was brought in 2011 against both Princeton and the taxing municipality and alleged that Princeton's distribution of "tens of millions of dollars in profit" in patent royalties to faculty, "operation of a venture capital and joint venture business to commercialize technologies," its other "commercial and/or profit seeking conduct" including retail business operations, printing operations, retail restaurant operation, and "commercial, profit driven hedge fund operation and catering."

The case was presented before the Tax Court of New Jersey. On the University's motion to determine the burden of proof, the Court concluded that although there is a presumption of validity afforded for an assessor's original tax assessment, the burden is on the University benefiting from the exemption to establish that it is entitled to the exemption under State law.

Following that decision, the parties settled.

It is quite likely that these cases will continue to arise due to stress on municipal and individual budgets. Colleges and universities should evaluate their risk and implement a strategy to clearly establish that the properties owned by the organization are used for exemption-qualifying purposes. To some degree, this may require a strategy on a property-by-property basis and implementing a facilities use policy for outside users related to the mission of the institution. Colleges and universities should further use care in documenting voluntary payments and contributions made to the municipality, create a community contributions report and communicate about those contributions on a regular and consistent basis, and monitor the structuring royalties distribution programs and agreements.

Managing Fraternity Real Estate – Legal, Risk Management and Property Management Challenges.

(Roman Petyk, [UPenn OGC] and Edwin D. Datz [UPenn Director of Real Estate]).

At most colleges and universities, the fraternity housing system evolved gradually and largely outside the school. Many schools took the position on the basis that it was best to leave control in the fraternity system. A series of tragedies that led to school liability has led many colleges and universities to examine the issue with respect to property condition and maintenance issues.

For tax reasons, many fraternity houses are now owned by colleges and universities. But where control remains with the fraternity, spotty compliance with building code and higher school building standards can result. Taking control of the houses can create conflict with the fraternities, but if it is part of a larger portfolio management program, it should result in more uniform, code-compliant houses within the university system.

Opportunities and Risks of Design-Build Project Delivery.

(Michael A. Schollaert and Paul Sugar, Baker, Donelson, Baltimore Maryland).

Design-Build is increasingly popular for institutional projects, with the purpose of expediting projects with a reduction in cost. Design-Build benefits also include having a single point of responsibility and liability, potentially stronger negotiated guarantees for the overall success of the design and construction, reduction in change orders, and early knowledge of costs. Design-build may be best used in conventional and perhaps more functional projects with definable criteria, as opposed to singular, define-the-campus projects. Owners must, however, overcome the limited owner control in a design-build arrangement by contractual provisions to add back owner protections, and are advised to have well developed program criteria and concept plans in place. They should also have their own independent expertise to watch out for the Owner's interest, with an independent or in-house owner's representative.

Structuring Campus Infrastructure Investments to Maximize Institutional Flexibility.

(Bruce Baker and Michael J. Cooney [Nixon Peabod]), Kevin Wayer [JLL], Mark Meredith [U. of California], and Janet L. Holmgren [President Emerita, Mills College]).

The panel discussed challenges faced by institutions to program, design, finance and build campus projects and infrastructure and related issues including the prominent role of campus real estate in strategic planning.

The panel discussed the 2016 Sightlines report, *The State of Facilities in Higher Education*. The report details the pressure on existing facilities that arise from flat or falling enrollment, aging facilities, and capital investment that lag maintenance and renewal need. The report advises that more capital is needed to address facility needs, but that in its absence, schools are addressing facility aging through several strategies, including lowering capital and operational demands, making the problem "smaller" for decision-makers, making the most of capital funding, and managing operational resources more effectively.

The case studies for these strategies present interesting ways in which schools are addressing aging facilities. While the fact that smart and creative people are finding ways to make do with less is not earth-shaking, the particular strategies are nonetheless worthy of review.

Mark Meredith, Senior Counsel of the University of California presented a case study of the unique University of California Merced expansion. This major project to increase the enrollment from 3,400 to 10,400 students calls for 1.2 million new gross square feet, will cost $1.3 billion, and will be constructed in three phases between 2016 and 2020.

To meet these time and budget requirements, the University is using a public private partnership with a complex funding and legal structure. This includes a long term relationship with the developer having responsibility for property management, resulting in a total project contract period of 39 years. The University has extensively relied on performance standards rather than specific design criteria for procurement. While elements of this project may well be of use in smaller scale projects, this specific structure is best suited to a major public works project on a greenfield site, with compressed delivery and cost requirements. While this project will be an extraordinary accomplishment, it comes with significant loss-of-control cost.

Section 179D – Energy Efficiency Tax Credits.

(Tiffany Melchers [U. of Houston], William Volker [Efficiency Energy]).

The final session was a lively discussion of energy efficiency tax credits under Section 179D of the I.R.C. These are a one-time tax credit available for energy efficiency renovation or new construction projects in commercial buildings. The tax credit covers interior lighting, HVAC/hot water, and building envelope improvements on buildings owned by commercial and public entities that must be taken in the year the project is placed in service. (These credits are not currently available to non-profits but this omission may be corrected when, and if, the program is extended.) Importantly, governmental owners may allocate the credits to a tax-paying third party "designer." Thus, by using these credits on applicable projects, the public entity may reduce bid prices and overall costs. Eligible entities may find it useful to hire a 179D Coordinator to look at current and past projects, as there is a three-year look back period for projects completed 2013 – 2016 to recover credits that have not been taken.

Just as importantly: the public institution or entity should look out for instances where a project manager or other person may be signing allocation letters (for current or past projects) without realizing that a third party is soliciting the entire allocation in the name of the designer, without the school actually being aware of the true nature of the document signed and without the school obtaining any benefit from the tax credits. There are numerous instances of this occurring, and it is incumbent on counsel to review any prior allocation letters that may have been signed without knowledge of the foregone tax allocation. It is also obligatory of counsel to institute procedures to prevent unauthorized allocations in the future and to recognize the availability of the tax credit on upcoming projects.

The tax credit is available for projects that were put into service by December 31, 2016, although it has been extended four times in the past and Congress may extend the tax credit through 2019. There is a possibility that an expansion will extend the credit so that nonprofit independent institutions may have the right to allocate the credit as public entities are able to do under the current law.