Alternative Higher-Ed Financing: Using Energy Conservation and Tax Credits to Maintain the Campus-Quo

Executive summary

The mission to finance operations, equipment and projects at institutions of higher education has become a formidable challenge due in no small part to mounting energy costs, the demand for IT services and upgrades, diminished endowment and investment income, and the competition for students. In response, college and university officials need to understand alternative sources of financing in order to maintain facilities, keep current with the latest technology and ultimately attract the best students.
Energy conservation and financing solutions

One of the first places institutions of higher education can look to for savings and increased cash flow is energy use. According to the Environmental Protection Agency’s ENERGY STAR program, U.S. colleges and universities spend in excess of $14 billion annually on energy, a figure that can be reduced by as much as 30% through conservation.

In considering ways to finance energy costs, schools should first conduct a comprehensive analysis of their energy consumption and waste, an analysis that might also include efficient ways to add production, such as solar panels, parking lot shade and geothermal heating and cooling.

Bank of America Merrill Lynch plays a role in guiding client higher-ed institutions to energy service companies, or ESCOs, which are in the business of assessing campus energy consumption and designing comprehensive energy conservation plans. The value of a professional assessment, says Christopher Giuliano, managing director of energy services at Bank of America Merrill Lynch in San Francisco, is that it “helps a university or college see the total picture of what they’re using, what they’re spending, and then manage the spend to attack the biggest areas where they can get the most cash back or the most efficient systems to accomplish long-term goals.”

Once an energy conservation plan has been completed, a financial model that shows the cash flows associated with energy-related savings is used to tailor a financing solution that balances development costs and energy savings over time. “The ultimate goal is a cash-flow-neutral or even positive project for institutions,” Giuliano says. “Clients get new assets, new upgrades to their existing systems, critical maintenance, and deferred maintenance for no money down. And when the financing is paid off, the schools continue to realize savings with those assets and generate positive cash flow.”

Qualified energy conservation bonds

Bank of America Merrill Lynch also makes use of Qualified Energy Conservation Bonds, or QECBs, federal tax credits that are allocated to states and can be re-allocated to state universities. QECBs are direct subsidies in which 70% of the posted tax credit can be used as a subsidy from the federal government and, in some cases, can be cheaper than tax-exempt lease purchase agreements (TELPs), which higher-ed institutions frequently use. Since a QECB often covers only a portion of a campus project, however, the bank structures solutions that combine the tax credit with a TELP.

“The goal is the optimization of the available products to drive to the lowest possible and most efficient form of financing,” notes Giuliano. “When an institution can partner with someone who can model the QECB for them and show them how it works, it can be a very effective tool.”

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Managing Director
Energy Services
Bank of America Merrill Lynch
New markets tax credits

Meanwhile, two other tax credits, which have largely gone unpublicized and underutilized, are being used to help fund public-private developments that serve the needs of both public and higher-ed communities.

The New Markets Tax Credit program was rolled out near the end of the Clinton Administration and is managed by the U.S. Department of the Treasury. Designed to attract private capital to low- and middle-income communities in order to support small businesses and residents, the program has evolved to aid the higher education sector by partnering investors, like BofA Merrill Lynch, with private developers, non-profits, and colleges and universities to develop off-campus, mixed-use real estate.

In New Brunswick, New Jersey, for example, New Markets credits made up the biggest subsidy funding a large mixed-use project — including market-rate housing, affordable housing, retail and office space — whose anchor tenant is a much-needed campus bookstore for a nearby university. As a partner in the development, BofA Merrill Lynch is monitoring its investment, along with job benefits and income levels in the community.

“The financial benefits are best demonstrated by the amount of the subsidy that goes into the development, and the millions of dollars in equity that we place in the transaction,” says Brian Tracey, a Community Development, Lending and Investments executive at BofA Merrill Lynch in Washington, D.C. “If the project works, then that equity stays in the transaction.”

Historic tax credits

A lesser-known federal tax credit for off-campus projects in partnership with private developers is the historic tax credit, administered by the National Park Service under the U.S. Department of the Interior. In cities where a college or university is a major property owner with an interest in the vitality of the community, the credit can assist it in attracting private capital and playing a major role in redevelopment while serving students and staff.

On the west side of Baltimore, Maryland, BofA Merrill Lynch made a $100 million commitment 15 years ago to develop several distressed properties in collaboration with a local university, city government, philanthropic organizations and the business community. Key to the success of the large-scale project was the use of historic tax credits, with the bank providing the equity.

“That redevelopment effort has spurred millions of dollars of investment,” Tracey says. “Our $100 million commitment eventually resulted in the bank providing loans and investments totaling more than $200 million.” BofA Merrill Lynch is continuing to invest, along with the school, in that part of the city.
Equipment financing

Perhaps the greater area of growing need for colleges and universities, nationwide, is financing for new IT assets and upgrades.

“It’s become a huge line item that’s bubbled up on balance sheets, and universities are looking closely at it more than they ever did in the past,” says John D. Lynch, a senior client manager at BofA Merrill Lynch in Raleigh, North Carolina. “In the past, schools would most likely use cash to pay for these assets or go to the bond market, where they would get rolled into a big bond deal. But they’re not doing that so much now. The bond market has changed, the higher-ed market has changed.”

As IT becomes a larger — and more competitive — factor in attracting students, some schools are including the cost of new laptops for undergraduates, for example, in tuition and using equipment financing to pay for them. In these instances, BofA Merrill Lynch acts as the leasing partner with an IT service company, which provides a standing refresh program for old laptops, and structures four-year repayment plans that match incoming tuition payments.

But BofA Merrill Lynch is also making more tax-exempt direct loans to colleges and universities than in the past, with the tenors stretched to new lengths. Where the bank would lock in pricing on a 20- or 25-year amortization for a three- to five-year period, now it is committing to pricing for seven, ten, and in some cases 15 years.

In general, institutions of higher education are rethinking how to pay for nearly every aspect of campus operations, while maintaining curb appeal and responding to pressures to reign in tuition inflation.

“Schools are having to get creative,” Lynch observes. “You can only do more with less for so long before you get to the point where you’re doing less with less.”