

ECONOMIC DYSFUNCTION: CITIES MAKE RISKY BETS TO LURE PRIVATE UNIVERSITIES

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Ryan Schulte is on the hook for what he considers two bad investments stemming from the private university built with the financial backing of the town of Gilbert.

As a student, Schulte spent about \$20,000 and a year of his education to attend Saint Xavier University in the city's downtown. But less than a year after opening in August 2015, university officials announced the local campus would close because of financial difficulties. That means Schulte will have to retake the classes he completed when he begins the MBA program at the University of Arizona, he said.

As a Gilbert resident, he and other town taxpayers are also on the hook for the approximately \$36 million in city-issued bonds that financed construction of the four-story Saint Xavier building in the historic downtown. Unless the town can find a new tenant, it will find itself making bond payments on an empty building that was supposed to bring prestigious economic development and throngs of people to the area.

"Time to move I guess," Schulte said in frustration. "Twenty grand in debt and credits that really wouldn't transfer to any other programs . . . I learned my lesson I guess."

Gilbert is not alone among cities scrambling to lure private, four-year universities with taxpayer subsidies. Peoria is spending about \$2.6 million in taxpayer incentives to bring Huntington University, another private college, to that city. Huntington will be paid almost \$1.9 million over three years if it meets some basic requirements, such as qualifying as an institution that can receive federal student aid and enrolling at least 150 students by its third year.

In addition, the city is paying \$737,600 in direct reimbursements to the owner of the property that Huntington will lease for building improvements tailored to the university's needs.

The Goldwater Institute today filed a lawsuit challenging the Peoria payments as a violation of the "gift clause" in the Arizona Constitution. That provision bans the payment of taxpayer money or the use of government credit to benefit a private entity except as adequate payment for a legitimate public purpose.

The lawsuit alleges Peoria is not requiring Huntington to provide any unique service to city taxpayers beyond the things it would normally have to do to open a campus without the subsidy.

Spurring economic development alone is not considered adequate justification for government subsidies, even if it might generate indirect benefits such as increased sales tax collections or job creation, the Arizona Supreme Court ruled in a 2010 decision.

The problem with both the Gilbert and Peoria deals is that neither shows sufficient tangible and guaranteed return to the city for the investment, said Jim Manley, senior attorney at the Goldwater Institute.

The risk is all to the taxpayers.

"The problem with these economic development deals is they leave the taxpayers on the hook if the businesses go bust," Manley said. "In the university context, we've seen it happen, so it doesn't really take a lot of speculation to know what it looks like when one of these deals goes wrong. It's the taxpayers who suffer and it's the students who suffer. It's just foolish and reckless to spend other people's money this way."

Richard Vedder, director of the Center for College Affordability and Productivity, a nonprofit research organization focusing on higher education, said he's never heard of cities using economic development incentives to lure private universities the way Gilbert and Peoria have done. The schemes strike him as risky, he said. Student enrollment in the United States has stopped growing in the past several years. If there is a demand for a university in a particular community, market forces will make it feasible without city incentives, he said.

"The whole idea is a little wacko," said Vedder, a professor emeritus of economics at Ohio University who supervises the compilation of *Forbes Magazine's* America's Best Colleges list.

"It's a big, rosy scenario," Vedder said of the promises of prosperity used by the two Arizona cities to justify taxpayer incentives to lure the universities. "The fact that it is not going on routinely, regularly around the country, to me is indicative that this is not an idea that has resonated, even with people who are traditionally activist in using government subsidies to try to shape economic development."



ROSY PROJECTIONS

Economic development is the standard pitch used by cities to justify subsidies.

In Gilbert and Peoria, attracting private universities was touted by city staff as an economic engine that would draw students and teachers into their business districts, where they would shop at local stores and eat at local restaurants.

Projections in Gilbert were that Saint Xavier would boost the town's economy by about \$281 million over 10 years while creating 170 new jobs, according to a city staff presentation citing research by Phoenix-based Applied Economics.

Equally rosy predictions were made in Peoria, where the city council was told of a study by Elliott D. Pollack & Co., which estimated landing Huntington would produce more than \$1.1 million in state and local tax revenues in the first five years.

It is too early to tell how things will pan out in Peoria.

In Gilbert, it's already clear they did not work out as planned.

In 2011, members of the Gilbert town staff set out to recruit a private university that would open a campus in the historic district. Two years later, the development plan that resulted was submitted to the town council for approval.

Gilbert would issue bonds to raise the money needed to design and construct the building on city-owned land next to a new city-owned parking garage. The building would be custom designed to meet the needs of Saint Xavier, which would enter into a 15-year lease to rent the facility. Lease payments would be used to repay the bonds and other city costs associated with the project.

Since the project was financed with tax-free municipal bonds, interest rates would be lower for the city and lease payments would be lower for the university.

In return for leasing the city-owned building, Saint Xavier would open a campus there and offer, at a minimum, degrees in nursing, business, and education. The campus was to open no later than August 2015, according to a development agreement that accompanies the lease on the property. By the end of the second academic year, there had to be at least 200 full-time students enrolled; 500 by the end of the fifth year, and 600 by the end of the sixth year.

With economic development and job growth cited in the agreement as the city's priorities, there also was a provision that at least 80 percent of the credits taught and awarded at the campus must be through live classes rather than an online curriculum.

Town residents would be eligible for special grants and tuition reductions.

The development agreement also includes a declaration that without the town's incentives, Saint Xavier would not open a campus in Gilbert.

The only security required of Saint Xavier was that it would pay a penalty of \$250,000 and all lease payments due at the time if it breached the lease. At the end of four years, the university could

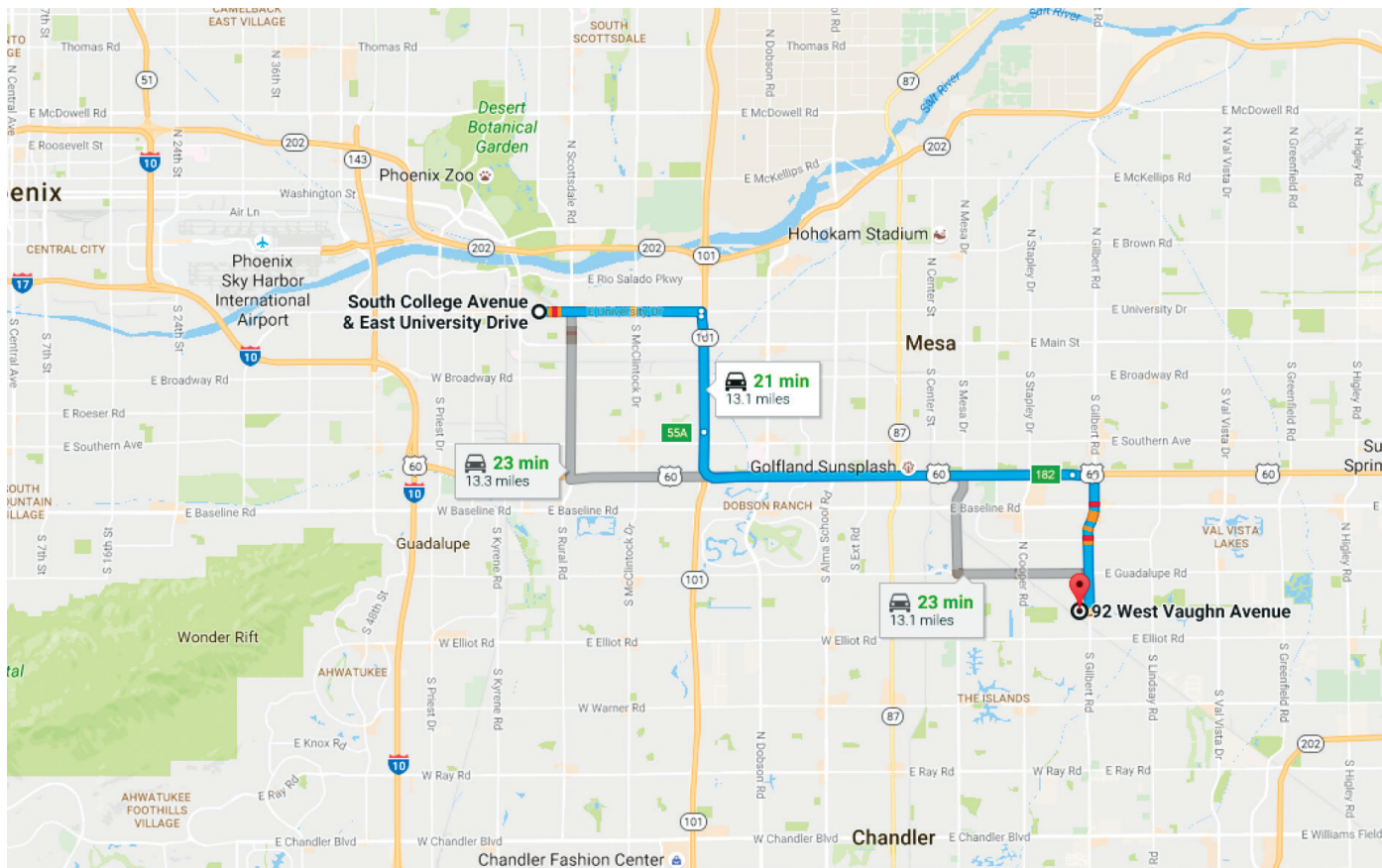
notify the town that it planned to leave two years later, and after six years it would be allowed to get out of the lease without paying any penalty.

It seemed like a safe enough bet. Saint Xavier is a nonprofit Catholic university founded in 1846 by the Sisters of Mercy in Chicago. It has about 4,500 students enrolled in its Illinois campus, and its online graduate nursing program is among the best in the country, according to rankings from U.S. News and World Report.

Signs of trouble were evident as soon as Saint Xavier opened in August 2015. The campus was built to accommodate 1,000 students. Yet when the doors opened, only about 25 students had signed up, and most of those were taking online classes.

Trouble was also brewing in Illinois. The legislature was in an impasse over the state's budget and, as a result, did not fully fund state higher education grants that helped bankroll more than a third of Saint Xavier's students in that state.

In May 2016, nine months after it opened, university officials announced they would close their Gilbert campus at the end of the fall semester, and had no plans to reopen it.



‘HOLDING THE BAG’

That left students like Schulte in a bind. Saint Xavier seemed like a perfect fit when he enrolled in the master of business administration curriculum. He wanted the experience of a live classroom, where he could interact with teachers and others seeking their MBAs because he'd found that a valuable learning experience in his previous education. Saint Xavier was near his home and would fit his schedule.

It was also a plus that the university, like Schulte, is Catholic.

When classes began, Schulte was struck with how few people attended. There were only two people in his first class and three in his second. Several of his in-person classes were cancelled because there were not enough people enrolled, he said.

Saint Xavier announced in May that it would shutter the Gilbert campus at the end of the fall semester, and that those already enrolled would have to finish their current classes online.

Schulte immediately cancelled the future classes he'd already signed up for and eventually enrolled in the MBA program at the University of Arizona's Phoenix campus. Because of the way courses are taught there, the credits he completed at Saint Xavier will do him no good and he will need to retake them, he said.

Since Saint Xavier did not cancel the classes in the fall semester but allowed students to complete them online, it would not refund his tuition, he said.

Beyond the issue of transferring credits, the fact that the Saint Xavier campus was open for only one school year would not look particularly good on his transcripts, he said.

"They've been in the community for 10 months and they took off and left," Schulte said. "I really don't think the credibility would provide me much. The credibility I don't think was there. I felt better spending the money to go and get the MBA with (UA), someone that's been here for a while and is reputable."

Gilbert Town Manager Patrick Banger did not talk about the financial risk the city was undertaking when he made the staff's presentation for the development agreement to the town council in November 2013.

But two council members said at the time they were concerned the risk was all on the city's side, and that there was very little being assumed by the university. The town was required to issue bonds that it will have to repay for the \$36 million building to house the campus. Aside from the \$250,000 penalty Saint Xavier deposited into a holding account, the university bore virtually no up-front cost or risk.

"At the end of the day, the development agreements will leave us holding the bag if there's not enough at risk," said Councilman Jared Taylor.

Councilman Victor Petersen had similar concerns. Banger responded that even if Saint Xavier failed, the building could always be leased to another tenant.

Since the university announced it would close, Gilbert officials have been trying to lure another tenant to assume the lease. So far, they've not been successful, though town attorney Michael Hamblin told the Goldwater Institute there are discussions with several other potential tenants, including other private universities.

Taylor and Petersen were the only two council members to vote against the development agreement when it was approved 5-2.

Both told the Goldwater Institute in recent interviews that they were not told Saint Xavier's financial position was so tenuous that a budget impasse in Illinois could imperil its campus in Gilbert.

Taylor said town officials were too focused on the promise of downtown development when they structured the deal. A charter school business official himself, Taylor said he was in discussions with a bank to finance a new facility in his own business when the Saint Xavier deal came up, so he knew the kinds of collateral private lenders require. With taxpayer money at risk, the town should have made similar demands, he said.

"I just didn't feel that there was enough either collateralized or enough cash at risk or enough skin in the game from Saint Xavier's standpoint," Taylor told the Goldwater Institute. "It's really just more security for our taxpayers, given what we're putting into it. Any bank would ask that. They would ask for a lot more than we have in that deal, so I didn't think it was unreasonable to ask for anything any investor should be asking for."

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– **Jim Manley**

Like Taylor, Petersen said he is not a fan of government subsidies, saying a better approach is to create a favorable business climate and let the marketplace determine whether opening a university in the downtown would be a good investment.

The line in the development agreement stating that Saint Xavier would not open a campus in Gilbert without the city incentives should have been a red flag, Petersen said.

“If it’s really true that they wouldn’t come here without that incentive, it makes you wonder how viable it is of an enterprise,” he said. “That it needs a government subsidy makes you question the strength of the business or the market or whatever it is. No matter what you do, if it’s going to be taxpayer subsidized, it’s going to put the taxpayers at risk.”

Hamblin, the town attorney, said Saint Xavier is still not in breach of the lease, and has not notified the city that it will not fulfill its obligations. If it does break the lease, it would lose the \$250,000 penalty, and would be responsible for any lease payments due.

Any missed lease payments between the time Saint Xavier stops making payments, and whenever a new tenant assumes the lease would also be damages the town could recover. The town might have to go to court to get those.

Once a new tenant is found, Saint Xavier’s obligations under the lease would end.

Beyond the lease though, it is clear Saint Xavier will not be complying with the separate terms of the development agreement by operating a university at the location.

So far, the city has not incurred any damages. The first lease payment is not due until January 2017, and the first payment on the bonds is due in July.

If Saint Xavier misses the lease payment, and no new tenant is found, the city will have to come up with the bond payment on its own.

Saint Xavier officials would not agree to an interview. Karla Thomas, executive director of media relations at the university, did respond to written questions about its future in Gilbert.

“The payment of lease obligations on January 1 depends on a number of factors that are still developing,” she wrote. “We have and will continue working with the Town of Gilbert for a smooth and efficient transition of the building.”

As to Schulte’s complaints that his Saint Xavier classes will do him no good in the UA program, Thomas wrote:

“We made no promises to students about credits being able to transfer to U of A, but we did indicate that we could work with students to assist in finding another institution/program.”

PERFORMANCE BENCHMARKS

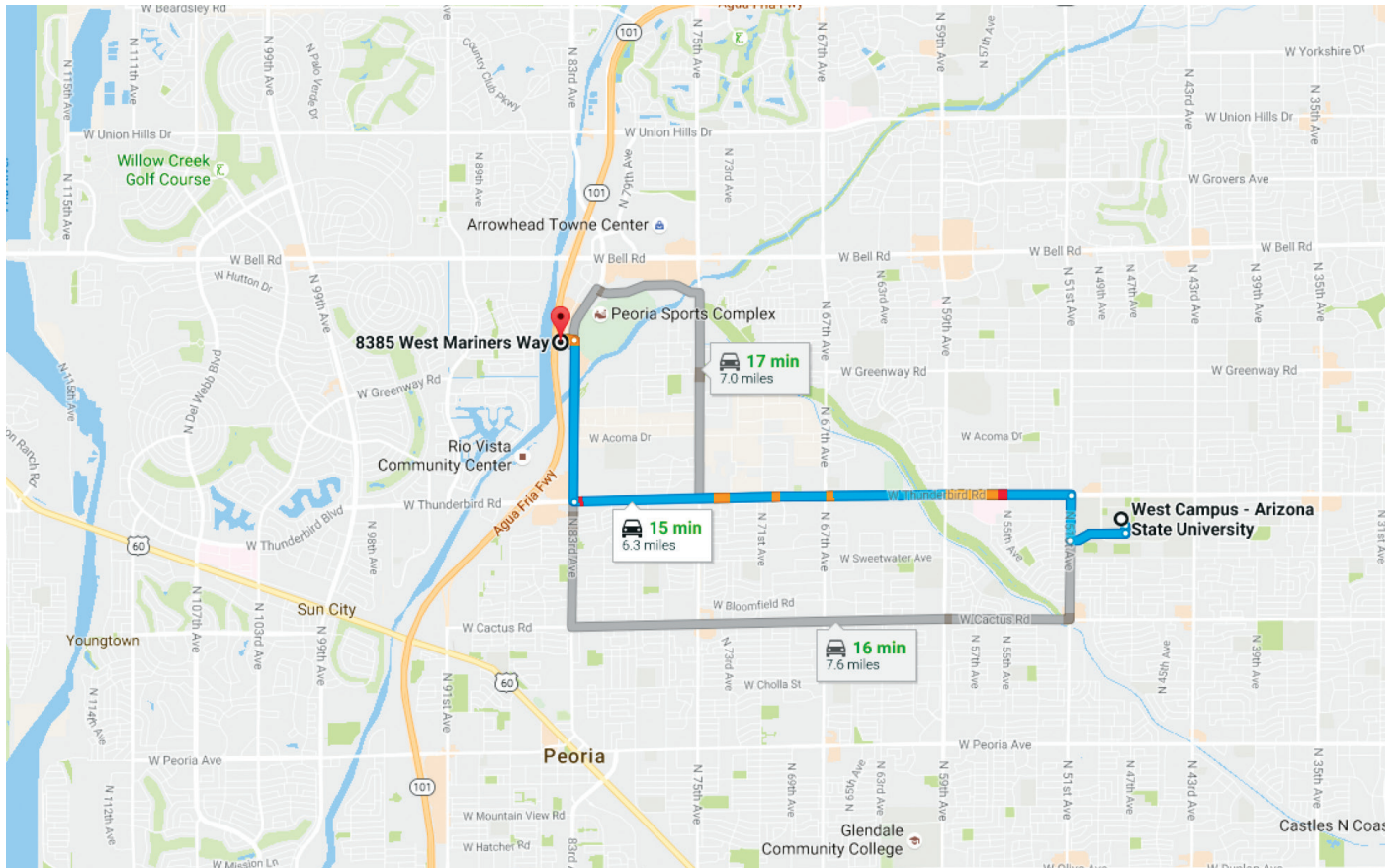
The deal in Peoria is less complicated because the city is giving incentive money directly to Huntington University and a private landowner, rather than washing it through a bond and lease deal.

Payments to Huntington are to be made over time as benchmarks are met, according to an agreement initially approved by the city council in July 2015.

In the first academic year, Huntington is to appoint campus leadership and get approval to offer degree programs from state and national accreditation entities. It also must submit marketing plans and lease not less than 15,000 square feet for its campus, which is to initially offer a digital media arts program.

If it meets all of the conditions, the city will pay Huntington \$900,000.

Beginning in the 2017 academic year, Huntington will be required to enroll and offer instruction to at least 100 students. That will be enough to qualify for an additional \$550,000 in city funds. By 2018, the second full academic year, Huntington



will need at least 150 students enrolled to qualify for another \$425,000 in taxpayer incentives.

The total cost to Peoria taxpayers is about \$1.9 million.

Peoria entered a similar deal with Trine University, another private institution, in 2012.

In a separate agreement, Peoria agreed to pay \$737,596 over 10 years to Arrowhead Equities, LLC, the company that owns the building Huntington will lease, to help pay for improvements to the property to suit Huntington’s needs. That raises the total cost of the deal to about \$2.6 million.

City officials would not agree to an interview with the Goldwater Institute because they were aware of the pending lawsuit, which was filed today. They did release a statement citing the Pollock study showing that within four years the university will generate more than \$2 million in wages and \$4.5 million in economic activity in the region.

“From a legal perspective, the city of Peoria did its due diligence through the legal analysis,” the statement reads. “The agreement complies with the state constitution and state law associated with the gift law. All of the city’s economic devel-

opment agreements are put through a rigorous process to ensure that we are complying with all legal standards.”

GIFT WITHOUT GUARANTEE

The gift clause in the Arizona constitution prohibits the use of taxpayer funds or government credit to benefit any private business or individual. The state Supreme Court ruled in the 2010 case, brought by the Goldwater Institute, that any expenditure of taxpayer money to a private entity must serve a legitimate public purpose, and can only be made in exchange for “adequate consideration.”

What that means is the spending must be offset by goods or services of sufficient value to justify the expenditure.

Vague predictions of such things as projected sales tax revenues or job growth are not sufficient to meet the gift clause’s requirements because



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those are not things that can be guaranteed, said Manley, the Goldwater Institute lawyer.

Neither Huntington nor Saint Xavier could guarantee Peoria or Gilbert will recoup their investments, Manley said. In fact, neither university assumed much risk in either deal. The risk fell mostly on the taxpayers, he said.

The Huntington deal does not even guarantee any specific benefit for Peoria residents, as Gilbert attempted to do by requiring scholarships and tuition discounts for its residents, Manley said.

“All the benchmarks are ‘do your business,’” Manley said of the Peoria agreement. “Run your university”— that’s the only benchmark they have to achieve. For them, it’s just free money. And that’s the whole gift clause problem. They don’t have to actually put up any collateral. They don’t have to do anything they wouldn’t otherwise be doing.”

“Time to move I guess. Twenty grand in debt and credits that really wouldn’t transfer to any other programs . . . I learned my lesson I guess.”

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Hamblin, the Gilbert town attorney, said economic development was not the driving factor in the decision to finance the Saint Xavier campus, despite the financial benefits to the downtown area touted in presentations to the council. Rather it was an investment in the education of Gilbert students, who have few options other than Arizona State University and more distant private colleges in the Valley.

“Governments traditionally have supported higher education and education as well,” Hamblin said. “Nearly all education is subsidized. Education is deemed as a public good, and so it’s not unusual for governments to subsidize education.”

Hamblin likened Gilbert’s financial participation to public funding of charter schools or state universities. But the state constitution requires a free public education for kindergarten through the 12th grade, whether it be through a charter or a traditional public school. Even at that, those schools are run through local school districts, not cities.

And unlike state-run public universities, which must make their tuition as “nearly free as possible,” Saint Xavier is a private business. Cities have no responsibility for university funding.

Beyond the lack of legal obligation, the deals in Peoria and Gilbert seem particularly risky because both seek to skew market forces that should dictate whether a university is built to serve a need, said Vedder, the Ohio professor and author of numerous articles on tax breaks for private universities. That is especially true since downtown Gilbert is only about 15 miles from Arizona State University’s main campus in Tempe, and the Peoria site is less than 10 miles from ASU West in Glendale.

“You can go to a known quantity, ASU, that is respected in the area, well known and offers a huge variety of courses,” Vedder said. “Or you can go to a school that is from Chicago that we’ve never heard of before and is known for having an online nursing program. But who cares? Most of the students are not majoring in nursing, and moreover this is a non-online program. This is a traditional program. Why would you expect students to go there? It seems like a pretty risky thing to do to me.”

BAITING THE TRAP

Schulte is trying to be positive about the classes he took at Saint Xavier, and which he will have to retake when he enters the MBA program at the University of Arizona. If nothing else, it should make it easier to get through those classes when he takes them again, he said.

What galls him the most, he said, is that other students might have passed up opportunities to go to another school because they enrolled in Saint Xavier based on early promises made by officials at both the university and the city.

“There could be a kid that’s wasting an opportunity with another school or maybe somewhere else they would get an experience from, and they turned down that opportunity for this place, and lost hope,” Schulte said.

Manley also said Gilbert officials betrayed their own residents when they agreed to finance the Saint Xavier property, which amounted to putting their stamp of approval on it.

“The city essentially baited the trap,” Manley said. “In some ways it’s even worse than going to just some private university that opens up in your city. The city has sort of blessed this with its imprimatur and said basically, ‘We think this is a good institution. We think it’s so good we’re going to put your money behind it.’

“I think it’s much more tragic than just somebody going to a school that goes bust. It’s going to a school and being betrayed by your own city government.” ■



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