Q&A with Goulston & Storrs Attorneys Darren Baird and Martha Frahm on "Reimagining Real Estate"

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Darren Baird and Martha Frahm

*In this Q&A series, "Reimagining Real Estate," **Brian Carrozza**, Senior Manager of Strategic Growth at Goulston & Storrs PC, sits down with attorneys from the firm's market-leading real estate practice to talk about how they see the pandemic reshaping commercial real estate in 2021 and beyond. This month, he spoke with **Darren Baird** and **Martha Frahm**, real estate and tax partners (respectively) in the firm's Boston office, about trends affecting higher education.*

Carrozza: We've seen the grim headlines about the future of small liberal arts colleges, particularly those in the outer suburbs and rural areas. Can they survive in the longer term? Are we likely to see consolidation as some of these institutions shutter? What are some of the ways you've seen real estate—often schools' largest asset—play into these scenarios?

Baird: Institutions with large endowments can deal with a loss of tuition, room and board, and other fees for longer periods without meaningful impacts. But many institutions—especially smaller liberal arts colleges—are struggling because a number of them are already operating at the margin and, in some instances, at a deficit, so they do not have substantial reserve resources at their disposal on which to fall back.

A number of schools implemented relatively aggressive cost-saving measures to help mitigate COVID-19-related losses. That certainly helped them, but those measures are only going to do so much over the long term. If nothing else, COVID-19 has accelerated some of the hard decisions that would have faced institutions in the next decade (i.e., whether to pivot or close), and as a result, we will likely see more closures. With that said, I don't think it's going to be at a rate that will make people's jaws drop. More likely, it will be a couple more schools annually than it would have been otherwise.

Frahm: The issue of survival is going to be compounded by the ability of college leadership to pivot and address the fact that many students coming out of high school in the next year or two have essentially lost a year of education (depending on the school).

If these smaller liberal arts schools can pivot to address those gaps, and maybe launch a different path forward—so it's not the typical four years of high school and four years of college—they might be able to shift the market in a new and interesting direction that meets the needs of the unique circumstances of where we are now.

Carrozza: Has the pandemic forced educational institutions to look for new ways to reduce the capital risk and operational risk associated with things like student housing? Has it created new opportunities for private developers of student housing?

Baird: I expect we will see more universities looking to develop public-private-partnership (P3)-type deals with private developers as it relates to augmenting their student housing stock. The need to deliver a substantial number of quality student housing units is likely going to increase post-pandemic as it is less likely that universities and students will be comfortable in "triples" and "quads." We expect that the newer product will focus on singles, larger doubles, and apartment-style housing, as opposed to suite-style or hall-style dormitories.

P3 housing deals are relatively complex transactions with many competing desires and risk transference issues that need to be negotiated by parties and counsel.

For universities, there is often tension between the desire to maintain control of student-related issues and the academic experience and whether and how such controls will result in the housing having an impact on the university's credit rating, debt capacity, and balance sheet.

For developers, who may be willing to take a bit more risk on a project, they need to know there is enough market demand for the housing and that the university is in strong standing and will continue to be viable when the students return post-pandemic. We think that P3 housing that is located off-campus or near campus may be particularly attractive to a developer and students. Even during the pandemic when several universities are (or were) fully remote, occupancy levels for off-campus P3 housing—especially in more urban areas—remained relatively high as students generally don't want to quarantine with their families.

Carrozza: On the one hand, it's vitally important for higher education institutions to remain flexible, nimble, and responsive to the needs of the community. On the other hand, they must also think about and plan for the future. How are colleges and universities trying to strike the right balance among triaging critical issues, supporting the community, and ensuring institutional longevity for generations to come?

Baird: The reality is that most universities are going to need more physical space to house students if they want to have them on campus. The pandemic emphasized the need for resilient and flexible planning to allow universities to make faster pivots, if there is a need in a certain area, such as the need to separate students in a living and learning environment. Universities face an interesting longer-term issue in their campus planning as they look to expand their campus and physical plant to accommodate current enrollment levels. This planning needs to be done within the context of a currently rising median age demographic worldwide (especially in large, industrialized nations), and a resulting shrinking pool of college-aged people. The smaller applicant pool will undoubtedly impact smaller, less well-heeled institutions that require a full complement of tuition-paying students to remain viable. While these are not legal issues, they are some of the things we help clients think about as counselors and advisors.

Carrozza: How have key tax considerations for higher education institutions changed in light of the pandemic? Are there tax-related changes on the horizon of which they should be aware? What are some of the key issues that higher ed institutions should consider from a tax standpoint when undertaking revenue-generation strategies such as rents, mortgages, and joint ventures?

Frahm: At this point, we don't know to what extent Biden will unwind the Trump administration's excise taxes on higher education endowments and executive compensation. I don't believe there will be a change in the tax provisions associated with real estate development and investment. Most of my discussions right now are focused on the technical rules surrounding unrelated business taxable income (UBTI) and the pandemic's impact on UBTI carveouts such as activities conducted for the "convenience of students." I think we are going to be living with the current UBTI rules for the foreseeable future.

Carrozza: Many colleges and universities have allowed popup COVID-19 testing and vaccination sites to use their buildings, which have been a huge boon to local communities. What are some of the key issues institutions should consider when hosting such sites?

Baird: If a university is leasing space in one of their buildings to a third-party provider doing testing and/or vaccinations, then they have to address tenant issues. From a land use perspective, there might be zoning issues (i.e., whether this use is allowed in the building or on the site) that need to be considered. For the most part, however, municipalities have been creative in allowing these temporary testing facilities to operate under existing zoning, understanding the need to address the immediate public health crisis caused by the pandemic.

Many institutions have provided testing locations during the pandemic and I expect that we will start to see the number of these temporary testing locations contract relatively rapidly as more people are vaccinated.

Frahm: That said, this "the rules don't apply" mentality right now will not last forever. I have been reminding my clients a lot recently that what they've done during the pandemic out of necessity should not set a precedent for post-pandemic operations.

Carrozza: Academic medical centers in the United States have taken on a significant amount of debt within the last few decades as they have worked to improve and expand their clinical facilities. Given this pre-pandemic economic vulnerability, and their reliance on clinical income to maintain cash flow, are academic medical centers being disproportionately affected by COVID-19?

Baird: As we start to recover from the pandemic, it will be interesting to see how quickly the revenues of hospitals recover, and how fast other medical procedures will return. From both revenue and expenditure perspectives, academic medical centers have consistently grown on a year-over-year basis for decades. Last year was the first year since 1960 where revenue growth was generally negative.

This year, it is expected that academic medical facilities will begin to grow again even though home health care and telehealth are likely here to stay in some areas. Pre-pandemic, many academic medical centers had already embraced a more cost-focused, disciplined approach, and this type of scrutiny on costs is going to increase as the recovery continues in this sector.

Carrozza: Finally, I want to turn to two issues that have been ubiquitous throughout much of the pandemic: Paycheck Protection Program (PPP) loans and rent concessions. To what extent have you seen colleges and universities availing themselves of PPP loans? What are some of the trends you're seeing in rent concession negotiations (where the school is the landlord)? How do these two factors impact tax planning and structuring?

Baird: Institutions must have fewer than 500 employees to qualify for PPP, which means that most of our large higher education clients do not qualify for these loans.

Frahm: I helped several smaller, non-endowed colleges with PPP applications which they truly needed. As everyone knows, the guidance was all over the map, but we were able to structure the loans in a way that won't trigger negative tax implications or any special reporting and accounting rules that could otherwise apply.

***Darren Baird** focuses his practice on complex commercial real estate transactions and development. He represents non-profit institutions in all aspects of their real estate and facilities, with a particular focus on academic medical centers and other health care providers as well as institutions of higher education. He is co-Chair of the firm's **Medical, Educational and Cultural** industry group. Martha Frahm is a tax lawyer with broad expertise representing tax-exempt and charitable organizations including educational institutions, health care organizations, academic medical centers, foundations, and other non-profit and charitable tax-exempt organizations. Brian Carrozza focuses on business growth and practice management, serving as strategic advisor to Goulston & Storrs' Real Estate Group, including acting as "chief of staff" to the group's co-leaders. They can be reached at **dbaird@goulstonstorrs.com**, **mfrahm@goulstonstorrs.com**, and **bcarrozza@goulstonstorrs.com**.*

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