Growing the Greater Campus

The Use of Institutionally Related Foundations in Real Estate Activities

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AGB ASSOCIATION OF GOVERNING BOARDS OF UNIVERSITIES AND COLLEGES

About AGB

Since 1921, the Association of Governing Boards of Universities and Colleges (AGB) has had one mission: to strengthen and protect this country's unique form of institutional governance through its research, services, and advocacy. Serving more than 1,300 member boards, 1,900 institutions, and 36,000 individuals, AGB is the only national organization providing university and college presidents, board chairs, trustees, and board professionals of both public and private institutions and institutionally related foundations with resources that enhance their effectiveness.

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Introduction

Public colleges and universities have long turned to institutionally related foundations ("IRFs") to raise private support and manage endowments and other financial assets. From the start, however, IRFs have also served as vehicles enabling public institutions to engage in real estate transactions and related entrepreneurial ventures that advance important institutional priorities but would be impractical or impossible for a state entity to undertake alone.

In recent years, the ongoing decline of state funding, reluctance on the part of state legislatures to allocate funds for capital projects, and the search for alternative revenue sources have led many public educational institutions to look to their foundations to finance, acquire, develop, and manage property.[1] Evolving real estate markets, backlogs of deferred maintenance, long-term returns on investments in sustainability, and student demands for enhanced amenities all require more sophisticated, strategic, and opportunistic approaches to real property development.

A Quick Governance Survey conducted by the Association of Governing Boards of Universities and Colleges (AGB) in 2014 found that over 40 percent of participating IRFs had assumed an increasingly active role in real property projects and entrepreneurial ventures over the past five years.[2] IRFs can be essential partners, advancing multi-faceted solutions to complex institutional challenges. In some cases, foundations function primarily as financial partners, provide essential support in financing, and allow institutions to pursue opportunities unavailable to state agencies. IRFs can also contribute strategic guidance and vision, working with other nonprofits, municipalities, or for-profit corporations in public-private partnerships that might blend philanthropy, revenue generation, and mission-related functions that advance the interests of the institution, community, and business partners. For institution boards, however, simply asking the foundation to do it isn't the answer. AGB's recent report of the National Commission on College and University Board Governance posited that institution boards should devote greater attention to improving oversight of auxiliary and affiliated foundations.

This paper focuses on the new and/or increased role of the IRF and the questions raised concerning (a) which organization is most appropriate to undertake these activities, (b) how the organization should be structured, with an emphasis on the possible advantages and disadvantages of different configurations, (c) how the organization should be governed, managed, and staffed, and (d) the types of real estate projects in which it may get involved.

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1 The acquisition of real property by charitable foundations in support of their state universities is not a new concept. Over 100 years ago, Kansas University Endowment Association acquired property for use by Kansas University. (Lanier & Bass, 2008.)

2 AGB Quick Governance Survey, "The Changing Role of Foundations." January 23, 2014. http://agb.org/2014/01/23/survey-results-the-changing-role-of-foundations-infographic.

IRF versus Institution

Generally, the first question to be asked is, "What are the advantages and disadvantages of an IRF over using the institution proper?"[3] This differs from state to state, but some of the items to consider are:

Advantages of an IRF:

- Flexibility
    - Increased speed and agility to make and quickly close on a transaction
    - Allows a purchase price closer to market value versus one tied to an appraisal
    - May be less rigid on certain contractual provisions (e.g., governing law, indemnification, or environmental issues)
    - Avoids entanglement in state procurement requirements
    - Easier to build off-campus
- Financing
    - Use of alternative methods—secured loans, lines of credit, fixed-and variable-rate loans, interest-only loans, seller-financing, internal investment funds—in addition to taxable and non-taxable bond financing
    - Quick turnaround with private lenders versus working through the state government
    - Possible bargain sale or other donative options
- Construction
    - Commercial building construction standards versus state building construction requirements
    - Ability to choose contractors and suppliers for qualities other than just price because of no "low bid" requirements
    - Less-costly design requirements versus constructing a building on campus (e.g., no LEED certification)
- Use or Disposition
    - Ability to change use or even dispose of property if no longer needed and retain the proceeds, including appreciation in real estate value
    - Adds to the attractiveness of campus by allowing desired retail establishments

[3] This paper is most applicable to public colleges and universities and systems, but independent institutions may find some of the information relevant to their purposes, as well. The focus of the paper is on "off-campus" property development.

- Financials
    - Generates unrestricted revenue
    - Building equity versus paying rent
    - Helps shield the institution from liability
    - Insulates the property from possible disposition due to state budgetary pressures

Disadvantages of an IRF:

- Financing
    - Institution may have a greater ability to obtain financing or have a higher credit rating
- Construction
    - Institution already has existing and experienced construction and facilities staff but the IRF may need to hire such specialized skill sets
- Use
    - Institution may not have to comply with local zoning and use requirements
    - IRF may need to add staff to manage real estate development and operations
- Financials
    - IRF may have less ability to offset unrelated business income (UBI)
    - IRF may have fewer resources to cover start-up losses
    - IRF may have "going concern" issues if there are consistent ongoing losses
    - IRF does not have sovereign immunity or condemnation powers
    - IRF may have to pay real estate taxes

To provide some context, consider that an IRF may have more flexibility financing certain types of real estate transactions. For example, an IRF may be able to finance through a traditional bank loan by allowing a lien to be placed on the property, as opposed to an institution that may be restricted from placing liens on its property. Thus, the IRF will be able to more advantageously leverage the assets for the benefit of the institution. This in turn generates a variety of alternative financing options that can be utilized to further the mission of the institution or organization, such as public-private partnerships or joint ventures.

Also, an experienced IRF may be able to act with greater efficiency, resulting in overall cost savings for the college or university. Compared to an institution engaged in real estate ventures, an IRF is encumbered by far fewer regulatory and administrative burdens. An IRF can act quickly to acquire a property and has greater flexibility on price, contract terms, and even timing than an institution. The approval process for an IRF for property acquisition may be exponentially shorter given that the project is not subject to state governmental review and approval requirements. Moreover, those individuals who have ultimate authority over such development projects at the institutional or state level may be unfamiliar with the real estate's location. This can easily translate into financial issues caused by delays in site plan or permit approval, or a failure to understand and follow local development practices, or a lack of knowledge about whom to contact in an applicable municipality's organization. An IRF should be able to navigate those hazards more easily given its dedicated mission, professional staff, and familiarity with the location. However, unlike an institution, an IRF has to deal with local zoning requirements.

Cost and timing are not the only benefits an IRF can confer to its institution. For example, an IRF is not constrained by having to accept the lowest-cost bidder. This enables the IRF to select the best contractor rather than being compelled to merely accept the cheapest proposal. An IRF must still follow reasonable business practices and conduct arms-length transactions. However, lowest cost is not the only factor that should be considered in undertaking real estate ventures. A better product or faster delivery can correspond to an increase in the functioning of the space, furthering its use and even resulting in lower operational costs. Additionally, projects may be leveraged advantageously based on the use of a particular contractor on multiple projects. Furthermore, the selection of local contractors can provide benefits that ultimately generate unquantifiable returns to the institution on other projects, as well as goodwill in the local community. Future projects may also benefit from employing local contractors, as they are already familiar with the nuances and preferences of the IRF, the institution, and the locality.

Finally, an IRF has significantly more freedom to sell or otherwise dispose of real property based on the changing needs of the institution. The IRF can sell the property without having to follow state surplus property laws or being subject to delays in accepting an advantageous offer because of the need to involve state government. An institution that sells surplus property may be required to transfer the proceeds from the sale into the state's general fund instead of reinvesting the proceeds into the institution. The money received from the sale of property owned by an IRF can be reinvested in other real estate or assets for the use or benefit of the institution. An IRF can also better respond to market conditions and choose whom to sell property to and when, thereby maximizing potential return on its assets. For example, instead of selling a property, an IRF may lease the property to a private entity or even exchange properties, again allowing the IRF to better leverage assets and even limit potential market loss. Often, before an institution can sell a property, it must first offer the property to other public entities or agencies, thus causing more delay and loss of potential revenue from the sale. Additionally, the IRF may have the opportunity to sell the property to the institution at a later date in order to recoup its investment and limit its loss, all the while accomplishing the goals of both the IRF and the institution.

IRF versus REFF

If the answer to the first question is that an IRF is preferable to using the institution, then a logical follow-up question could be: "Is there a need for a dedicated real estate-focused IRF ("REFF"), or can the main IRF undertake these activities?" Some general considerations of an REFF versus the main IRF include:

Advantages of an REFF:

- Isolates risk from the corpus of the main IRF's assets
- Focuses the mission of the organization on real estate
- Develops a board of directors and staff with real estate experience
- Favorable tax treatment of unrelated business income and real estate tax benefits
- Possible non-mission real estate investment opportunities

Disadvantages of an REFF:

- Additional administration/staff time and financial resources
- Another company and board of directors with which to deal
- Further financial/tax reports and filings with resulting expenses

An REFF may be unnecessary:

- If you do not have a concern about risks to the IRF's core assets
- If UBI is not a concern
- If real estate assets are not significant or there is a no plan to undertake a significant amount of real estate acquisition or development
- If there are not significant unrelated uses expected in the real estate development

The examination of REFF advantages over disadvantages listed above is not a uniform comparison, as each IRF is unique in its circumstances and situation. The default position may be to keep all real estate activities within the IRF because of the institution's desire for control and simplicity. To know why and when an IRF would need to create a separate REFF, one must have a complete understanding of what the IRF and its institution wish to accomplish.

REFFs are particularly effective if the desire is to utilize more-complex and subsequently more-lucrative mixed-use development projects. Such projects can enable unprecedented flexibility by allowing the property development to respond more effectively to the needs of that market and thus generate unrestricted revenue as well as attract and retain students and faculty. Many IRFs have boards that are focused on fundraising and composed of donors who have little experience with or appetite for undertaking significant real estate projects. A smaller board comprising real estate professionals may have the capacity to undertake such a project. This also has the added benefit of further involving successful alumni and possibly bringing forth additional resources. An REFF may also isolate the risk of such a development from the core of the IRF's assets. There are downsides an IRF needs to consider, as well. One of the best ways to help make this determination is to understand what is involved in creating and managing an REFF.

REFF Entity Structure

The selection of the proper organizational structure for an REFF should be based on many factors, including but not limited to: subsidiary or independent organization, preferred form of legal entity, the appropriate IRS classification for income tax, governance and administration, and the relationship to the IRF and its institution.[4]

Subsidiary or Independent Organization

A threshold issue will be the amount of direct control the IRF wishes to have over the REFF. If the IRF wishes to assert direct control or even ownership over the REFF, then it needs to be a "subsidiary" organization. The IRF will direct the activities of the REFF. It may control and/or appoint the board of directors of the REFF. It may provide the administration and staff of the REFF. The relationship to the institution would be through the IRF. The mission of the REFF may be a complementary mission of the IRF to develop private real estate assets to benefit the IRF and institution. Alternatively, the REFF may be an "independent" organization with little IRF control. The IRF would not "own or control" the REFF. The board could be self-appointing. It may have a direct relationship with the institution separate and apart from the IRF. It may have a separate mission from the IRF that may be focused on fundraising. The choice of subsidiary versus independent status will affect the type of legal entity that needs to be created.

REFF Entity Structure

Subsidiary or independent real estate focused foundation supporting the college or university and/or the main IRF

- Subsidiary
  - Direct control or ownership by IRF
  - Relationship with institution through IRF
  - Potentially less independence and separation from IRF
- Independent
  - Independent board/leadership from IRF
  - Direct relationship with institution
  - Potential separate mission from IRF

[4] The discussion provided herein related to legal structure or taxes is for informational purposes only and should not be substituted for seeking appropriate guidance from your legal and tax professionals for your particular situation and circumstances. Nothing in this paper should be construed as providing legal or tax advice.

Corporation versus Limited Liability Company

The most common business entities for REFFs are traditional non-stock or nonprofit corporations or, more recently, limited liability companies ("LLC").[5] The tried and true traditional corporation with a separate board, annual meetings, and all of the usual corporate trappings remains the most favored. Although there are ways to streamline the corporate structure through interlocking boards and administrative staff without creating the full operating structure that a separate corporation would normally require, another corporation may still be overly burdensome because of its costs and required procedures for its operation. If the goal is merely to create a secondary legal barrier for real estate development and litigation purposes, an LLC may be a better option, depending upon the requisite state law. Creating a single-member LLC (SMLLC) may provide the flexibility in structure without adversely affecting the purpose. An SMLLC does not need many of the traditional corporate formalities, and the IRS classifies an SMLLC as a "disregarded entity," which means it assumes the tax status of its tax exempt parent and will not be required to make any separate tax filings. This designation, versus seeking tax-exempt status as a traditional corporation, will save time and administrative work. However, many people, especially board members and university senior administrators, are more comfortable with traditional corporations, so expect some pushback resulting from a

Corporation vs. LLC

Subsidiary or independent real estate focused foundation supporting the college or university and/or the main IRF

- Corporation
  - Need to follow corporate formalities
  - Need board of directors
  - Taxable or tax exempt
    - Need IRS approval for tax-exempt status
  - Additional tax return and audit expenses
  - Long standing familiarity with corporate structure
- Limited Liability Company (LLC)
  - Avoids most requirements for corporate formalities
  - More flexible company structure
  - No separate board or meetings required
  - Single Member LLC (SMLLC) – must be owned by IRF
    - Disregarded by the IRS for tax purposes
    - Automatically classified as a tax- exempt entity
    - Financials roll into parent
    - No separate tax return or audit required
  - Recent IRS ruling allows tax-deductible donations to LLC
  - Relatively new type of entity, so possible lack of familiarity by legal counsel, board, and your local and state governmental officials on tax-exempt status

[5] This paper will not address the question of whether real estate activities could be undertaken in a for-profit entity.

move towards the relatively newly created LLC format. Please note that there are times when a separate corporation with its own tax-exempt classification will make more business sense than an LLC, as we will describe later in this paper.

IRS Classification

An REFF may be organized in a way to engage in a variety of real property development that makes it better suited to not incur unrelated business income tax. Specifically, the main IRF, based upon its classification and relationship to its institution, may not enjoy the same flexibility as an REFF when it comes to the use of debt-financed property and unrelated business income tax. These tax nuances characterize the potential need to utilize an REFF over that of the main IRF.

Determining the structure of the entity is important, especially as it concerns how the IRS classifies the relationship between the REFF and its IRF and/or institution. In light of recent scrutiny, if careful attention is not given to these relationships, there may be serious adverse tax consequences.

In order for any organization to receive tax-deductible contributions and beneficial tax treatment, it must be tax-exempt under IRC (Internal Revenue Code) §501(c)(3). REFFs are and should be designated as 501(c)(3) public charities and can achieve this status in one of three ways: as a publicly supported organization or §509(a)(1), a supporting organization or §509(a)(3), or a hybrid organization.

- Publicly Supported
  - An REFF can qualify as a public charity under 509(a)(1) and 170(b)(1)(A)(iv) or (vi) if it derives a "substantial part of its support" from donations from direct or indirect public contributions.
  - Often, an IRF acts only as the fundraising arm of the institution. Another model is to have the IRF serve as an asset management organization, with the fundraising role left to the institution itself. In most instances, an REFF would not normally be looked to as a fundraising organization, although it might accept donations of real property from time to time.
  - To qualify as a publicly supported organization, an REFF would be required to meet a public support test requiring that it have a broad base of support from the general public. Thus, a majority of administrative efforts might be spent raising donations and engaging in compliance activities instead of real estate development. This level of distraction could limit the effectiveness of the REFF.

- Supporting Organization
  - Supporting organizations under IRC §509(a)(3) receive public charity status because of their relationship to another public charity or public instrumentality without regard to the source of the organization's income and through its assistance to its affiliated public charity or organization. To qualify as a "supporting organization," the IRS requires that the organization meet three criteria:
    - First, it must be organized and operated exclusively for the benefit of, to perform the function of, or to carry on the purposes of one or more publicly supported organizations, as described in IRC § 509(a)(1) or IRC § 509(a)(2), the "organizational and operational tests."
    - Second, it must be operated, supervised, or controlled by, or in connection with, one or more publicly supported organizations (the "relationship test"). The relationship test requires an REFF (supporting organization) to hold one of three statutorily described close relationships with the public university (supported organization). The REFF must be: (1) operated, supervised, or controlled by a publicly supported organization ("Type I"), (2) supervised or controlled in connection with a publicly supported organization ("Type II"), or (3) operated in connection with a publicly supported organization ("Type III"). When a public university is involved, Type III status is often preferred to avoid control of the REFF by the university, which can subject the REFF to state rules and reporting requirements. Federal tax law changes, however, have made it more difficult to be designated a Type III supporting organization.
    - Third, in order to qualify as a supporting organization, it must not be controlled directly or indirectly by one or more disqualified persons other than foundation managers and other than one or more publicly supported organizations (the "lack of outside control test").
  - Given the nature of the REFF activities, it would seem that a supporting organization classification would be most reflective of its desired activities of real estate development to benefit the institution.

- Hybrid
  - One hybrid structure is an IRF that is classified as a publicly supported organization under §509(a)(1) with a subsidiary REFF set up as a separate supporting organization or 509(a)(3). It can be a Type I supporting organization that avoids the Type III rules by having the IRF appoint a majority of the directors of the REFF. Thus, the IRF acts as the REFF's parent, but the REFF retains its own separate tax and legal status.
  - A similar model is to create an SMLLC (which does not have to apply for tax-exempt status, as it receives such status automatically from its exempt parent as a disregarded entity) so that if the tax-exempt parent is classified as a public charity (509(a)(1)) or a supporting organization (509(a)(3)), then the SMLLC holds the same tax status. The SMLLC must still comply with the obligations of its owner's tax classification to avoid jeopardizing its owner's tax-exempt status. The REFF could be created as an SMLLC under a 509(a)(1) or 509(a)(3). In addition, a series of SMLLCs could be created for various real estate projects if needed under the ownership of either the REFF or the IRF.

There are a multitude of tax considerations to be evaluated when IRFs seek to diversify their interests, and even more when it involves the development of real property. One such consideration is UBI.[6] "An exempt organization is not taxed on its income from an activity substantially related to the charitable, educational, or other purpose that is the basis for the organization's exemption."[7] Generally, all rents from real property are excluded from being considered unrelated business income tax (UBIT).[8] However, all or a portion of the income from a "debt-financed property" is included in the calculation of UBIT as determined under Internal Revenue Code section 514.[9] Thus, otherwise "passive" income in the form of rent, originally not subject to UBIT, may become subject to UBIT if the property generating the income is "debt-financed property." Passive income includes amounts received or accrued as consideration for entering into agreements to make loans, dividends, interest, annuities, royalties, or rents from real property. Debt-financed property refers to any property that is held to produce income, with respect to which there is an "acquisition indebtedness" (some form of borrowing used to acquire or improve the property) at any time during the taxable year.[10]

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6 The IRS has noted that unrelated business income tax is a concern. Colleges and Universities Compliance Project, IRS, 2013. http://www.irs.gov/Charities-&-Non-Profits/Colleges-and-Universities-Compliance-Project.

7 IRS Publication 598 (March 2012).

8 IRC § 512(b)(3)(A)(i) (2011).

9 IRC § 512(b)(4) (2011).

10 IRC § 514(b)(1) (2011).

Debt-financed property does not include property whose use is substantially related (aside from the need of the organization for the generation of income or funds) to the organization's exercise or performance of its exempt functions.[11] Thus, one way to avoid the effect of the debt-financed property rules is to use the debt-financed property in this manner. The most common scenario in which debt-financing property rules do apply is when the property is used for the purpose of producing income (i.e., as an investment), rather than for carrying out an exempt function.[12]

Thus, to avoid rent from real property being subject to UBIT, the property at issue must either be used in furtherance of the organization's exempt purpose, or the organization's real property investment must avoid being categorized as debt-financed property because of "acquisition indebtedness." Generally, both instances are almost impossible for general educational IRFs to avoid given the fact that most real property includes some private tie-in and the need to borrow to fund most real estate projects.

However, having a separate and distinct REFF from the main IRF may avoid the adverse consequences of UBIT. This is evidenced in a special exception from the definition of "acquisition indebtedness" that may be available in the case of educational organizations. Under IRC §514(c)(9)(A), acquisition indebtedness does not include indebtedness incurred by a "qualified organization" in acquiring or improving any real property. A "qualified organization" is defined in IRC §170(b)(1)(A)(ii), and its affiliated support organizations are described in IRC §509(a)(3).[13] Pursuant to IRC §170(b)(1)(A)(ii), a qualified organization includes an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

As discussed previously, many IRFs may not be classified as supporting organizations under IRC §509(a)(3), but instead as organizations described in IRC §509(a)(1). An REFF may not be deemed a qualified organization under IRC §514(c)(9) unless it is classified as a supporting organization to an educational institution. However, if properly formed and classified, an REFF may have unrelated uses as well as debt-financing but still avoid having UBIT.[14] A final thought is to also look closely at so-called "good and bad use" as related to certain types of tax-exempt bond financing, which has different IRS rules than UBI. These sorts of circumstances demonstrate the need for using experienced professionals, as described in more detail below.

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[11] IRC § 514(b)(1)(A)(i) (2011).

[12] Property "substantially all" is defined as at least 85 percent of the use is substantially related to the exercise or performance by an organization of its exempt purpose or function. Treasury Reg. § 1.514(b)-1(b)(1)(ii).

[13] IRC § 514(c)(9)(C) (2011).

[14] Thanks to Michele A. W. McKinnon of McGuire Woods LLP for her assistance in framing this section.

Governance and Administration

The advantage of developing a board of directors or advisors with real estate development, construction, and financing experience should not be underestimated. These board members can often provide sage advice, help avoid pitfalls, find opportunities, supplement staffing, and even offer funding solutions. However, it is an important to keep in mind that board members (such as developers) may not benefit personally from these real estate opportunities because of conflict of interest rules and certain IRS regulations. Additionally, board members may want to be more involved than the institution or the IRF's management prefers them to be, thereby creating a potential future internal governance conflict. This issue may be mitigated by outlining the roles and responsibilities of the board members at the outset. It may even make sense to develop a smaller real estate committee within the IRF board to help narrow focus and permit (or limit) board involvement. In some circumstances, having a small, dedicated committee with real estate experience could prove quite beneficial because the full board may be resistant to undertaking these types of activities without the encouragement and supervision of board members with relevant business experience.

Governance and Administration

- Building the board's expertise
  - Tapping into the board's experience and service
  - Board develops its own agenda
- Staffing requirements
  - Foundation resources/staff
  - Management experience
  - Appropriate skill sets needed in:
    - Construction
    - Real estate
    - Project management
    - Leasing
    - Facilities management
  - In-house, university, or outsource functions
  - College/university resources/staff
    - Independence concerns
    - Diversion of state resources
  - Workload
- Relationship with the college/university
  - Importance of maintaining an excellent and transparent collaboration

When staffing an IRF/REFF, one must be careful to not blur the line between the institution and the IRF/REFF, which could subject the autonomy of the IRF/REFF to further state scrutiny. In some states, an IRF may risk its independence if it accepts benefits from the institution. Despite this concern, IRFs/REFFs often share human resources with their institutions to avoid duplication of services and costs, and to avail themselves of specific expertise available at the institution. Often, the institution's employees also serve as the staff for an IRF/REFF. In other examples, the REFF will employ its own employees, separate and distinct from the institution or even the IRF. To avoid the blurring of this line, it may be advisable that the employees of each organization be kept separate and that their responsibilities remain distinct from one another. An alternative is to hire outside third parties to undertake most of the real estate activities of the REFF, although that may be an expensive endeavor that ultimately does not increase the skill set or ability of the in-house REFF staff.

Regardless of the specific staff and governance structure, both board members and staff should be vigilant to avoid or scrupulously manage conflicts of interest or the appearance thereof. Some of the most devastating breaches of fiduciary duty on the parts of foundation boards and senior executives have stemmed from outright conflicts of interest, conflicted loyalties, or lapses in obedience to the mission of the institution and/or foundation. As in the case of financial investment management, it may be appropriate for institutions and foundations to apply heightened standards regarding conflicts of interest to staff and board members closely involved in real estate project decisions. (For more, see the 2013 "AGB Board of Directors' Statement on Conflict of Interest with Guidelines on Compelling Benefit.")

As previously described, having an REFF separate from a main IRF provides certain benefits. Regardless of whether an REFF or the main IRF itself engages in real property development, if financially feasible and provided there is sufficient workload, it is advisable to employ certain specialized staff who have the ability to handle the nuances associated with such projects. The IRF/REFF staffing needs are dependent upon the number and/or size of the projects undertaken by the REFF. Thus, even though it might be ideal to have specifically dedicated employees for each function, it may not be realistic. Generally, a real estate director, property manager, leasing manager, and facilities manager would all be helpful to effectively facilitate an REFF's real estate projects. It is useful to develop a financial model on the costs involved in developing such a specialized staff, keeping in mind that said staff is likely to bring an increased level of efficiency and future cost savings.

Relationship of IRF/REFF and the Institution

The IRF/REFF, and especially the institution, must be fully supportive of each real estate transaction and project undertaken by the IRF/REFF. The relationship between the organizations must be strong and transparent in order for it to succeed. If there is a lack of confidence in the IRF/REFF by the institution, then it will never achieve its true potential. This is true on all levels of governance and administration of the organizations, not just the institution's board and senior management. For example, if the lower-level real estate department staff at the institution does not have a strong relationship with or feels threatened by the IRF/REFF, then it may be quite difficult for the IRF/REFF to fulfill its mission or to reach its maximum potential.

Do you need an REFF? Some questions to consider before deciding:

- Do you foresee future real property development as a means to meet the growth needs of your institution or as a source of revenue?
- Do you require flexibility in the use of property?
- Do you have concerns about potential liability of an activity being conducted at the property?
- Will the building have mixed uses unrelated to your exempt mission?
- Do you plan to debt-finance the development?
- Do you have a staff with real estate experience?
- Do you have a desire to develop or cultivate a separate board with real estate experience?

One way to address the relationship is through a formal memorandum of understanding (MOU) between the IRF/REFF and the institution. At a minimum, the MOU should clearly define the relationship between the institution and the IRF, if it is a fully autonomous or independent IRF. An MOU with an interdependent IRF should clearly articulate its standing as a separate 501(c)(3) organization serving a public trust.[15]

Types of Projects

Many institutions tap outside developers, including their own IRFs, to assume the responsibility for the growth area of student housing development and maintenance. The reasons vary but they include a desire to avoid spending limited capital on student housing or accruing the additional costs associated with construction of student housing under or through state building requirements, or a wish to complete the construction in a quicker timeframe than state construction practice normally permits, and with non-traditional amenities. There are great rewards in these types of developments, but there are also risks that an IRF may want to isolate from the corpus of its other assets. Employing a separate supporting organization, such as an REFF, may help mitigate these risks but still allow the rewards to accrue to the IRF.

In addition, institutions may want to involve IRFs in the construction of academic and administrative buildings, laboratories, hotels and conference centers, upscale retail and restaurants, research parks, athletic facilities, golf courses, student centers, structured parking, mixed-use projects, shopping centers, international properties, and other sophisticated facilities located on or off-campus.

An IRF may also want (or need) to look to some sort of public-private partnership (PPP) or joint venture (JV) with private entities to create a development on either university-owned or privately owned land. These PPPs or JVs can take many forms, and in some localities, it may be easier to undertake a JV through an IRF rather than through the institution itself. Some reasons for engaging in a JV include greater access to private capital or to privately held, well-located land, or a desire to benefit from the experience of a for-profit entity in certain types of development projects. Please note that the IRS has particular rules about joint ventures between nonprofits and for-profits, so it is important to consult experienced legal counsel as appropriate.

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15 "Illustrative Memorandum of Understanding Between a Public Institution or System and an Affiliated Foundation." Association of Governing Boards of Universities and Colleges, 2014. This illustrative MOU provides some excellent suggestions about what an MOU between the institution and IRF should contain to help clearly define the relationship between the organizations.

Conclusion

An IRF can be an essential player in the success of an institution's overall real estate efforts. The flexibility, reduced regulatory burdens, and overall cost savings an IRF offers can be significant. There are various legal structures for the IRF that may result in both favorable and unfavorable tax results. The IRF's ability to undertake a wide range of projects offers many possibilities but requires an experienced board, dedicated management, and knowledgeable staff. Also, for an IRF to serve its ultimate purpose, a coherent partnership between the institution and the IRF must be maintained in order to produce the most beneficial outcomes for the college or university. The determination to create an REFF has advantages and disadvantages, as well, depending on the overall real estate strategy. What is clear is that higher ed's need for additional real estate will continue unabated, and utilizing IRFs for such purposes offers but one approach to filling that need.

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About The Authors

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