

**Analyzing the Alignment of Incentives, Control, and Economics in Development
Agreements between Private Developers and Mission-Driven Institutions**

by

F. Samuel Reiche

**B.A. Economics, 2007
Trinity College**

**Submitted to the Center for Real Estate in Partial Fulfillment of the Requirements for the Degree of
Master of Science in Real Estate Development**

at the

Massachusetts Institute of Technology

September 2013

**©2013 F. Samuel Reiche
All rights reserved**

The author hereby grants to MIT permission to reproduce and to distribute publicly paper
and electronic copies of this thesis document in whole or in part in any medium now
known or hereafter created.

Signature of Author _____

**Center for Real Estate
August 1, 2013**

Certified by _____

**Peter Roth
Lecturer, Center for Real Estate
Thesis Supervisor**

Accepted by _____

**David Geltner
Chair, MSRED Committee, Interdepartmental Degree
Program in Real Estate Development**

Analyzing the Alignment of Incentives, Control, and Economics in Development Agreements between Private Developers and Mission-Driven Institutions

by

F. Samuel Reiche

Submitted to the Center for Real Estate on August 1, 2013 in Partial Fulfillment of the Requirements for the Degree of Master of Science in Real Estate Development

ABSTRACT

This thesis examines and analyzes the alignment of incentives, project control, and economics in development agreements between private developers and mission-driven institutions. Mission-driven institutions, such as churches, hospitals and universities, need to compete in their relative industries, and must leverage real estate assets as effectively as possible. In many cases, the best opportunities for underutilized institutional real estate is in the private market.

In order to develop institutional real estate for the private market, institutions can partner with private development firms to utilize their knowledge and experience to maximize efficiency through complex development processes and create the best possible product for a given marketplace.

This paper reviews existing literature on the topic of institutional-private development partnerships, then explains and analyzes two case studies: The Charles Street Jail, and a Market Rate Student Housing Project. The case studies act as real examples, and are used to examine the issues that can arise due to differences in incentives between private developers and mission-driven institutions, as well as possible ways that organizations can approach such concerns to mitigate associated risks.

Thesis Supervisor: Peter Roth
Title: Lecturer, Center for Real Estate

TABLE OF CONTENTS

Chapter 1: Introduction	7
1.1 Why do Mission-Driven Institutions Develop	8
1.2 Ground Leases	10
1.3 Opportunities and Challenges in Private Partnerships	11
1.4 Thesis Intent	13
Chapter 2: Methodology	14
2.1 Definitions	14
2.2 Review of Existing Research	14
2.3 Identification of Representative Projects	16
2.4 Approach to Case Studies	18
Chapter 3: Charles Street Jail Case Study	20
3.1 Background	20
3.2 Stakeholders and Their Incentives	29
3.3 Deal Structure	32
3.4 Development Concerns	33
3.5 Case Conclusion	39
Chapter 4: Market Rate Student Housing Case Study	41
4.1 Background	41
4.2 Stakeholders and Their Incentives	43
4.3 Deal Structure	46
4.4 Development Concerns	47
4.5 Case Conclusion	53
Chapter 5: Case Study Analysis	55
5.1 Stakeholders and Their Incentives	55
5.2 Deal Structure	57
5.3 Development Concerns	58
Chapter 6: Conclusion	61
Bibliography	65
Appendices	67

Chapter 1: Introduction

Mission-driven institutions, including churches, hospitals and universities, have been rooted in urban centers as long as cities have existed. As cities have developed around these institutions, demand for land has increased, and property values have adjusted accordingly. These changing market forces have resulted in both challenges and opportunities for urban institutions, and these organizations are being forced to rethink the use and management of their real estate assets.

The location of some institutions, such as the Cambridge setting of Massachusetts Institute of Technology (MIT), was historically considered less desirable than other Boston locations, such as historic Beacon Hill, Back Bay and Downtown. In fact, MIT moved to its Cambridge location in 1916, because there was no more room for expansion in the original Boston building. The new campus location was not ideal, as it was on top of fill from the Charles River and subway excavations, but the school took on the extra construction costs of installing 22,000 piles so that it could remain stable into the future¹.

Over time, many institutions defensively purchased abutting properties to control the environment and security of their campuses. Many surrounding areas were gentrified, and today some institutions are finding great opportunities to advance their mission financially and otherwise through development of that real estate. MIT has harnessed the

¹ Marchione, William P., *The Charles: A River Transformed*. (Charlestown, SC: Arcadia Publishing, 1998), 71.

opportunities of expanding its mission to “advance knowledge and educate students in science, technology, and other areas of scholarship”², by facilitating and encouraging development of nearby Kendall Square. Today the businesses located in Kendall Square are largely technology companies; which benefit, and benefit from, their academic neighbor. This development encourages advancement of the Institution’s academic mission, and also increases cash flow, which will ultimately ensure the organizations’ sustainability into the future.

A question stands of how such institutions can effectively approach managing their real estate assets, while maintaining focus on their mission. It is important they continue to advance their priorities as needed, and also remain focused on their mission in the public eye, rather than beginning to appear as a for-profit developer. A common solution is to partner with a private developer, who has the market expertise and skills to efficiently execute a development project. Through various legal structures, institutions can leverage their real estate holdings for mission-supporting revenues, and also allow for future growth within the organization.

1.1 Why do Mission-Driven Institutions Develop?

Whether a university, hospital, or religious organization; all urban non-profit institutions are competing with other organizations in their industry and must work to attract the desired audience. The facilities and overall environment on a campus, or within a building,

² Massachusetts Institute of Technology, 2001. <http://web.mit.edu/mission.html>.

can have a strong impact on peoples' impressions and must be considered when trying to maintain or grow the user base. These institutions must continually renovate outdated space, maintain existing buildings, and build new spaces to adapt for future uses and anticipated growth³.

In addition to developing for their own needs, mission-driven institutions should also consider developing for the needs of their neighbors. A study on universities as urban developers states that, "the institutional health of an urban university is inextricably bound to the health of its surrounding community"⁴. By entering the private market, and properly developing complementary uses within or around a campus, urban institutions can improve their immediate environment, and thus the appeal of the environment *and* their institution. Residential, retail, restaurants, hotels, and office/R&D can all be highly synergistic with institutional uses, and can also offer revenue sources for the non-profit organizations. While profit generation is not the primary goal of the educational or healthcare mission of an organization, increasing the value of and cash flow from its endowment and investment portfolio is an important part of an institution's overall management, and revenues can assist in maintaining existing buildings and grounds, supporting faculty and research, or added to its endowment for long term institutional sustainability. Additionally, by properly developing real estate for leasing purposes, institutions can give themselves the option of expanding into the created spaces as growth may occur in the future.

³ Educational Facilities Laboratory, *Campus in Transition*. (New York, NY: Educational Facilities Laboratory, 1975), 38.

⁴ David C. Perry, Wim Wiewel, *The University as Urban Developer: Case Studies and Analysis*. (New York, NY: M.E. Sharpe, 2005), 13.

As mentioned above, a third reason for institutions to develop is for revenue generation. Although mission-driven institutions are not built around revenue generation, they do have an underlying profit motive and they tend to act accordingly. As previously discussed, cash flow can assist with facility maintenance and future sustainability. Since such institutions usually do not specialize in real estate development, or the surrounding private markets, it can be highly beneficial for them to partner with a private developer who has the proper experience and motivation for a successful project. A common way to structure such a partnership is through a ground lease.

1.2 Ground Leases

In a traditional ground lease, the landowner leases a piece of property to a developer for a period of time that is between 50 and 99 years. Ground leases require long time horizons because large amounts of capital are often invested in the properties so that the developer can make a profit. The length of time allows for sufficient amortization of debt for any improvements to a property, including the construction of new buildings and facilities⁵, and an adequate return on the developer's investment. The involvement of the landowner in ground lease development and operations can vary, but in general the landowners act as a silent partner and are not especially concerned with the projects to take place. This is especially true in the private market, and less common with institutional landowners.

⁵ Dale-Johnson, David, "Long Term Ground Leases, the Redevelopment Option and Contract Incentives" (University of Southern California, 2000), 5.

When considering private market development, the ground lease can appear to be a particularly favorable option for institutional owners, because the structure allows institutional resources to remain focused on the organization's mission.

1.3 Opportunities and Challenges in Private Partnerships

There are several reasons for a mission-driven institution to partner with a private developer, and with each of these opportunities also comes some notable challenges. First, a private developer can increase the efficiency by which a development is planned and executed, simply through the introduction of private market forces⁶. Since private developers are generally motivated by profit, they have more pressure to make quick decisions, and negotiate more thoroughly. In a past thesis, called "Analyzing the Private Development Model for University Real Estate Development", two laboratory development projects at the University of Pennsylvania were compared; one managed internally and one through a partnership with Forest City. The hard costs of the project developed by Forest city were 24% less than those of the internally developed project⁷. This is a great example of how the experience of a private developer can reduce costs and increase efficiencies.

Second, if the proposed project is for a non-institutional use, a private developer is likely to have more experience with financing, constructing, leasing and managing that type of real

⁶ James F. Gerrity, "Analyzing the Private Development Model for University Real Estate Development" (MSRED Thesis, Massachusetts Institute of Technology, 2009), 72.

⁷ James F. Gerrity, "Analyzing the Private Development Model for University Real Estate Development" (MSRED Thesis, Massachusetts Institute of Technology, 2009), 74.

estate⁸. For example, if a religious organization wishes to build a hotel they will likely get a better product and a more successful outcome if they team up with a developer that specializes in hotels. This presents a clear opportunity to maximize the efficiency of constructing and operating such a property. On the same note, if the project being developed is something unique to the institutional arena, such as an iconic lecture hall, then development may be more successful if managed internally. A partnership could still be beneficial, but a development-for-fee arrangement would likely be most effective, rather than a joint venture approach.

Further, private developers generally have much shorter time horizons for ownership than institutions, and so their specifications can vary more widely⁹. In the short term institutions may want private sector real estate products, but may also need flexibility to use the space for their own occupancy in the future.

Third, many large institutions would prefer to minimize direct representation of large development projects, especially those that are proposed outside their existing "campus" boundaries, as they often encounter controversy with the community. By partnering with a private developer, institutions have more ability to expand into surrounding neighborhoods in the future, and they may also minimize the number of concessions the community may demand in return for project approvals. Though the private developer experience is valuable in these situations, institutions must also set clear guidelines with

⁸ James F. Gerrity, "Analyzing the Private Development Model for University Real Estate Development" (MSRED Thesis, Massachusetts Institute of Technology, 2009), 76.

⁹ James F. Gerrity, "Analyzing the Private Development Model for University Real Estate Development" (MSRED Thesis, Massachusetts Institute of Technology, 2009), 75.

representatives to make sure their true intentions and community initiatives are in fact being presented properly. The institutions do not want to give the community an opportunity to take advantage of them, but should also want to maintain good relations¹⁰.

There are many synergies and efficiencies that can be found in an institutional-private development partnership, but the parties involved need to make sure they are in sync with regards to control of the project and the ultimate goals of the development. Non-profit and for-profit organizations have different priorities, timelines and community expectations, and it is crucial that a project works to maximize the outcome for both parties.

1.4 Thesis Intent:

It is clear that mission-driven institutions need to develop real estate to stay competitive, and that there is opportunity in doing so through partnerships with private companies. Through the following methodology, this thesis intends to examine some possible answers to the following questions, through two case studies.

1. What are examples of successful partnership structures, which have developed private market properties on institutional land?
2. What do these stakeholders look like, and how are their incentives aligned?
3. How are these deals structured?
4. What concerns arise during negotiations and project development for each party in these partnerships?

¹⁰ James F. Gerrity, "Analyzing the Private Development Model for University Real Estate Development" (MSRED Thesis, Massachusetts Institute of Technology, 2009), 74.

Chapter 2: Methodology

2.1 Definitions

As previously identified, the goal of this thesis is to analyze the alignment of incentives, project control, and project economics in institutional-private real estate development agreements. For the purpose of this paper, the term *mission-driven institution* is intended to include tax-exempt organizations that have a mission prioritized above any economic motivations. Within this definition, this paper will limit its examination to churches, universities and hospitals within urban environments.

Again, for the purpose of this paper, the term *development agreements* is intended to include real estate joint venture agreements, ground lease agreements, or other land disposition agreements between mission-driven institutions and private developers. Through this examination, the author hopes to introduce concepts that may be beneficial in crafting such agreements in the future.

2.2 Review of Existing Research

The author is unaware of any literature that has examined the alignment of incentives and issues of control in institutional-private development agreements. However, there are many related subjects that have been researched and are incorporated and addressed in this paper, particularly in the introduction section above.

An MIT Center for Real Estate thesis entitled, “Analyzing the Private Development Model for University Real Estate”, by James F. Gerrity in 2009, compares the financial, design, and construction metrics used by private and university developments to determine where private market practices can improve upon the university model. Gerrity’s paper is helpful in laying groundwork for this thesis, as it focuses on the development process of each type of organization. In contrast, this paper will examine the deal characteristics, and the motivations of such parties attempting to craft successful joint venture partnerships.

Substantial literature exists on university real estate development, and the partnerships that can beneficially occur with surrounding communities. Of the literature found, “The University as Urban Developer”, by Perry and Wiewel is most helpful. This book is a collection of university development case studies, to be used in researching the impacts of such development on institutions and their surrounding environments.

Several books and journal articles have also been reviewed, which examine the benefits and challenges of partnerships between Universities and the private sector in business. This category of reference material is of particular interest, as it addresses many of the same mission versus profit-motive challenges that this paper will discuss, though many of these pieces focus on businesses in the technology and research fields; not real estate. Because so many private businesses, and their underlying founding technology or research, comes from academic institutions, there can often be a conflict between the university’s original motivation versus the product or technology’s eventual use in the private market.

Together these areas of research inform this thesis, though neither focuses on the benefits and challenges, and alignment of partnerships in real estate development.

2.3 Identification of representative projects

Through discussions with real estate development firms, university real estate managers, and institutional real estate development consultants, several projects were identified as being particularly interesting examples of partnerships between private developers and mission-driven institutions. The projects identified as potential case study examples include:

- *University Park at MIT:*

This 27-acre mixed-use development is located right next to MIT's main campus. It was developed, and is still operated by Forest City, through a ground lease with MIT. The size and location of the project make it a unique example of an institutional-private development agreement.

- *Crescent Place at Trinity College, Hartford*

Trinity College is currently in a partnership with Kirchhoff Campus Properties to build new student housing. The college has acquired properties on a neighboring block over several years, and is working to improve student-housing options while minimizing direct financial and

development risk for the institution. Since the project is currently underway, the involved parties are unwilling to share any details of the deal.

- *Charles Street Jail*

Partners HealthCare and Carpenter and Company worked together develop a historic jail into a unique luxury hotel. The historic structure, and close proximity to the hospital create interesting challenges, and lessons to learn from.

- *Market Rate Student Housing project*

A prestigious East Coast university negotiated a participating ground lease with a private developer to design and build market rate student housing. This example introduces several unique interests of each party, and helps explain how differing incentives can be aligned through negotiated project controls and economics.

After review of existing literature and case study materials, and communicating with development agreement parties, the Charles Street Jail and the Market Rate Student Housing Project have been selected for case studies in this paper. University Park has had extensive case studies written about it, and was completed too far in the past to be a good example for modern practice. Trinity College is currently in the midst of the

Crescent Place project, and the involved parties are not currently in a position to disclose information or perspectives on the agreement. These limiting factors have directed the author to the two chosen case study examples, and those will be the focus of this paper.

2.4 Approach to Case Studies

In order to understand these two projects, and the perspectives of both sides of the deals, the parties involved have been interviewed. The goal of these interviews was to understand the project itself, and to focus on the benefits and challenges of the private-institutional partnerships for each organization. The information on the deals, and the various issues they present, is documented in the case studies. After presenting the case studies, this paper analyzes the incentives of each party going into the deals, and what issues or concerns came up through agreement negotiations and project development.

In examining these two case studies, the author will review the perspectives of each partner in each deal. Each case begins by reviewing the background the two partners, and the project itself, then identifies the incentives of the various stakeholders in the deal. This leads into a review of the deal structure used, and the development concerns for each party. The section on development concerns focuses on the identification of the partner, project controls, and project economics, and leads into the case conclusion,

and an analysis of lessons learned. After review of both cases, the author analyzes the cases together, and identifies common themes.

Chapter 3: Charles Street Jail Case Study

3.1 Background:

The Institution:

Massachusetts General Hospital (“MGH”) has had a presence in the West End neighborhood of Boston since its founding in 1811¹¹. Over time, the hospital has become recognized as one of the best in the world and in 2012 it was recognized as the best hospital in America¹². MGH is also Massachusetts’s largest non-government employer, with more than 19,500 on its payroll¹³. In such a competitive healthcare market, it is critical that the hospital maintain its reputation and position itself to attract the best doctors and staff possible. In doing so, the hospital must have the best available equipment and facilities. When the hospital was founded, it was located in an open field and initial growth was simple; the area has since been densely developed, and expansion has become more and more difficult.

Though MGH was founded as an independent hospital, the organization joined forces with Brigham and Women’s Hospital in 1994 to form Partners HealthCare. Today, Partner’s is a hospital group that includes many healthcare organizations in the Boston area. The hospitals joined because of their mission alignment, as stated on its website:

¹¹ Massachusetts General Hospital,
<http://www.massgeneral.org/history/narrativehistory/>.

¹² Massachusetts General Hospital,
<http://www.massgeneral.org/about/pressrelease.aspx?id=1483>.

¹³Massachusetts General Hospital,
<http://orientation.massgeneral.org/physicianorientation/pages/mghsub.htm>).

“Partners Healthcare is a not-for-profit health care system that is committed to patient care, research, teaching, and service to the community locally and globally. Collaboration among our institutions and health care professionals is central to our efforts to advance our mission”¹⁴.

As a health care organization, profit and real estate development are not part of its core mission. However, having state-of-the-art facilities with room to grow over time is critical, so as a consequence, real estate is a critical part of their mission-driven operation.

Today, the organization continues to understand the importance of constantly improving its facilities. The following is from a fundraising campaign:

“Our environment sets the stage for our day. The places we go and experiences we have influence our mood and outlook. When patients arrive at Mass General for treatment and families come to support loved ones, they are entering unfamiliar territory – they see a maze of hallways and medical machines. They trust that the environment will be efficient and comfortable”¹⁵.

The Developer:

Carpenter & Co. is a Boston-based real estate development firm. Founded in 1898, the firm has developed, owned and managed a diverse portfolio of innovative projects. Their focus is in the Northeast region of the United States, and they have completed projects in a variety of use types, including hotel, retail, office and residential¹⁶. They have extensive

¹⁴ Massachusetts General Hospital, <http://www.partners.org/About/Default.aspx?id=1>.

¹⁵ Massachusetts General Hospital, 2011, <http://www.thirdcenturyofmedicine.org>.

¹⁶ Carpenter and Company, Inc. <http://carpenterandcompanyinc.com/about-us/>.

experience working in partnership with other organizations, and have done many projects located on publicly or institutionally owned land¹⁷. Through its long history, Carpenter & Co. has prided itself on the relationships built over time, and is able to use those strong relationships in successful project execution.

Carpenter & Co.'s mission in developing real estate is to find unique opportunities to create economic returns. They do this by focusing on "diverse and innovative projects, including hotels, shopping centers, office buildings, and housing"¹⁸. Some examples of past projects include Charles Square in Cambridge Massachusetts, and the Hilton Hotel at Boston's Logan Airport.

The Project:

Adjacent to the MGH campus stood the historic Charles Street Jail. The jail was originally built around 1850, and was constructed primarily of granite. The design followed a trend of the time to make jails more "humanitarian," primarily through increasing natural light and ventilation, and decreasing risk to prisoners in the case of fires. This was accomplished by locating the prison cells at the interior of the four wings, with atriums separating cell-blocks from the exterior walls. Despite structural additions over time, the jail became overcrowded in the 1970's, and the Commonwealth of Massachusetts decided

¹⁷ Carpenter and Company Inc.

<http://carpenterandcompanyinc.com/projects/hotels/hilton-boston-logan-airport/>

¹⁸ Carpenter and Company, Inc. <http://carpenterandcompanyinc.com/about-us/>

to sell the property in 1991. Due to its history, and highly visible location, the original jail was listed on both the State and National Registries of Historic Places¹⁹.



The Charles Street Jail, 1980's²⁰.

MGH identified the sale of the Charles Street Jail as an opportunity for their organization. The acquisition of the former jail would allow MGH to “control the front door, add critical square footage to the campus, enhance [the] physical image of the hospital, enhance quality of life in overall community, clarify MGH circulation patterns, and improve [the] connection between MGH, MEEI (Mass. Eye and Ear Infirmary), and the MBTA”²¹. All of these goals for this deal were critical to the MGH and Partners mission, allowing the organization to adapt

¹⁹ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

²⁰ American Buildings Survey, <http://www.loc.gov/pictures/item/ma1484/>.

²¹ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

for new programs and initiatives, and reducing long-term facility costs through the introduction of more efficient building features and systems²². MGH purchased the Charles Street Jail from the Commonwealth of Massachusetts in 1991 for \$16 million dollars²³.

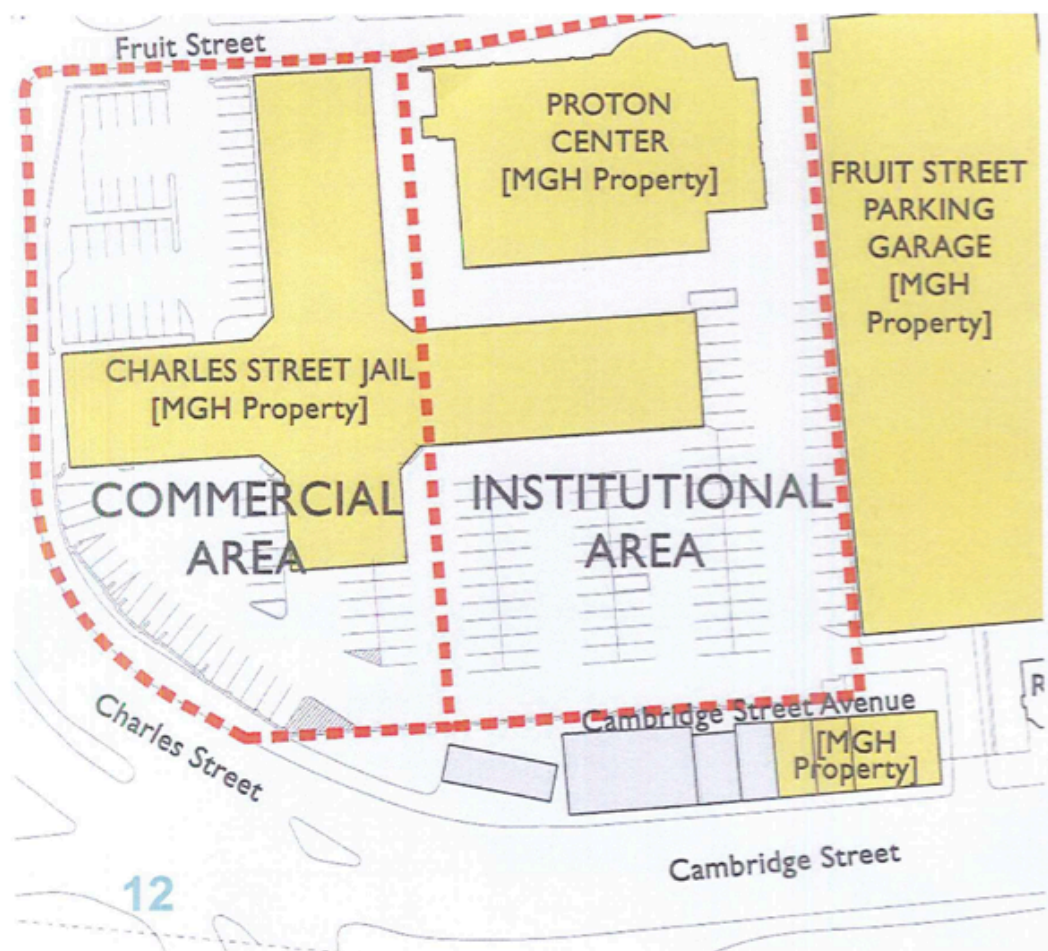
Though the acquisition was in line with MGH's long-term mission by creating flexibility for future growth, due to the complexities and inefficiencies of the historic building MGH ultimately decided it would not redevelop it. Instead, the hospital focused on the remainder of the site, and how the site could serve immediate MGH needs. Soon after purchasing the property, the decision was made to build the Northeast Proton Therapy Center on a portion of the new site, the second facility of its kind in the United States.

To solve the question of use for the remainder of the site, the hospital hired architecture and planning firm of Graham Gund²⁴. Many uses and potential plans were considered, and by the year 2000 the hospital's needs were identified and a plan was established. The hospital needed a new ambulatory care building and additional parking. The hospital also wanted to generate an economic return, and realized that a majority of the jail building could be developed for non-hospital uses. For this non-hospital development, MGH decided to partner with a private developer, who could manage the risk associated with the adaptive re-use project.

²² Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

²³ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

²⁴ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.



Charles Street Jail, Site Subdivision²⁵.

Once the requirements of the hospital were identified, planning began for the new 400,000 SF ambulatory care building (to become known as the Yawkey Center) and a 700-car parking garage. The Partners real estate office also issued a Request for Expressions of Interest, to gain an understanding of the private market's interest in developing the former jail for other uses²⁶. Once a use and a developer were identified, ground lease terms were

²⁵ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

²⁶ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

negotiated and construction of the new hotel began in May of 2005²⁷. Carpenter and Co. was selected as developer, and its Vice President and General Counsel Peter Diana was identified to lead Carpenter's team. MGH and Partners felt that Carpenter's proposal for a high end hotel would enhance the mix of hotel offerings in the area, improve the feel of the hospital entrance, and add positive energy to the surrounding community²⁸. This hotel project was selected over other proposals including condominiums, and even a pet hotel.

Partners had weekly meetings throughout its planning process, to discuss concerns and ideas with hospital leadership, administration, doctors and other stakeholders. Partners was sophisticated enough to invite Peter Diana to these meetings, and he attended several even though they were not focused on Carpenter's portion of the development project. In retrospect, both parties view this interaction as critical to the rest of the project.²⁹

One example of project synergies that were identified through such open communication was the possibility of putting a connecting corridor between the hospital and the hotel³⁰. An opportunity was found to offer patients, especially cosmetic surgery patients, a way to live comfortably out of the public view for a period of time. These patients could have access to hospital care, yet remain in their hotel room in-between visits. Carpenter & Co. also considered dedicating a floor of the hotel to hospital rooms, for patients who might prefer to remain near a hospital with the comfort of a hotel room. Neither of these plans

²⁷ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

²⁸ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

²⁹ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

³⁰ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

were executed, but they both exemplify the interaction between hotel and hospital motivations.

Since planning for the Liberty Hotel began after planning for the Yawkey Center, construction of the hotel started six months after the new outpatient facility opened its doors in October of 2004. This timing created some synergies as well as challenges for the development partnership. MGH was able to use the jail site as a staging area during their construction period, and logistical issues were minimized by having one project follow the other. In addition to the construction that took place at the Yawkey Center, a great deal of city infrastructure work was also being done to adjacent Cambridge Street, the Charles Street intersection, and the nearby Charles Street MBTA station. All of this activity heightened the community's sensitivity to the inconvenience of ongoing construction, and the potential effects of extensive change³¹. MGH also played a role in the planning process for these infrastructure projects, and assisted with some financing, as it would benefit from all of the surrounding improvements³².

The permitting process for the hotel went smoothly, largely due to open communication, the sharing of contacts, and the previously established expectations of each party in the development agreement. Construction began in May of 2005³³. An early concern for both parties was the presence of the recently opened Proton Center next door to the construction site. The hospital was concerned about potential construction-related

³¹ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

³² Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

³³ Diana, Peter, Personal Interview. June 18, 2013.

vibrations that could distort the effectiveness of the equipment, and the developer was concerned about the presence of any radiation that could harm workers and future hotel guests³⁴. The concerns and goals around this topic for each party were quite different, but through proper logistics coordination and construction planning, Carpenter was able to manage the vibrations with no negative effects on the hospital or its highly sensitive equipment.



Completed Project: The Yawkey Center, and The Liberty Hotel, 2011³⁵.

³⁴ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

³⁵ Alex MacLean Aerial Photography,
<http://landslides.photoshelter.com/image/I0000hYTaq.Gadqc>.

3.2 Stakeholders and Their Incentives:

Though the incentives motivating Partners and Carpenter & Co. in the development of the Charles Street Jail were not the same, both parties were able to compromise and ultimately align their motivations with those of their counter party. The project team set expectations early, and worked together through the process to ensure that both groups were positioned to meet their goals.

The Institution:

Real estate planning and the decision making process for development of MGH's facilities is managed by the Partners HealthCare real estate office. The primary contacts within the office for this particular project were Tim Pattison and Robin Berry. Mr. Pattison is the Director of Real Estate for Partners, and Ms. Berry is a Senior Real Estate Development Manager. They worked together, with many others from the Partners organization, to plan, negotiate, and execute the jail site development, and the agreement for lease of the jail building with Carpenter & Co. Though Pattison and Berry were representing the mission-driven institution (MGH), they had both been trained on the private side of the real estate industry, and were able to use that knowledge to correlate the needs of Partner's to the needs and requirements of their counter-party³⁶.

Partners HealthCare was incentivized to purchase the Charles Street Jail property because it was a unique opportunity to acquire such a large parcel of land right next to their main

³⁶ Diana, Peter, Personal Interview. June 18, 2013.

campus.. In the short term it would give MGH the flexibility to build new facilities, such as the Northeast Proton Therapy Center and the Yawkey Center for Outpatient Care. MGH was also able to plan for the addition of much-needed parking, and the acquisition gave it control of the “front door”³⁷. As with any major institution, this “front door” control is important, as it represents the way that the campus interfaces with the community. The healthcare mission of the organization drove all of these incentives, but there was also an economic incentive, which could be captured through the partnership with Carpenter & Co. and the development of the jail building.

In approaching this deal, MGH was looking for value through three different avenues. Its ultimate goal was to enhance the hospital, and it did this through motivations for economic, community oriented, and healthcare improvements. With regards to economic returns, MGH generated revenue from the jail development. To bring value to the community, the hospital improved the nearby roads and MBTA station, and also improved the architecture and landscaping in the development site. Through enhancing both the hospital campus and the immediate vicinity, MGH was able to improve the healthcare experience.

Qualitatively, Partners and MGH considered how much the new hotel would improve its image, and that of the surrounding community. Similarly, Carpenter & Co. wanted to share in the success of the long presence of MGH.

³⁷ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

The Developer:

As noted earlier, Peter Diana, Carpenter's Vice President and General Counsel led the project's development team. Mr. Diana and his team developed the project proposal, negotiated the partnership, and managed the project. Throughout the planning and execution of the project, Mr. Diana was in close communications with the Partners team and their associates.

Carpenter & Co. perceived this project as a unique opportunity for the firm to create a one-of-a-kind hotel in a landmark building, and on a site that offered great access and Charles river views. However, Carpenter & Co. was especially attracted to this deal as a result of the strong economic returns from developing a hotel in such a prominent and historic location. To realize these returns, Carpenter and Co. had to understand and adapt and align its goals with the mission of MGH³⁸.

Carpenter & Co. needed to complete the project as quickly as possible, and wanted to ensure the hotel stood out among others in the city. Given the height restrictions of 125' at the jail location and 155' to the north, Carpenter's architects at Cambridge Seven designed a tower that efficiently housed the number of rooms that made the expensive jail renovation worthwhile³⁹. Ultimately, Carpenter's success in the project would not just be determined by what was built, but also by how the hotel was eventually operated.

³⁸Diana, Peter, Personal Interview. June 18, 2013.

³⁹ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

3.3 Deal Structure:

Carpenter & Co. was designated as the developer for the adaptive re-use project in June of 2000. By November of that year Partners and Carpenter & Co. came to an agreement on deal terms. Just before starting construction, in May of 2005, an agreement for a 75-year ground lease of the jail was executed⁴⁰. In preparing for negotiations, Partners examined 8-10 similar deals that had been completed in the past⁴¹. Though this was a helpful exercise, few hospitals had developed hotels that were focused on commercial demand, rather than providing an amenity to patients and visitors to the hospital⁴². During this period, prior to agreeing on final ground lease terms, the tragic event of September 11, 2001 took place, which shocked the hospitality and tourism industries. After the terrorist attacks, business travel sharply declined and remained below pre-9/11 levels through 2004⁴³. In addition to reducing demand for hotels, 9/11 created a very difficult environment for financing large real estate projects, and as a result construction of the hotel was delayed⁴⁴.

The 75-year ground lease is less than Carpenter and Co. would have accepted in other situations (explain what they normally would accept.), but it understood Partner's need to maintain future flexibility and was able to make the shorter timeline work⁴⁵. In fact, Carpenter & Co. wanted to purchase the property outright, which would have been

⁴⁰ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

⁴¹ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

⁴² Berry, Robin, Telephone Interview. July10, 2013.

⁴³ East West Center, "The Impact of 9/11 and Other Terrible Global Events on Tourism in the U.S. and Hawaii" (East West Center, 2006), 4.

⁴⁴ Berry, Robin, Telephone Interview. July10, 2013.

⁴⁵ Diana, Peter, Personal Interview. June 18, 2013.

extremely profitable for Partners, but this would have limited flexibility for the long-term plans of the hospital⁴⁶.

For the 75-year period of the ground lease, pre-established base rent would be paid to Partners by Carpenter & Co. on a monthly basis. In addition to this base rent, Partners has some level of participation when revenues exceed certain performance metrics. This deal structure allows Partners and MGH to focus their resources on their mission to advance healthcare, and also find economic returns without the risk of managing a development project, and without having to operate a hotel.

3.4 Development Concerns:

Identifying a Partner:

Once Partners identified the way each part of the acquired parcel would be used, the institution issued a Request for Expressions of Interest to the development community for the remaining site area, which included most of the historic jail. After reviewing seven different development proposals, Partners and MGH decided that a high-end hotel would be the right fit for the site, and Carpenter & Co. would be the developer. Condominiums and other uses such as apartments and offices were also considered, however Partners had the foresight to understand that the transient population of a hotel would allow more flexibility for the future needs of the hospital, and would ultimately ensure the ability to

⁴⁶ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

focus on the healthcare mission in the long run⁴⁷. Had this been pure private development, condominiums might have been the most economically profitable use, though it was not in line with Partner's long-term mission. On a similar note, many people in the Partners organization felt that the hotel should offer affordable rooms, to be accessible to all hospital patients. The eventual decision for a higher end hotel created a mix of hotel options in the immediate vicinity of MGH, along with the existing Holiday Inn, and the improved economics were able to support the higher than expected redevelopment costs associated with the project⁴⁸.

Partners viewed the selection of Carpenter & Co. to be a critical first step toward the success of the project. Carpenter & Co. had a strong track record of successful hotel projects as well as historic renovations, and the personalities of Carpenter representatives, specifically Peter Diana, seemed to complement those of the Partners team. They found communicating with Carpenter and Co. to be comfortable and appreciated their open mindedness in project approach. This last point proved to be a very important factor in the eventual success of the project. Additionally, Carpenter & Co. used Cambridge Seven architects for the proposed design of their hotel, which happened to be the same firm that Partners was using to design the Yawkey Center. Different teams within the office were working on each project, so there was no conflict, however the overlap created several opportunities for efficiencies and promised compatible designs⁴⁹.

⁴⁷ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

⁴⁸ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

⁴⁹ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

Project Control:

Control of Project Design: When Carpenter & Co.'s team first submitted its proposal for redevelopment of the Charles Street jail, they had already worked through schematic designs with their architect, Cambridge Seven Associates, so Partners could evaluate the direction of the design.⁵⁰ Since MGH was also working with Cambridge Seven for the Yawkey Center, Partners and MGH had confidence that the projects would ultimately complement each other. Additionally, since the Jail building was listed with the State and National Registries of Historic Places, many design issues that would otherwise be of concern to a neighboring institution were addressed through regulation⁵¹.

Even though Partners was comfortable with the early schematic design, and knew that the historic regulations would govern the renovation, the ground lease still outlined design controls, which the hospital could ultimately invoke if necessary. The lease specified the hospital's approval for the permitted use of the site per the proposal, design, development, as well as construction management plans and schedule approval⁵². Prior to the events of 9/11, the hotel and the Yawkey Center were scheduled to be built at the same time, so Partners was extremely concerned about logistics and the effects of construction on the surrounding hospital facilities.

⁵⁰ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

⁵¹ Berry, Robin, Telephone Interview. July 10, 2013.

⁵² Berry, Robin, Telephone Interview. July 10, 2013.

Control of Retail Tenant Selection: The hospital does not have specific approval rights over the exact tenants of the restaurant and retail space, however it did lay out certain restrictions in the ground lease documents⁵³.

Though Partners did not negotiate for control over tenants, it did have control over the garage. The underground garage was built beneath the East wing of the jail, which had to be dismantled stone by stone, and then re-constructed with documentation of each stone's location. The high costs associated with building this garage may not have been justified by a private developer, though it made sense in this situation because of the hospital's infinite timeline for ownership⁵⁴. In building the garage, MGH planned to have additional spaces for the hotel, and the two parties negotiated the number of spaces and the rates to be incorporated in the ground lease. Since it was owned by MGH, it had complete control over this critical aspect of the hotel's operation.

Reporting Standards: During project planning and development, there was a weekly meeting to discuss any updates. Partners had to approve any major changes to the plans, so it was in Carpenter & Co.'s best interest to keep its team informed. Partners real estate managers also held weekly meetings with hospital administration and staff to discuss project concerns, and progress on the Yawkey Center. Peter Diana was invited to attend these meetings and he went to as many as possible. Mr. Diana did not have experience working on the institutional side of deals, but he had worked with similar organizations in the past and understood the vital importance of creating a platform for open

⁵³ Berry, Robin, Telephone Interview. July 10, 2013.

⁵⁴ Berry, Robin and Pattison, Tim, Personal Interview. June 12, 2013.

communication⁵⁵. Partners received regular updates from Carpenter & Co. through permitting and construction, and the institution was willing to be actively involved when it could be helpful to the developer's process.

Project Economics:

Ground Lease Terms: Partners and Carpenter & Co. had different views on the ideal length of the ground lease; Partner was hoping to do a 65-year term, while the developer wanted something closer to 99-years. Both groups compromised, and settled at a 75-year term. This difference in perspective about timelines is typical of ground lease negotiations⁵⁶. The lease negotiated includes a monthly ground lease payment, which acts a base rent. The hospital also negotiated for additional rent, through participation of rents that exceed certain metrics of hotel operating performance. The Partners team recognized the uniqueness and value of the Jail site, and felt that the hospital should continue to be rewarded for its future use⁵⁷.

Financial Structure: Partners did not have any specific restrictions on funding sources, or the amount of debt the developer could use in the development project, except that the source of financing could not be perceived as incompatible with the mission of the hospital.⁵⁸ Instead of creating precise guidelines for financing, Partners focused on their base ground lease payments to protect their returns. Additionally, a provision was included in the agreement that would enable MGH to participate in rent over a certain

⁵⁵ Diana, Peter, Personal Interview. June 18, 2013.

⁵⁶ Berry, Robin, Telephone Interview. July10, 2013.

⁵⁷ Berry, Robin, Telephone Interview. July10, 2013.

⁵⁸ Diana, Peter, Personal Interview. June 18, 2013.

threshold return⁵⁹. The exact terms of this provision were not disclosed, but Partners feels that it protected the hospital's interests⁶⁰.

Lease Rates: MGH/Partners selected Carpenter & Co. as developer of the Charles Street jail because Carpenter was very experienced and understood the hotel market in Boston. With this understanding, Partners understood the need for Carpenter & Co. to manage their own project and steer it to success. Although the parties did agree to some restrictions on prohibited uses for retail and restaurant space, the institution had no involvement in negotiating terms for the food and beverage spaces⁶¹.

Since the hospital wanted the hotel to provide rooms to patients who chose to stay there, they did negotiate for hospital users to receive the best available rates⁶². Patients and doctors do get specially discounted rates as well. This rate structure also creates an alignment of incentives for the hotel to avoid giving any other groups special pricing treatment.

⁵⁹ Berry, Robin, Telephone Interview. July10, 2013.

⁶⁰ Berry, Robin, Telephone Interview. July10, 2013.

⁶¹ Berry, Robin, Telephone Interview. July10, 2013.

⁶² Berry, Robin, Telephone Interview. July10, 2013.

3.5 Case Conclusion:

Both parties in this development agreement view the resulting Liberty Hotel project as a great success, and are both proud to be a part of it. As previously discussed, MGH improved the surrounding community and improved the mix of local hotels available to patients, and was also able to ensure the future flexibility that may be required by their organization. Through the private partnership with Carpenter & Co., it was able to succeed economically, and further advance its healthcare mission.

Both parties in this deal reached its goals, and together they formed a relationship that could benefit both groups moving forward. Both groups speak very highly of the other, and say they would not hesitate to do another deal together in the future. An example of the state of their relationship after project completion was evident when Carpenter wanted to consider leasing some office space from MGH in the East wing, to build additional ballroom space⁶³. While Carpenter & Co. eventually decided not to move forward with this plan after further consideration of its market potential, MGH was more than willing to discuss the idea. Such a discussion could not have moved forward if the parties had not worked so well together, and if they did not understand how their success depended heavily on that of the other party.

The completed re-development of the Charles Street Jail eventually be known as the Liberty Hotel. As part of a clever branding strategy, which was established during project execution, the hotel was named and other elements within the hotel were designed to

⁶³ Diana, Peter, Personal Interview. June 18, 2013.

compliment the desired jail-theme. This included components such as the bars called “Clink” and “Alibi”, and the exterior area called “The Yard”. Since the hotel’s opening it has exceeded the project team’s economic expectations, and the developer and hospital are both pleased with the overall outcome.

Chapter 4: Market-Rate Student Housing Case Study

For the purpose of this case study, the interviewed parties have requested that their names and the name of the case project be anonymous.

4.1 Background:

The Institution:

The institution involved in this development project is a prestigious undergraduate American university. The university has expanded greatly over time, and has used several different approaches to real estate development in accommodating its growth. This has included traditional joint-venture agreements with private developers (owning anywhere from 30% to 75% of a given project), hiring a developer-for-fee to manage the planning and construction of a university owned project, negotiating ground lease agreements with private firms, and combinations of these various ownership and development agreement structures.

As a university, the mission of this institution was, and still is, to provide an environment to advance education and research. To do this most effectively, the university's environment must compete with alternative top-tier schools to attract the best professors, students, and administrators and staff. This means that the administration and real estate office must continuously evaluate the use and condition of existing facilities, the needs of current students, and way to approach growth and additional needs in the future.

Private Developer:

The private developer has a focused track record of student housing projects. This developer had also executed many joint venture structured agreements, but had not partnered with a non-profit institution prior to the subject project. The developer has extensive previous experience in the southern region of the United States, and mostly utilized open shop (non-union) construction labor.

The mission of the developer is to acquire real estate assets, or property development rights, which could be improved and operated for a profitable return. It generally seeks to add value and create a platform to generate returns on investment through cash flow yields, and appreciation to be recognized at an eventual project exit.

The Project:

Prior to the identification of this project, the university's Board of Trustees created a master plan, which called for an immediate effort to create an additional 1,000 beds through new development. The intention was to achieve this goal through partnerships with private development firms. The university's Board of Trustees wanted a private developer to be involved to minimize risk and to create up-to-date units designed to contemporary private market standards.

The project site was home to an underperforming retail mall, already owned and operated by the university as a commercial investment property. Given its location next to the

university's campus, this was a prime development site for a residential building, specifically student housing. A private developer would be chosen to develop and operate this site through a Request for Qualifications process administered by the university.

Once the developer was selected and plans were completed, the project took approximately eighteen months to build, and was completed just in time for students to move in to their new apartments before the start of the 2008 school year. Almost a year before opening, a marketing office was set up at the development site and in just two weeks every unit was pre-leased.

4.2 Stakeholders and Their Incentives:

The University:

The university's Director of Real Estate Development (Director of RE) manages and coordinates the implementation of all of the institution's real estate development projects, many of which are implemented through partnerships with third party developers. For this project the Director of RE managed the initial strategy, and acted as an intermediary between the developer and the individual stakeholders within the university, including faculty, staff, students, and the Board of Trustees. Although the Director of RE managed the project, any important decisions affecting the university's mission were to be determined by the Board of Trustees. In addition to the Board of Trustees, a Design Approval Board was established within the university, to review the project's architecture and programming.

The goals of the university were primarily focused on its advancement of education. As it relates to real estate development, and this project specifically, the university was looking to improve the quality of life for its students, avoid risks associated with development and construction, and improve economic returns on an otherwise under-performing asset.

Quality of Life: The goal of improving the quality of life for students included the hope to create a safer and more controlled environment that was close to campus. As the university grew over time, students moved to surrounding neighborhoods because the existing supply of housing was not sufficient in the immediate area around the campus. To have students closer to campus would allow the university to take more responsibility for their safety, and improve relations with the surrounding community. The lifestyles of undergraduate students and neighborhood-dwelling families often do not align, and it was in everyone's interest to have the two groups living in separate areas. Similarly, the university also sought to influence the undersupplied market, wherein landlords appeared to be taking advantage of the students, who were essentially guaranteed tenants.

Risk Avoidance: Through its experience with other development projects, the university knew that it wanted to avoid direct risks associated with developing a dormitory or apartment building. In addition to the financial risk associated with construction, another risk of great concern was "non-completion risk"; the risk of not completing the project on schedule, and not being able to house students for the following academic year.

In the private market, it is always important to complete a building as soon as possible so that cash flows can be recognized and permanent financing can be put in place. If a private project is delayed and comes on the market later than planned, it is still possible for the leasing projections to be met. In a university setting, however, lease revenues for an entire year are dependent on students being able to move in before the start of classes. Though this is a unique pressure for a private developer, the university knew that a private firm would be better accustomed to working under similar pressures, and they would likely be more efficient in project execution. The previous commercial use of the development site was already a safe investment vehicle for the university, and by avoiding internal project management and building ownership, it minimized any increase in their risk profile. By keeping the project off-balance sheet, their credit rating could also remain unaffected.

Economic Returns: Though the university's primary goal with this development project was to advance its academic mission through improved student housing options, it was also one of economic interest.

The Developer:

The private development firm's team for this project included approximately six people, who were responsible for management of design, entitlements, and completion of the residential project. A single project manager lead the team, and was ultimately responsible for communication with the university's Director of RE, and the ultimate outcome of the project. Since the development team had very few layers, they were able to make quick decisions and execute.

The developer was primarily concerned with economic outcomes, especially cash flow yields. In order to meet their economic goals, they had to be focused on the overall project cost and schedule. As with any project, the sooner they could deliver the completed project, the sooner they could receive leasing revenues. The schedule was also very important from a financing standpoint, as they needed to establish a stable income stream in order to obtain permanent financing for the new asset, and the actual rents would dictate project value and the cost of financing. As mentioned before, this timeline was especially important in this situation because the project's success was largely dependent on students moving into the apartments prior to the start of the school year.

4.3 Deal Structure:

The negotiated deal structure for this project was a 65-year participating ground lease. In this case, that meant that the university would receive a base ground lease payment, which equated to 4% of residential rents and 8% of commercial rents, on a gross annual basis. Beyond these payments, the developer had a 12% promoted interest; meaning there was a hurdle rate of 12% that had to be met before the university could participate in any additional income. Any gross rents that exceeded that 12% return to the developer would be split evenly between the two parties. This hybrid of a ground lease and traditional private joint venture waterfall structure allowed the university to mitigate nearly all of the

risk associated with the project while still capturing some of the up-side. This type of deal structure is commonly used in municipal public-private partnerships⁶⁴.

4.4 Development Concerns:

Identifying a Partner:

The university began its process of identifying a private-market partner for this development by sending a request for qualifications (RFQ) to more than ten real estate development firms that had experience with market rate student housing. Through the review of responses and initial interviews, the university reduced its list of candidates to five firms, and then with further review selected the project developer.

The university's final developer choice was based on a few factors. The university liked the proposed deal structure with the opportunity to have a participating interest beyond a traditional ground lease. The chosen developer also had the best track record for comparable projects and its team had similar working styles to those of the university real estate team. Further, it was important that the developer be detail oriented, who would likely "lay awake at night" due to their level of concern for the quality of the final product.

In addition to considering the prospective developers' resumes, personalities and working style, the university also needed to be confident that their partner would be a good public representative of the institution.

⁶⁴ Dale-Johnson, David, "Long Term Ground Leases, the Redevelopment Option and Contract Incentives" (University of Southern California, 2000), 6.

The developer knew that there would be many layers in the decision making process at a large institution, and many audiences that would need to be pleased. This task was daunting to the developer, especially since it would be dependent on the university's ability to make quick decisions to meet the aggressive schedule of having a completed building for the start of classes. In response to this concern, the developer paid extra attention to the details of the schedule, and had to approach it with a higher-than-normal level of confidence.

In addition to concerns about partnering with a university, the developer was concerned about doing work in the institution's city. The firm had not done any development in this market, and had to trust the university's knowledge of the local market dynamics. Eventually, the university's market understanding would prove helpful in planning, working with city officials, and introductions to local consultants. Further, unions dominated the local construction industry, and since the developer's previous experience was primarily with non-union crews, the developer was unsure how the premiums associated with union work would affect the development process and budget.

Project Control:

In negotiating the detailed terms of the partnership agreement, there were several issues around the question of control for various aspects of the development project.

Control of Project Design: Even though the architect worked for the developer, the university wanted to have final approval rights over the final plans. The building would likely be associated with the university by the public, and so the university wanted to make sure the project's design was aligned with its long-term plans and mission. The developer, on the other hand, felt that it needed to have control over the design process, because the design would affect construction costs and schedules, and would also be important for operation of the building once complete. In the end both parties compromised, and the university maintained approval rights over the proposed building's massing and the total number of units and beds. Any details, and all finishes and building systems for the interior of the building were left to the developer. This outcome was a compromise for both parties. The developer was actually able to benefit from the involvement of the university's appointed "Design Approval Board", as the group had an understanding of student needs, and was especially helpful with unit layout and amenity design.

The university and developer were in general agreement about the building design, and no extreme costs were incurred due to the influence of the Design Approval Board, but there was an example where approval of bed counts came into question. The developer wanted the right to add bunk beds if units became vacant to increase the number of students in the each unit, enabling the developer to increase rent per unit. The university denied this proposal, because it was not in line with its goal of creating a comfortable environment for their students.

Control of Retail Tenant Selection: The university did not feel the need to negotiate for approval rights over tenant selection, but they did set some guidelines the developer had to follow. Certain tenant groups were prohibited, including adult movie stores, strip clubs, and grocery stores. The first two were to ensure that the environment of the new apartment building would be in line with values of the institute, and the third was to protect the nearby university-operated grocery store from competition. This was a compromise for the developer, as they did identify an opportunity to position a grocery store there. Despite this, the developer identified tenants that were in line with university priorities, and the spaces leased up quickly and have thrived since.

Reporting Standards: The university had strict reporting standards for any internal projects, and the developer had to abide by them for this development project. This created additional work for the developer, but through negotiations they were able to maintain control over the elements they deemed critical for project success; as discussed above.

Since all project reporting through design and construction phases was channeled through the university's Director of RE, the developer was unable to hear concerns and interests directly from those voicing opinions. Although the single point of communication added efficiency to the development team's process, it also limited their ability to push for, and defend, ideas and plans that they felt strongly about. This did not turn out to be a problem, but it did cause many steps in the process to take longer than the developer feels they may

have otherwise, and thus put additional pressure on their already tight construction schedule.

Project Economics:

In negotiating the economic points of the agreement, both parties wanted to maximize their return through the future building's operation. For the institution, this could not come at the cost of further advancement of their mission, or their ability to focus resources on the mission-oriented goals.

Ground Lease Terms: In a purely private deal, the developer would negotiate for a ground lease term of at least 75 years, yet in this case the university would not extend beyond 65 years. This was important for the developer, because there would be no residual value in the project after that time, so any debt had to be fully amortized within that shorter-than-normal timeframe. Additionally, the developer had to justify developing a building that had a projected life span well beyond the ground lease term. This was a harsh reality for the developer, and it added even more pressure to the tight yield projections. The developer was able to justify the deal because of the high quality of the location, and also because they were able to negotiate a lower-than-normal up front payment to gain control of the property through the ground lease.

Through the ground lease structure, the university was able to establish separation between itself and the developer to reduce risk. In this scenario, for the term of the lease, the developer would own the property improvements (the building), and would lease the

land from the university. Through participating interest in gross rents, as described earlier, the university could benefit from the success of the project in the future.

Financial Structure: The university set a limit on the amount of leverage the developer could use for the deal. This leverage ratio was substantially lower than what would otherwise have been targeted. Fortunately, the developer's institutional investor had a relatively high equity profile, and was able to work within this requirement.

Lease Rates: In keeping with the university's goal to provide safe and comfortable housing to students, it also wanted to make sure that lease rates were set at a reasonable level to make sure the students were not economically punished for choosing to live in the new building. The developer would not agree to give the university such approval rights, but they did agree on a starting point for rents, which was in line with the developer's original pro-forma. This point worked for both parties, as it controlled the initial perception of the student housing and allowed for future movement with market forces.

The university also wanted to influence the market and force artificially high-priced buildings in the area to come down. This would give the students more choice in finding a place to live, and would pressure neighboring landlords to improve their buildings. Before the project began, one particular building was identified by the university as being unfairly overpriced, and under-maintained, and a goal was set to break that building's recent record of consistent full occupancy. Although no approval rights were granted for the university

to dictate rents, the developer worked with the university and eventually did have an effect on the market as hoped.

4.5 Case Conclusion:

Through the negotiations of this agreement, and development of the project, both parties took away insights that they would consider in a future deal of similar nature.

The university is pleased with the developer's execution of the project, and has also been pleased with the returns it has received from the ground lease and its participation in cash flows. The lessons learned by the university include the necessity to manage students during the initial move-in process for a new building. Construction was completed just the night before move-in day, and it could have gone much smoother if the school regulated students on a segmented schedule. Also, although the university does not have any complaints about the operations of the building, it has come to realize that standards in operating differ in the private market. In a university-owned and operated dormitory, the "landlord" is likely to make changes in response to the demands of students, regardless of economic impact; this is not necessarily the case for a private market building. A private building needs to react to the market, whereas a dormitory needs to do what is best for the students and the associated institution.

The developer also speaks very highly of the overall experience developing and operating this building; in fact it says it is the "most successful" project it has completed in the

company's 30-year history. That said, it wishes it had pushed harder on the structure of the university's participation. The developer would have liked to set an upper limit on the university's return, and also would have preferred to base that on net revenue rather than gross. Both of these items would have increased the developer's returns, but it realizes it cannot have it all, and feel it negotiated the best it could at the time.

Chapter 5: Case Analysis

5.1 Stakeholders and Their Incentives:

The types of stakeholders and their missions varied between these two case studies. Both partnerships included private real estate developers, who were primarily focused on economic returns, and both were examples of mindfulness of their partner's missions in order to work with the institutional landowners. The institutional partners varied, as one is a university and one a hospital group, yet the drive toward a mission was common. Both institutions were ultimately able to use economic incentives, along with other motivating factors to develop the projects and advance their organizational missions.

An important step for both of the institutions discussed in the cases was the realization that an economic opportunity existed. Once the economic opportunities were identified, the institutions considered options for development, to capture the potential economic returns, and recognized the need to find a partner in order to remain focused on their institutional missions. The university recognized the need to partner with a private developer from the start of its process, while MGH did not come to this conclusion until the planning exercise was complete with the help of a consultant. Once both institutions recognized the need for private partners, they utilized a similar path to achieve their goals.

The management teams for the developers were similar for both cases, and were examples of good leadership. Both Carpenter & Co. and the private developer for the student housing

project understood the importance of approaching each issue with an open mind and a demonstrated a willingness to listen to concerns of their partner. The differences of ownership time horizons for the institutions, as compared to developers, was one factor that developers needed to consider when approaching these types of partnership negotiations.

Although both sets of partners understood the importance of communication, the two institutions took different communication approaches by giving the developer varying levels of access to institution stakeholders. For example, access to institutional meetings varied: in the case of the MGH project, Peter Diana was invited and regularly attended planning meetings. Although Diana was not attending these meetings to present his company's design, he gained an understanding of what the hospital users needed and what concerned them, and was able to build a relationship with the hospital; these two groups would eventually be long standing neighbors. In contrast, the university developer was not invited to attend design review meetings to explain and defend the development plans, and inefficiencies resulted. Open communication in these projects was critical: for the parties involved in the Liberty Hotel development, open communication played a strong role in the success of the project, and their ongoing relationship.

5.2 Deal Structure:

Though the details varied between these two development agreements, both used the general format of a participating ground lease. Through these ground leases, the developers were able to gain control of sites in prime locations, and the institutions were able to minimize their risk, minimize the projects' effect on their balance sheets, and generate profitable returns. The institutions also benefitted from the eventual new uses introduced to the project sites, once development was complete.

The ground lease, and participating ground lease, is a common structure for institutional development for reasons noted above, though some challenges should also be understood. The private financing that is obtained for development through the ground lease is an expensive source of capital as compared to institutional options for selling bonds, though the ground lease allows institutional capital to remain devoted to the organization's mission. As the institutional-private ground lease deal structure has become more common, rating agencies such as Moody's have changed the way they look at such projects, and the projects' effect on institutional credit ratings⁶⁵. The extent to which an off-balance sheet transaction affects an institution's credit depends largely on the location of the development project, and the extent to which it is intertwined with the institution's mission-oriented strategy. For example, if a university leases land to a developer to build classroom space right next to campus, this would likely be seen as highly intertwined with the university's strategy, and the university would be likely to step-in in the case of developer default; thus the university does have some credit risk in the project. See

⁶⁵ Moody's Investor Service, "Privatized Student Housing and Debt Capacity of US Universities, March 2010.

Appendix A for Moody's full list of criteria in evaluating such institutional deals. Any institution pursuing a real estate development project should consider these criteria.

5.3 Development Concerns:

Identifying a Partner

The owners of the two case project sites took slightly different approaches to finding a partner for the development of their land, commensurate with the specificity of their goals. In the Charles Street Jail case, Partners published a public request for qualifications, with very few guidelines, as the institution was not sure what use would make the most sense in the marketplace. In the case of the student housing project, however, the university sent a request for qualifications to a select group of developers, with a specific use in mind. The university did not suggest any designs or factors in project appearance, but it did identify the use as market-rate student housing, along with the number of units and beds required.

Both institutions were pleased with the development of their properties, and gave a great deal of credit to their partners and the processes used to make each selection. Although both partnerships describe the two projects as having been successful, perhaps one could learn from the other. The university had an advantage in its selection process, because it was positioned to compare proposals from various developers who were all working within the same guidelines, and the same required use. This gave the university a wider variety of realistic options, and could have motivated the potential developers to be more exact in their plans within a competitive mindset. In retrospect, the hospital may have

benefitted by establishing the highest and best use for the jail site prior to receiving proposals, and the university may have benefitted from requiring initial project designs prior to developer selection.

Project Control

The mission-driven organizations associated with the Charles Street Jail and the Market Rate Student Housing Project took different approaches to issues of control. Since the student housing development was under an aggressive timeline, the developer hoped for full control of design; in the end the university could not give up design control, so the two parties negotiated a compromise. In contrast, Carpenter & Co. had complete control over the design of the Liberty Hotel, and Partners was comfortable with this because the initial proposal included a schematic design, and because the design firm was also working on the Yawkey Center.

In both cases, the developer saw significance in being able to select the tenants they saw as a best fit, and outside of some institution guidelines, they were able to manage this process. The same was true for lease rates; the developers had to be able to adjust rates with the market, even though it may be out of alignment with the preferences of individual institutional users.

In order for this type of institutional-private partnership structure to work, the parties involved need to be willing to compromise in order to move forward, but also should search for synergies, which may add value to negotiation outcomes for both sides of the

transaction. A participation clause for a ground lease, as seen in both case studies, can have this effect by creating further incentive for economic success for the institution, which has avoided most of its project risk. This additional incentive assists in aligning the mission-driven organization with the profit-oriented goals of the private developer.

Economic Control

The institutions in these two cases had similar concerns about financing sources, and leverage ratios, though they took slightly different approaches. In the jail development, Carpenter & Co. wanted as much flexibility as possible, and Partners was willing to give up this flexibility so long as the bottom line was not affected. In contrast, while the university developer also wanted flexibility, the university was only comfortable with a set limit on the amount of debt that could be in the deal. The university's restrictions worked for the developer because of its financing source, but in some cases this could have been a problem.

In these transaction structures, the institution is bringing in a partner to minimize its risk, so it needs to be willing to give up substantial economic control. The private developer adds value to the economics of the overall project, and in order for them to be effective they need to have some flexibility in terms of economic restraints.

Chapter 6: Conclusion

Through the examination of the Charles Street Jail and the Market Rate Student Housing Project it is clear that incentive alignment, clear project control and economic control are critical factors in the success of joint institutional-private development partnerships. The most significant factor, agreed upon by all interviewed parties, is finding a strong and trustworthy partner. As discussed, there are different ways of finding the best partner for a particular project, though a Request for Qualifications, or Proposals, process is most common; a thorough process with clear objectives should assist in this initial and critical step in any partnership.

Once a partner is identified, there are several ways of structuring that relationship. The structure examined in this thesis is successful on many levels in the two cases, though it also comes with some notable challenges around the concepts of control. Some institutions, such as Yale University prefer to manage all of their development themselves, primarily because of these issues, which usually arise⁶⁶. When institutions do decide to partner with private developers, a ground lease can separate the development project from an institution's balance sheet, though the project may still affect credit ratings. This is an important consideration in the formation of an institutional-private partnership. Both of the cases discussed in this paper involve compromises from the parties with regard to deal terms. In many circumstances, both parties in a negotiation can actually improve their

⁶⁶ Alexander, Bruce, Personal Interview. June 25, 2013.

positions simultaneously; that is, project negotiations do not have to be a zero-sum game. Opportunities to add value for both sides of a deal can be identified through in-depth understanding of each other's incentives and needs. This concept has the potential to be especially fruitful in institutional-private partnerships, because the two stakeholders have starkly different end-goals; and thus more potential for synergistic opportunities that do no harm to either party.

Urban institutions will continue to grow to advance their missions, and the real estate surrounding their core holdings is likely to become denser and more valuable over time. For a non-profit organization this is problematic, so these institutions must plan accordingly. With uncertainty of the future, institutions should give themselves as much flexibility as possible when developing real estate. Acquiring and holding additional parcels of land, and seeking economic returns through development of underutilized assets can assist with cash flow, and thus increase future flexibility. As institutions try to maintain this flexibility, private development firms can offer efficient and market driven solutions in the short-term; using ground leases while maintaining long-term ownership can create options for future institutional use.

Mission-driven institutions considering the formation of partnerships with private developers will benefit from an in depth understanding of the counter party's goals. A transparent, detailed oriented process is likely to minimize risk for both parties, and encourage negotiation outcomes that will benefit the entire partnership. This should be the goal of any private-institutional real estate development agreement.

BIBLIOGRAPHY

Bowie, Norman E., "University-Business Partnerships." Rowman & Littlefield Publishers, Inc., 1994.

Carpenter and Company, Inc. <http://carpenterandcompanyinc.com/about-us/>.

Dale-Johnson, David, "Long Term Ground Leases, the Redevelopment Option and Contract Incentives" (University of Southern California, 2000), 5.

Dees, Gregory J. and Elias, Jaan, "The Challenges of Combining Social and Commercial Enterprises." Business Ethics Quarterly, Volume 8, Issue 1, 1998.

East West Center, "The Impact of 9/11 and Other Terrible Global Events on Tourism in the U.S. and Hawaii" (East West Center, 2006), 4.

Educational Facilities Laboratories, "Campus in Transition: A report from the Educational Facilities Laboratories." Educational Facilities Laboratories, 1975.

Gerrity, James F., "Analyzing the Private Development Model for University Real Estate Development." MIT Center for Real Estate Thesis, 2009.

Johnson Chase, Katie, "New co-owner for Boston's Liberty Hotel", Boston.com, January 11, 2011. http://www.boston.com/business/ticker/2011/01/new_co-owner_fo.html.

Marchione, William P., "The Charles: A River Transformed." Arcadia Publishing, Charlestown, SC, 1998).

Massachusetts General Hospital, <http://www.massgeneral.org>.

Massachusetts General Hospital,
<http://orientation.massgeneral.org/physicianorientation/pages/mghsub.htm>).

Massachusetts Institute of Technology, 2001. <http://web.mit.edu/mission.html>.

Moody's Investor Service, "Privatized Student Housing and Debt Capacity of US Universities, March 2010.

Perry, David and Wiewel, Wim, "The Urban University as Urban Developer, Case Studies and Analysis." Lincoln Land Institute of Policy, Armonk, NY, 2005.

Clabaugh, Jeff , “Buys Stake in Boston’s Liberty Hotel”, Washington Business Journal, January 4, 2013, <http://www.bizjournals.com/washington/news/2013/01/04/lasalle-hotel-buys-stake-in-bostons.html>.

Wiewel, Wim and Knaap, Gerrit-Jan, “Partnerships for Smart Growth, University-Community Collaboration for Better Public Spaces.” Lincoln Land Institute of Policy, 2005.

Interviews:

Bruce Alexander

Vice President for New Haven and State Affairs, Yale University.

Robin Berry

Senior Real Estate Development Manager for Real Estate and Facilities, Partners Health Care.

Peter Diana

Vice President and General Counsel, Carpenter and Company.

Tim Pattison

Director of Real Estate for Real Estate and Facilities, Partners Health Care.

Market-rate student housing project team, Names anonymous.

APPENDIX A

FIGURE 1

Impact on Credit Quality/Analysis

PROJECT CHARACTERISTIC	LIMITED IMPACT	MODERATE IMPACT	STRONG IMPACT
Location	Project located off-campus and not adjacent to campus	Project located on campus or adjacent to campus	Project located in central on-campus location amid university-owned student housing
Ground Lease	Housing not constructed on university or foundation owned land	University or foundation owns underlying land which is ground leased to a third-party	University or foundation owns underlying land which is ground leased to a third-party
Share of Student Residences	Project is minimal amount of student housing (less than 10%)	Project is meaningful amount of student housing (10-30%)	Project is strategic component of student housing (over 30%)
Student Market Segment	Project is not limited to university use	Project is intended to house upperclassmen, graduate, or professional students	Project is intended to house undergraduate students, especially freshmen
Student Services	No university services available at project	Some minor university services available such as shuttle bus	Similar services available as at other university housing
Rental Rates	No university involvement in setting rental rates	University involvement in setting rental rates along with third-party	University substantially controls rental rates
Marketing and Management	No university involvement in management, marketing, or directing students	University involved in management, marketing, or directing students	University markets project as on-campus housing and manages housing
Project Assistance	No direct/indirect assistance	University assists the project to obtain tax-exempt status	University assists the project in obtaining access to same utility rates and other public services as university-owned student housing
Cash Flow	University does not receive residual cash flow or project at end of financing term	University receives residual cash flow or project at end of financing term	University receives previously established cash flow (not dependent on project performance) and/or is required to purchase project at end of financing term
Construction Risk	No interim or other type of financing extended from university or foundation to developer	Implicit university oversight of the project is an important aspect of mitigation of construction risk	Interim loan to construct the facility eliminating construction and lease up risk
Non-Compete Clause	University does not enter into non-compete clause	University agrees to limited lease up or occupancy tests in privatized housing before building additional housing	University agrees to stringent lease up or occupancy tests in privatized housing before building additional housing
Guarantees and Support Agreements	No university guarantee regarding minimum beds or rent levels; no first fill policy or support agreement; if the university markets the privatized student housing project, it is distinguished from other university housing options	Privatized housing is marketed along with university housing with minimal differentiation in the status of the housing; university agrees to recommend housing to students who are on waiting list.	University enters into minimum bed or rent guarantee, first fill policy, or support agreement
Other	No action taken to enforce payment of rental fees on privatized student housing	University offers option to have financial aid applied directly to rental housing payments, but does not take other action if payment is not made	University requires that financial aid be applied to rental payments and withholds transcripts if rental payments are not made on a timely basis

University Credit Impact Varies Based on Specific Project Characteristics

Moody's believes that affiliated privatized student housing projects always impact the credit profile of an affiliated university to some degree. This conclusion holds for the more traditional as well as newer models of privatization that use equity or corporate level debt of a third party to finance the transaction. In Moody's view, the absence of project-level debt alone does not imply that there is no credit impact, particularly if the project can be leveraged in the future.

ⁱ Moody's Investor Service, "Privatized Student Housing and Debt Capacity of US Universities, March 2010.