RISK TAKING:

PUBLIC-PRIVATE PARTNERSHIPS AND EFFECTIVE GOVERNING BOARDS

BY DARRYL G. GREER AND MICHAEL W. KLEIN

TAKEAWAYS

1 Risk assessment reflects the fundamental purpose of trusteeship, which is to protect and preserve the integrity of an institution in all respects and to provide appropriate guidance to assist the institution to fulfill its mission.

2 Diminished state and federal funding have contributed to a changed financial environment in which institutions must find new revenue streams, together with more efficient cost-management tools. One way is by building public-private partnerships with businesses and other constituencies outside of higher education.

3 Any successful partnership requires, from the beginning, explicit agreement on goals, a commitment to shared responsibilities, and transparent communications. And all public-private partnerships must, in the final analysis, serve the mission of the institution.

ENTERPRISE RISK MANAGEMENT (ERM) should be at the heart of what governing boards do. The concept of risk assessment crystallizes the board's explicit fiduciary responsibility, reflecting the fundamental purpose of trusteeship, which is to protect and preserve the integrity of an institution in all respects, and to provide appropriate guidance to assist the institution to fulfill its mission. In the final analysis, the whole should be greater than the sum of the parts, one in which the dynamic of focus on the big picture and big idea of mission accomplishment connects with sustaining public trust.

With this principle in mind, we suggest some ways in which boards may employ ERM—using public-private partnerships (PPP) as an example—to advance effective trustee governance. We will highlight some of the benefits, note cautions about things to avoid or overcome, and pose key questions that presidents and trustees need to consider.

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New Revenue Demands, Greater Risks, and Transparency

The model by which we finance American higher education is rapidly changing from one characterized by public financing as a public good to one that is privately funded from tuition and user fees and supplemented with revenue from non-educational business income. Expectations for greater accountability for college value and outcomes stem from students paying an ever-increasing share of educational cost at public institutions (which educate the majority of students), a diminishing proportion of college revenue coming from state appropriations, and increasing student and family indebtedness to pay for college.

Coupled with a changing financial environment, universities must grapple, too, with several other tests to support their educational and service missions. These include educational delivery challenges, such as competition from new, non-traditional providers; the purchase and integration of current technology; and the renovation and construction of facilities that are not funded by public dollars.

These trends have created an era of enterprise for all institutions, one in which new revenue streams, together with more efficient cost-management tools, must be found by building partnerships with businesses and other constituencies outside of higher education.

An Inadequate Response to Risk Assessment

Entering into new partnerships with private and nonprofit organizations has often required colleges to create their own entities, beyond those that already exist, to take advantage of the new flexibility. These organizations, usually created as nonprofits, typically are governed by a board of directors, separate from the board of trustees, but often overlapping with constituent members of the institution. In many cases, these members include president, vice president for finance, chief development officer, trustee and foundation representatives, students, and community members. In other words, their makeup looks much like that of existing foundation boards.

Yet, the business and legal complexity, and special purposes of these new organizations designed to foster meaningful public-private partnerships, raise questions regarding transparency and public accountability for college and university boards of trustees. These new organizations and partnerships require a governing board to take greater responsibility in assessing risk and more responsibility for evaluating how these structures and partnerships support and advance the institution's mission.

Unfortunately, a 2009 AGB report, "The State of Enterprise Risk Management at Colleges and Universities Today," found that 60 percent of trustees surveyed said their colleges do not use comprehensive, strategic risk assessment to identify risks to mission success, and that less than one-half of respondents agreed that senior administrators and board members actively engage in discussion of institutional risk.

Beyond student housing, public-private partnerships help to finance and construct redevelopment projects.

A Strategy for Enterprise Risk Assessment

As the National Association of College and University Business Officers (NACUBO) pointed out in a 2001 white paper, "Developing a Strategy to Manage Enterprisewide Risk in Higher Education," all successful organizations engage in risk taking that may be categorized by at least five different types:

1. Strategic risks that affect a university's ability to achieve its mission, such as market competition and enrollment management.
2. Financial risks that may threaten the assets of a college, for example investments and endowment management.
3. Operational risks that affect administration of the institution, such as implementation of new systems to manage information technology or human resources.
4. Compliance risks that relate to meeting standards established by law or regulation, as well as those stemming from internal policy and procedure.
5. Reputational risks that affect the college's image or brand, for example opening a new branch campus or making major new investments in controversial athletic programs.

In dealing with these types of risks, an important conceptual factor for governing boards to consider is performance versus design risk assessment. Put another way, some risks are built into the way in which policy and administrative decision making is structured, while others are more dynamic in nature, and spring from external challenges and opportunities, or crisis situations unforeseen by boards. For example, failure to put in place administrative safeguards to comply with environmental standards required when constructing a new building indicates a breakdown in internal policy needed to monitor and administer such compliance. Noncompliance could lead to strategic, financial, and reputational penalties.

On the other hand, a board's policy and administrative practice governing land acquisition may be clear, but the process by which the real estate transaction is conducted results in legal disputes or financial exposure that places the institution at a strategic disadvantage or risks the college's reputation. Other clear examples include how a college responds to grievances from faculty,

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staff, and increasingly students concerning racial and gender inequities and unwarranted or unethical behavior of staff or athletes.

Conversely, not all risks are negative in nature. Some risks stem from opportunities to advance the institution's mission, such as a prospective major gift from a donor or a request from the government or a corporation to conduct a major study of regional, state, or national importance. Accordingly, board members need to engage in continuous ERM in order to be aware of the risk of missing an opportunity.

Key Elements in Managing Risk

In order to effectively manage these five types of risk, boards of trustees should seek to:

- Place risk management at the center of board decision making about mission accomplishment;
- Ensure that senior management is committed to ongoing risk assessment;
- Make certain that someone other than the president is assigned central responsibility for risk management;
- Encourage and reinforce the benefit of ERM throughout the institution;
- Ensure proper board and staff training in the value and application of ERM;
- Establish human resources policy to reward effective risk management;
- Focus ERM processes on opportunities as well as potential problems; and
- Integrate risk management into the internal audit function, then monitor and evaluate its application.

In providing for these important ERM good practices, boards and presidents are cautioned to avoid some common obstacles to effective risk management, as suggested by the accounting and consulting firm Grant Thornton, LLP:

- Viewing ERM as a project rather than an ongoing process;
- Failing to use ERM as a means of setting priorities, and instead getting bogged down in inaction by attempting to identify all possible risks;
- Creating processes to go around risk management for the sake of comfort or convenience;
- Failing to properly identify the intensity of and long-term versus short-term nature of certain risks; and
- Inability to evaluate risks because of absence or inappropriate use of risk indicators.

Public-Private Partnerships: Purpose and Structure

Federal agencies such as the Federal Highway Administration define a PPP as a contractual agreement between a public agency and private body to allow greater private-sector participation to deliver and finance projects. Usually a PPP provides innovative means of contracting, including varying degrees to which the private entity assumes responsibility, including financial risk. The private entity performs functions often associated with a public agency to serve a public purpose, but the public partner remains accountable for the facility or service provided.

Such is the case with colleges, which often create an affiliated body with nonprofit status, and may involve a quasi-public facilitating agency, in addition to contracting with a private company to renovate, construct, operate, maintain, or manage a facility or system. Types of PPP contractual arrangements include design-build, construction manager at risk, build-own-transfer, lease back, and other types of arrangements.

Public-private partnerships are often used to construct student housing. Under a typical PPP, a university leases property to a developer, which finances the project with its own equity or with corporate debt. After the facility is constructed to the institution's specifications, the developer usually handles the maintenance of the facility. The developer recovers its costs through room fees. For example, Montclair State University in New Jersey built a 2,000-bed facility called The Heights in 2012 through a public-private partnership with Capstone Development Partners, which financed the $211-million project with tax-exempt bonds. The University of Kentucky transferred control of about 6,000 campus beds and apartments to Education Realty Trust in 2012. The university receives ground-lease payments for its land. In exchange, Education Realty collects rent payments from students, and it will also spend up to $500 million to upgrade and construct new dorms, providing more than 2,500 beds in the next few years.

Beyond student housing, public-private partnerships help to finance and construct redevelopment projects. Mixed-use facilities connecting colleges to their towns benefit local businesses and residents as well as students, faculty, and college staff. For example, Kent State University is partnering with the city of Kent, Ohio, and private developers on a $110-million, 500,000-square-foot project that includes facilities for the university, such as a building for its College of Architecture and Environmental Design; retail and office space; and a transit center. The College of New Jersey's Campus Town and Rowan University's Rowan Boulevard are two mixed-use PPP success stories in New Jersey.

A key distinction of a PPP from traditional asset development-management schemes is mutual sharing of risks, and in the case of the college, shifting some of the risk burden for performance from the institution to the private sector. Accordingly, important considerations for boards of trustees are the primary purposes served by the partnership, the incentives provided to the private partner, and a thorough understanding of how risks will be shared and assessed.

A PPP proposal from Ohio State University in February 2015 reflects the types of risks at stake. Ohio State proposed a 50-year concession and lease regarding its energy systems, with four components for the private partner: (1) operate and maintain the utility system on the Columbus campus; (2) procure the energy supply for the Columbus

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campus; (3) achieve energy savings goals, including energy conservation measures; and (4) develop an affinity relationship with Ohio State, including research collaboration with faculty, scholarships and internships for students, and integrated co-branded energy marketing opportunities. The private partner risked a 50-year investment in exchange for an anticipated long-term, predictable cash flow, especially with new facilities for health sciences, student housing, and athletics scheduled over the next 10 years. The university risked the certainty it had in short-term contracts for electricity in exchange for a substantial up-front payment and a new compensation structure under proposed rate-setting mechanisms with the private partner.

Principles of Good Practice and Some Issues to Avoid

Even though PPP may provide significant benefit, some principles suggested by Hanover Research and the National Conference of State Legislatures require careful consideration:

1. Keep the mission-related purpose in focus.
2. Stay informed and make decisions on a factual basis.
3. Continually assess the public interest.
4. Define success in the long term.
5. Involve and educate stakeholders.
6. Make the purpose drive the means, not the other way around, as things change.
7. Make sure that the partnership approach is superior to the traditional one.
8. Be clear about financial means and outcomes.
9. Be sure not to cut corners in meeting existing requirements of law, regulation, and labor agreements.

Above all, creating new entities to enter into PPP requires that trustees view the innovative tools provided as a means and not an end themselves. Furthermore, any successful partnership requires, from the beginning, explicit agreement on goals, a commitment to shared responsibilities, and transparent communications. As with any college-affiliated organization, the PPP must, in the final analysis, serve the mission of the institution, and board members must be held accountable for the authority delegated to the body to enter into a partnership and conduct business on behalf of the institution.

As institutions of higher education act more entrepreneurially, they will seek more creative—and risky—ways to raise revenue through expanded partnerships in the face of decreased public funding.

Questions that Boards Should Ask

To take advantage of ERM and PPP as a means of good governance, some questions that trustees should be asking include:

1. What relationships with affiliated organizations have been created over time, and do they continue to serve the strategic mission of the college, individually and as a whole?
2. How are affiliated organizations structured? Meaning, what is the makeup of directors? How are they appointed? Does it meet standards of transparency regarding meetings and financial reports? And how is it accountable to the board of trustees and public?
3. How often are the body's mission and bylaws reviewed by the trustees?
4. Is the organization's work included in the college or university's ERM processes, and do the trustees receive regular reports on risks associated with the affiliated body?
5. What controls are in place regarding legal representation and indemnification?

Enterprise risk assessment has been described as an "early warning system" for potentially high-risk activities. Institutions can transform their organizational cultures to routinely consider risk, assessing it against strategic mission-related goals and institutional priorities, instead of reacting to each event as it occurs. As institutions of higher education act more entrepreneurially, they will seek more creative—and risky—ways to raise revenue through expanded partnerships in the face of decreased public funding. In managing risks, trustees as stewards of place must find new ways to keep focus on paramount issues of transparency and accountability for the overall health of the enterprise and to continue to maintain the public trust. ■

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