



**BETTER SCHOOLS, BETTER NEIGHBORHOODS**  
New ways to create the schools New Jersey needs

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## **New ways to create the schools New Jersey needs**

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### Table of Contents

- 1 Executive summary**
- 3 Overview**
- 4 Public-private initiatives for school development**
  - Time savings**
  - Fiscal benefits**
  - Risk mitigation**
- 13 Mixed-use school development**
- 17 How to get there: Making public-private initiatives and mixed-use school development happen**
  - Removing legal constraints**
  - Ensuring a consistent and efficient review and approval process**
  - Establishing a sound planning and decision-making process**
- 25 Closing note**

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# ***Executive Summary***

This paper shows how school districts, communities and the state can all benefit from developing schools - both schools for exclusive school use and as parts of mixed-use projects, where the school is combined or co-located with other facilities – through joint public and private initiatives. While it focuses on New Jersey's thirty-one Special Needs or *Abbott* school districts and the role of the School Development Authority (SDA), its findings apply equally to any Regular Operating District (ROD) that appreciates the benefits to be gained from public-private initiatives and mixed-use school development.

## ***Public-private initiatives***

The term 'public-private initiative' is used to describe any approach to development of school facilities in which the public sector – represented by either a school district or the SDA – enters into a relationship with a private development entity to build or rehabilitate a school different from the conventional public bid process by which schools are typically developed. Public-private school development can yield three distinct and measurable public benefits:

### **Saving time**

Public-private initiatives are inherently more time-efficient than public bid projects, as long as the public sector does not impose arbitrary requirements on the internal management of the project.

### **Saving money**

Public-private initiatives are often less expensive in terms of development cost, and moreover, can benefit from a variety of fiscal mechanisms, including lease options and tax credits, to further reduce the cost to the public sector.

### **Mitigating public risk**

Public-private initiatives mitigate the public sector risk, by reducing the share of initial costs, including site acquisition costs, that must be borne by the public sector.

In addition to these measurable benefits, public-private initiatives may offer intangible benefits, by facilitating the creation of small learning communities and by giving school districts greater flexibility to address changing needs and priorities over time.

## ***Mixed use projects***

Mixed-use school projects are those where construction of a school is combined with construction of compatible non-school facilities in the same building or on the same site. Uses can include other public facilities, such as libraries or health care facilities; or private uses, such as housing, office or retail space.

While it is generally a good idea that every public school should be designed for shared use – such as after-school and weekend programs – not every school should be a mixed-use facility. Mixed-use schools should be developed only where their benefits exceed the potential difficulties. There are at least four distinct situations where mixed-use school development is most appropriate:

- To utilize available properties more efficiently where land or buildings for schools or for other needed development are in short supply.
- To generate capital revenues or cash flow to offset either or both school development and ongoing operation/maintenance costs;

- To create facilities which provide greater benefits to the neighborhood than the school will provide alone.
- To make possible synergies with school activities and educational programming.

Not every school project meets one or another of these criteria, but many do. Where they do, the SDA, school district and community can all benefit by developing them as mixed-use projects, rather than exclusive or sole-use schools.

### ***Making it happen***

Major barriers stand in the way of pursuing public-private school initiatives or creating mixed-use school facilities in New Jersey. Some critical elements are either not permitted under state law, or permitted under severe limitations, or discouraged in practice even where they are permitted. Furthermore, even if legislation is enacted to change those laws, significant procedural obstacles must be resolved before either public-private initiatives or mixed-use school development became more than rare and exceptions, including meshing the local regulatory process with the state school regulatory process. Finally, it is critical that those directly affected, whether in local government or in neighborhood organizations, be part of the process by which decisions

regarding public-private initiatives and mixed-use projects are made

In all, three areas must be addressed in order to make public-private initiatives and mixed use school projects an integral part of the way new schools are built in New Jersey:

- **Legal constraints must be removed, and clear procedures by which the SDA and school districts can partner with private entities established.**
- **A consistent and efficient review and approval process to minimize duplication between state and local entities, along with clear ground rules for property taxation of public-private school projects, must be established.**
- **A transparent planning and decision-making process, in which both the local government and residents of the communities in which schools are to be built, must be adopted.**

These changes will require legislative amendments, regulatory changes and changes in the practices of state and local bodies. They will not come easily or quickly. The benefits of making these changes, however, vastly outweigh the difficulty of pursuing them.

## **Overview**

This paper explores the issues associated with developing school and mixed-use projects through joint and private initiatives, and outlines the steps that will be needed in order to make such projects possible. In order to ground the analysis, the paper uses a case study of an actual site, the so-called Kroll site in the city of Paterson, but the issues and recommendations apply without exception to similar projects in any of New Jersey's thirty-one Special Needs or *Abbott* school districts. Indeed, although the focus of this paper is on the Special Needs districts and the role of the School Development Authority, the issues apply to any Regular Operating District that appreciates the potential benefits to be gained from public-private initiatives and mixed-use school development.

Two separate issues are explored in this paper. The development of schools as mixed-use projects is one issue, and the development of schools through a variety of potential public-private relationships is another. While mixed-use projects realistically require a public-private relationship to be feasible, there are strong arguments for public-private initiatives in many cases even where mixed-use development is neither feasible nor appropriate.

The paper is divided into three sections. The first explores the benefits and potential difficulties of school development through public-private initiatives, and the second through mixed-use development, identifying the conditions under which either or both are most appropriate. The third section outlines the steps that will be necessary in order to make it possible to carry out such projects. That involves changes to both the legal and financing provisions governing school development in New Jersey, as well as changes to the development process itself, once legal and financial changes are put in place.

While the Kroll site is used to illustrate many of the points made in the paper, it should be emphasized that references to this site are for illustrative purposes only. No agreements have been entered into with its owners or any other party with respect to the status or use of that property, and no representations are made that the site may or may not be available for any of the purposes described below.

## 1 **Public-private initiatives for school development**

The term ‘public-private initiative’ is used to describe any approach to building school facilities where the public sector – represented by either a school district or the New Jersey School Development Authority (SDA) – enters into a relationship with a private development entity to build or rehabilitate a school outside the conventional public bid process by which schools are typically developed. Under that process, the school district or SDA acquires a site for a school, retains an architect to develop plans for the school, and upon completion of the plans, selects one or more contractors through a competitive public bidding process. At all times, the school is the property of the SDA or school district.

Public-private initiatives for school development are very different. They can take a variety of forms, whether the project is an exclusive use school project, or a mixed-use project containing a school along with one or more other uses, as shown in Table 1. Within the scope of public-private initiatives, further alternatives exist based on the status of the property, the nature of the agreement between the school district, SDA and

**TABLE 1: SCHOOL DEVELOPMENT OPTIONS**

|                            |  |
|----------------------------|--|
| Public-private initiatives | School sole use facility                       |
|                            | Mixed use school facility                      |
| Public bid process         | School sole use facility                       |
|                            | Limited mixed use school facility <sup>1</sup> |

the developer, and the ultimate disposition or outcome of the project. The ways in which such initiatives can be organized, leaving aside potential mixed-use options discussed later, are shown in Table 2.

**TABLE 2: PRINCIPAL ALTERNATIVES FOR PUBLIC-PRIVATE INITIATIVES**

| Status of site              | Construction model                            | Disposition  |
|-----------------------------|---|--|
| School District or SDA owns | Design-build or construction contract         | School District or SDA owns school building                  |
| Developer owns              | Turnkey contract for construction and land    | School District or SDA owns school building                  |
| Developer owns              | Lease agreement on completion of construction | School District or SDA leases school building from developer |

<sup>1</sup> A public bid project can include non-school public sector facilities, such as a recreation center or a health clinic. It is all but inconceivable that a public bid project would include residential or commercial facilities.

Within this framework many variations are possible, particularly with respect to the way lease agreements are structured.

Public-private school development can yield three distinct, measurable public benefits:

- Time savings
- Fiscal benefits
- Risk mitigation

In addition to these quantifiable benefits, public-private initiatives may offer intangible benefits, discussed further below, that can expand school options and provide school districts with greater flexibility to address changing needs and priorities over time.

### ***Time savings***

Significant time savings can potentially be realized through public-private initiatives. *In and of itself, the private development process is a faster one than the public development process.* Not only do private developers not have to go through the time-consuming public bid process, but they have a variety of informal ways to obtain faster results from professionals and contractors.<sup>2</sup> It may be difficult, however, to realize those savings without important changes to practices by both state and local agencies to prevent delays that might otherwise reduce or eliminate those savings.

By entering into agreements with developers who already own properties on which schools are to be constructed, further time savings are obtained, because the school district or SDA does not have to acquire those properties. As is well-known, the process of acquiring urban sites for schools is slow, complicated and expensive, particularly because since dozens of separate properties must often be acquired in order to assemble a site large enough to accommodate a new school.

Leaving aside the time involved in acquiring property, a sample of completed *Abbott* school construction projects shows that the time elapsed from the award of the architectural contract to completion of construction tends to be between 4 and 5 years. This is illustrated in Table 3. The time from architectural award to construction award ranges from 18 months to 2 years, and for construction from 2 years to nearly 3 years. A

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<sup>2</sup> This is primarily a function of relationships. In contrast to public work, where each job is seen as a separate, unrelated transaction, many experienced developers maintain long-term relationships with key professionals and contractors, and benefit from those relationships in the form of faster performance, and in some cases, price adjustments.

realistic time frame for similar projects by private developers would be 9 to 12 months from architectural contract to construction contract, and 15 to 24 months from construction contract to completion. Public-private initiatives should be able to reduce the time period involved in creating new schools by roughly one-third.

**TABLE 3: SAMPLE SCHOOL CONSTRUCTION TIMETABLES<sup>3</sup>**

|                                   | Columbus School<br>Trenton | Science Park HS<br>Newark | Pre K-8 School #27<br>Elizabeth |
|-----------------------------------|----------------------------|---------------------------|---------------------------------|
| Architectural<br>contract awarded | August 2002                | February 2002             | November 2003                   |
| Construction<br>contract awarded  | February 2004              | February 2004             | September 2006                  |
| Construction<br>completed         | September 2006             | November 2006             | Summer 2008<br>(expected)       |

These time savings, however, can only be ensured if certain provisions govern public-private initiatives:

- Standardized provisions and templates for agreements between public and private entities involved in school development projects, including lease agreements;
- Expedited procedures for approval of development and building plans and, if necessary, tax abatement agreements;
- A minimum of public sector interference in the developer's internal management of the project.<sup>4</sup>

### ***Fiscal benefits***

Public-private initiatives offer a number of different ways to generate significant potential fiscal benefits. To begin, it is likely, although not certain, that per square foot development costs can be reduced. There is some evidence in support of this proposition, including a report from Houston, where a private development/construction management firm built two high schools for the school district, and was estimated to

<sup>3</sup> This information is taken directly from the SDA web site. The site does not provide information on whether site acquisition was needed for their projects, and if so, how much time and money were required for that to take place.

<sup>4</sup> An effort to foster public-private initiatives for school construction in North Carolina has been significantly hindered by a requirement written into the statute that developers must select subcontractors through public bid procedures, rather than through customary developer-contractor negotiations.

have saved approximately \$20/square foot relative to pre-construction estimates.<sup>5</sup> In order to generate such savings, as was previously noted, the rules governing public-private initiatives must permit developers to organize their projects in a manner as close as possible to customary private developer practice. While it may be appropriate for laws permitting public-private initiatives to require developers and their contractors to pay prevailing wage, those laws should not mandate practices (such as North Carolina's requirement that developers select their subcontractors through competitive bidding) that potentially impair the developer's ability to produce an efficient, cost-effective product.

Even without per square foot development cost direct savings, important other fiscal benefits potentially exist:

- ***Reduced need for public up-front funds***

Developers can typically obtain their own financing, so that public money is needed only at the completion of the project. This is also a significant risk mitigation factor, since no public money is placed at risk during the design or construction phases of the project. Moreover, since the developer is likely to take substantially less time to complete the project, the cost of pre-development and construction financing in the total development budget – even if a higher interest rate is charged – is likely to be lower.

- ***Potential savings through leasehold transactions***

A capital lease structured to enable the developer to recover his capital cost is not inherently less expensive than an outright purchase. In either case, the capital cost is financed, either through the lease or through a bond issue floated to buy the completed project from the developer.<sup>6</sup> There are some creative ways, however, through which it might be possible to reduce the size of the lease obligation.

***User payments.*** The Canadian province of Nova Scotia initiated a program under which developers built schools and leased them to the school system with a lease payment schedule equivalent to 85 percent of the developer's capitalized cost. In return for foregoing a percentage of the cost reimbursement, the developer was given the ability to use the school facility for compatible uses during those hours it was not needed by the school system, and retain the user payments. The process has been described as

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<sup>5</sup> Cited in Ronald D. Utt, *Public/Private Partnerships Offer Innovative Opportunities for School Facilities*. Maryland Public Policy Institute (2005)

<sup>6</sup> It is possible that there may be some fiscal management benefits to the SDA to having a pool of lease obligations, which could perhaps be financed differently than conventional capital contracts. This sort of analysis is beyond the scope of this project.

follows:

Such off-hours use could include renting the facility to for- and not-for-profit educational organizations, such as trade schools and refresher educational programs, day care, community colleges and universities, civic groups, religious organizations, local governments, political groups, and similar entities for which classroom-, meeting-, and auditorium-type space is essential. Organizations and businesses whose purpose and activities are not compatible with a building used primarily by children are prohibited from leasing space, and such prohibitions are defined clearly in the contract. By using the building more intensively than would be the case if its occupancy were limited to just public school functions, the developer/owner of the building would obtain more revenues and earn more profit. These extra revenues are "passed on," in effect, to the public school system in the form of below-cost rent.<sup>7</sup>

Such a provision could not be applied across the board. Some schools would offer greater and some fewer opportunities for user revenue, while developers' readiness to enter into such agreements would also vary.<sup>8</sup> An inner-city K-8 school might offer few opportunities for off-hours use revenue, while a high school with high-quality facilities in close proximity to downtown or major institutions might offer even greater revenue opportunities than the 15 percent level used in Nova Scotia.

**Tax credits.** The use of New Markets Tax Credits<sup>9</sup> is a second option. These tax credits have been used to defray the cost of developers' constructing charter schools. By using New Market Tax Credits, an organization in Los Angeles was able to raise \$11 out of a total \$36 million fund to finance construction of charter schools, so that debt service payments from the schools were required to finance only \$25 million of the total.<sup>10</sup> New Jersey CDC in Paterson has also used New Market Tax Credits for this purpose. A preliminary investigation suggests that there is no reason that they could not be used in

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<sup>7</sup> Roland D. Utt, *How Public-Private Partnerships Can Facilitate Public School Construction*, Heritage Foundation (1999)

<sup>8</sup> The right could be assignable, however, so that a developer could sell her rights under the lease agreement to a locally-based organization such as a CDC that would have an active interest in using them.

<sup>9</sup> The New Markets Tax Credit (NMTTC) Program, enacted in 2000, permits taxpayers to receive a credit against Federal income taxes for making qualified equity investments in designated Community Development Entities (CDEs). Substantially all of the qualified equity investment must in turn be used by the CDE to provide investments in low-income communities. The credit to the investor totals 39 percent of the cost of the investment and is claimed over a seven-year credit allowance period.

<sup>10</sup> P. Jefferson Armistead, *New Markets Tax Credits: Issues and Opportunities*. Pratt Institute Center for Community and Environmental Development (2005).

conjunction with a public school development project.<sup>11</sup> Furthermore, where a property is also eligible for the Federal Historic Preservation Tax Credit, as is the case with the Kroll property in Paterson, those tax credit proceeds can be used to further reduce the size of the lease payment.<sup>12</sup>

As Table 4 shows, some potentially offsetting costs are associated with each of these potential savings. In each case, however, the costs are modest in comparison to the gains. On a \$20 million project, legal and transaction costs associated with the New Market Tax Credit may raise the total project cost by approximately 2 percent. This is not a significant deterrent compared to the 30 to 33 percent in offsetting revenues that the tax credit may provide. Although it is unlikely that any but a highly unusual transaction would leverage the maximum potential in offsetting revenues, it is at least possible that in some cases they would reduce the lease payment from the school district by half or more.

**TABLE 4: POTENTIAL REVENUES AVAILABLE TO OFFSET LEASE COSTS**

| Source                           | Potential amount (as percentage of total cost) | Offsetting costs  |
|----------------------------------|--|---|
| Use revenues                     | 0-20%  | Additional construction costs associated with multiple uses and higher traffic          |
| New Market Tax Credit            | 30-33%   | Transaction costs of \$250,000-\$500,000  |
| Historic Preservation Tax Credit | 15-18%   | Transaction costs and higher construction costs to meet Secretary of Interior standards |

Property taxes may also offset savings from leasehold school projects if the project is determined to be subject to local property taxation. While projects leased by a school district on a short-term basis from a developer are considered to be subject to property tax, the status of a project with a long-term (30 years or more) lease, especially with a provision under which the school district can buy the property from the developer at the end of the lease term for a nominal sum is unclear in New Jersey law. In the

<sup>11</sup> Although the author is not aware of any such use, NMTCs have been used for facilities leased or owned by other public entities. The tax credits are not tied to the investor's ownership of the real estate, they could potentially be used even where the school district planned to buy the property outright as a turnkey transaction. Conversation with Jim Hartling, Urban Partners, April 18, 2008.

<sup>12</sup> Historic Preservation Tax Credits can only be used in conjunction with a leasehold transaction, since the developer must continue to hold the property for at least five years after putting it into service.

absence of a clear determination on this issue, the offsetting costs could be reduced significantly through a tax abatement agreement with the municipality.<sup>13</sup>

Table 5 illustrates the potential savings that could result from these features, comparing the development of the 150,000 square foot Kroll site as a high school (or two high school academies) through a conventional public sector transaction, and through a private developer lease to the school district or SDA. Over the life of the financing, the

**TABLE 5: COMPARATIVE COSTS OF PUBLIC SECTOR AND PUBLIC-PRIVATE LEASEHOLD DEVELOPMENT**

| CATEGORY  | LEASEHOLD           | PUBLIC SECTOR        |
|---|---------------------|----------------------|
| Land  | \$ 7,500,000        | \$ 7,500,000         |
| Construction (assume developer savings of 10%)        | \$33,750,000        | \$ 37,500,000        |
| Soft costs @ 20%                                      | \$ 6,750,000        | \$ 7,500,000         |
| Construction financing (1)                            | \$ 1,510,000        | \$ 2,250,000         |
| <b>TOTAL COST</b>                                     | <b>\$49,510,000</b> | <b>\$ 54,750,000</b> |
| Value of New Markets Tax Credit (31% of cost basis)   | (\$15,350,000)      |                      |
| Value of Historic Preservation Tax Credit (2)         | (\$ 6,050,000)      |                      |
| <b>COST TO BE COVERED BY LEASE</b>                    | <b>\$28,110,000</b> |                      |
| Annual lease payment (3) or debt service payment (4)  | \$ 2,244,200        | \$ 3,939,000         |
| <b>Total lease or debt service cost over 30 years</b> | <b>\$67,326,000</b> | <b>\$118,170,000</b> |
| Annual savings  | \$ 1,694,800        |                      |
| <b>Total savings over 30 years</b>                    | <b>\$50,844,000</b> |                      |

(1) Assumes construction financing for 1.5 years at 6% for developer, 3 years at 4% for public sector

(2) Assumes value of credit 16% on basis of 90% of development cost exclusive of land

(3) Assumes lease financed at 7% interest rate for 30 years

(4) Assumes 6% interest rate including SDA fees on long-term bonding for 30 years

state could save as much as \$50 million by having the school built by a developer and leased to the school district. This is a relatively conservative assessment, since in all likelihood the construction cost differential could be greater than the 10 percent estimate in the table, and – since the developer could potentially qualify for tax-exempt bond financing as well – there might actually be no interest rate differential for the long-term

<sup>13</sup> Abatement of taxes in return for a negotiated annual payment in lieu of taxes (PILOT) can be granted by municipalities under the Long-Term Tax Exemption Law, N.J.S.A.40A:20-1 et seq. The property, however, must be in a redevelopment area. In a number of cases, municipalities have designed single properties as redevelopment areas in order to enable developers to avail themselves of this statute.



Figure 1: Kroll Site, Paterson, New Jersey

financing used in the end.<sup>14</sup> Given the location of the school, we have assumed that use revenues, as described earlier, would *not* be available.

Not all school construction projects could take advantage of these savings. New Market Tax Credits are limited, and would not be realistically available for all school construction projects. Historic Preservation Tax Credits can be used only to rehabilitate qualified properties, and are not available at all for new construction. There is no limit on the amount of such tax credits that can be taken, however, and it would be in the state's interest to maximize their use by actively seeking out eligible rehabilitation projects. The

<sup>14</sup> Section 422 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (H.R.1836) extended the privilege of using tax-exempt, private activity bonds to qualified public education facilities.

state might be able to realize significant savings when rehabilitating an existing school building by having the school district sell it to a developer, who would qualify for the tax credits and then lease it back to the school district, rather than having the school district or SDA do the work directly. In the final analysis, it is clearly in the interest of the state, the SDA and the school districts to maximize its opportunities to save money through public-private initiatives.

### ***Risk mitigation***

Finally, the public sector benefits from the use of public-private initiatives because it is able to better manage its risks. In a project carried out by a developer, the state need not incur any fiscal outlays until completion of the project, since the cost of property acquisition, pre-development and construction are the responsibility of the developer.<sup>15</sup> The risk of overruns and delays is also significantly mitigated. Since the developer is at risk for the funds borrowed for the project, she is more strongly motivated to complete it on time and on budget than a contractor who is being paid by the state. The developer can also be required to post a letter of credit or other surety to ensure performance. Similarly, a fixed price arms-length agreement with a developer has far less scope for changes of the sort that regularly result in public bid projects ending up costing far more than anticipated.<sup>16</sup>

A rational developer is only willing to take greater risks than a general contractor selected through a bid process if she is also given the opportunity to carry out the project in ways that will enable her, if successful, to generate a meaningful profit from the construction. *Any attempt by the public sector to structure public-private initiatives in ways that significantly limit a developer's upside potential – through complex bidding requirements, provisions to recapture 'excess' profit, and the like – will reduce the developer's willingness to take on risk as well as her interest in participating in such initiatives, and ultimately prove counterproductive.*

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<sup>15</sup> It is instructive to compare this point with the experience of the SCC, which expended millions to acquire sites only to discover that funds were not available to construct schools on those sites. Even if the sites are all ultimately utilized for schools, the carrying cost associated with those expenditures alone is likely to be in the tens of millions of dollars.

<sup>16</sup> Despite the efforts of generations of public sector lawyers, the inherent structure of the public bid contract, with the government providing the construction financing, places the government in a weak negotiating position to deal with changes during the construction period.

### ***Other benefits***

Two other potential benefits of developing schools through public-private initiatives are worth mentioning briefly. By working with private developers, a school district creates the opportunity to utilize small sites, existing buildings, or even parts of larger development projects,<sup>17</sup> all of which lend themselves to the creation of small schools or learning communities. Such small learning communities, as considerable research has shown, often result in significantly better learning outcomes than the large schools that are the most common by-product of a highly bureaucratized public construction process.

In a similar vein, long-term leasing of schools may offer greater long-term flexibility to school districts than public ownership. During the course of the many decades that the schools being built today will remain in operation, it is likely that many changes will take place not only in educational needs and pedagogic principles, but also in neighborhood demographics and land use patterns. Leasing structures may well offer greater flexibility to school districts to make adjustments in the use of facilities and the organization of school spaces necessary to respond to these changes.

## ***2 Mixed use school development***

Mixed-use school developments are development projects where a school is combined with compatible non-school facilities within the same building or on the same site.<sup>18</sup> Uses can include other public sector facilities, such as libraries or health care facilities; or private uses, such as housing, office or retail space. The Conte School, built in 1963 in New Haven's Wooster Square neighborhood, contains, in addition to a public school, a health clinic, public library and senior citizens center, and provides a wide-range of activities for children, youth and adults after school hours. The New York City Educational Construction Fund (ECF), an arm of the school district, has packaged since 1971 a number of mixed-use school projects which utilize air rights to combine schools with both residential and non-residential space. The ECF's most recent project, under construction in the Upper East Side of Manhattan, is a 32 story tower. It contains 127

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<sup>17</sup> For example, under a turnkey contract, a school district could buy a certain amount of floor space in a condominium building for use as a school.

<sup>18</sup> Mixed-use development is sometimes referred to as 'co-location' of school and other facilities.

condominium units selling for \$713,000 to \$3.7 million, a small amount of neighborhood retail space, and a new public intermediate school for 520 students using roughly 80,000 square feet of floor area spread over five floors. A single developer is developing the entire complex.

Although other such examples can be found, there are fewer than there should be. Legal and other restrictions have limited the number of mixed-use public school facilities that have been developed. In recent years the use of mixed-use development to facilitate creation of charter school facilities – which are less constrained legally and often more open to creative solutions than many school districts – has far outstripped mixed-use public school development.<sup>19</sup>

While there are solid arguments to support the proposition that every public school should be designed for shared use – such as after-school and weekend programs – not every school should be a mixed-use facility. Along with its benefits, mixed-use school development raises many difficulties with respect to using, multiple financing sources, coordinating multiple users, and facility management and operation. To be justified, the benefits of mixed-use development must outweigh the potential difficulties.

There are, however, at least four distinct situations where mixed-use development is clearly appropriate:

- To utilize available properties more efficiently where land or buildings for schools or for other needed development are in short supply.
- To generate capital revenues or cash flow to offset either or both school development and ongoing operation/maintenance costs;
- To create facilities which provide greater benefits to the neighborhood than the school will provide alone.
- To make possible synergies with school activities and educational programming.

The two projects briefly described above each meet two of the four criteria. The Conte school was designed to provide facilities that would enhance the benefit of the new project to the community as a whole, while offering opportunities for synergy with the school's educational program. The projects of the ECF, by contrast, are designed to

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<sup>19</sup> A good example of this is the former Herron School of Art in Indianapolis, which is being redeveloped to include a new museum of contemporary art, a charter high school, and residential uses including artists' lofts and infill townhouses.

maximize efficient use of land and generate revenues to offset school costs. The different rationales for mixed-use development in these two cases dictated different spatial configurations. While the non-school facilities in the Conte school are closely integrated with the school facility and are part of a single pedestrian circulation system, in the New York City project, the two principal uses co-exist on the site with no direct internal connection to one another.

In parts of New York City experiencing strong housing demand, residential units command a substantial price premium. As a result, the ECF is able to generate a large amount of money for construction of new school facilities by identifying underutilized existing school sites, and leasing the air rights (the unutilized development capacity of the site) to developers who build a mixed-use project that includes both housing and a new school. The scarcity of buildable sites combined with the profitability of housing development in New York City makes mixed-use development a highly desirable proposition for both the school district and private developers.

Similar conditions can be found, although to a lesser degree, in parts of Jersey City and New Brunswick, two cities with strong demand for both private market housing and non-residential uses, as well as limited land availability in high-demand areas. It is doubtful, however, that either of these two criteria applies to the Kroll site. This is not because the land supply in Paterson is not limited, because it is severely constrained, but because of the nature of the Kroll site itself.

*The benefits of mixed-use development as a response to scarcity of land for development will usually depend on the ability to intensify the use of the site beyond what would be appropriate or feasible as a single-use school site.* In the case of the Kroll site, since the use of the property cannot be intensified, its use for non-school purposes represents a zero sum proposition with its use as a school. If less of the site is used for a school, the school district will have to make up that space elsewhere. That, however, may not necessarily disqualify the site as a mixed-use site. In an environment where sites are scarce, it may be substantially more difficult to find good sites for housing than for schools. In that case, adding housing and reducing school space in a facility such as the Kroll property may be a sound planning decision.

It is also doubtful that non-school facilities on the Kroll site would in fact provide offsetting revenues. At present, housing could not be built in that location without government subsidy, so that it would not throw off profits to offset the school costs. A modest amount of retail space (<10,000 SF) along 21<sup>st</sup> Avenue might be economically

feasible, but even if successful, would have a minimal effect on the school bottom line. It would probably be a desirable use of the 21<sup>st</sup> Avenue ground floor frontage of the property, even if it were no more than a break-even proposition, because it may help strengthen the existing commercial fabric of the street. It would have to be justified on the basis of its community benefit, not its ability to generate offsetting revenues.

The other two criteria – maximizing community benefit and creating synergies with the educational program – depend on the specific uses being proposed. While office space in the Kroll project offers no educational synergies in itself, a specific office use that would relate to the mission of the proposed high school academy might offer such synergies. For an academy focusing on engineering and construction technology, the office of an engineering firm, which could offer internships and the involvement of the firm’s personnel in teaching and mentoring, would be a valuable educational asset. If such a firm was willing to commit in advance to use space in the project, it would be worth creating office space for their use. In the absence of such a commitment, however, it would probably not be a good idea, since the space would be unlikely to provide offsetting revenues to justify it in the absence of educational synergies.

Adding non-school uses to confer community benefits can also benefit the school, either the educational program directly, or by providing complementary services or facilities for the children in the school. Facilities such as a library or health clinic benefit the school’s students as well as the adults in the community; as a recent article pointed out, “co-locate the school with a public library, fine arts center, senior center, community college branch, soccer stadium, public park, museum, or zoo, and you create a valuable new community asset that reaches beyond the traditional function of a public school. Suddenly the whole is greater than the sum of its parts.”<sup>20</sup>

In short, while not appropriate or feasible in every situation, mixed use school development may offer significant opportunities to:

- Further better site utilization and better planning
- Offset school development costs
- Add community benefits; or
- Enhance educational programs

Which, if any, of these benefits can be realized can only be determined by a site- and

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<sup>20</sup> Jim Romeo, “The ABCs of mixed use schools: schools and communities learn the meaning of 'co-location'.” *Planning Magazine*, July 2004.

school-specific assessment. As the foregoing discussion has suggested, while the Kroll site offers *possibilities* for mixed-use development, it is unclear whether they are likely to be compelling enough to justify pursuing them. There may, however, be other sites in Paterson where the opportunities for mixed-use development are indeed compelling.<sup>21</sup>

### **3 How to get there: Making public-private initiatives and mixed-use school development happen**

The first two sections of this paper have shown that the creation of schools through public-private initiatives and as part of mixed-use developments can often yield valuable benefits to the state, the school district and the community. While the benefits of private involvement in the development process cannot be realized in all school projects, and not all school projects are appropriate for mixed-use development, the fact remains that many school projects are suitable for either or both approach. By using these approaches, the state can make its money go farther toward achieving the goal of high-quality schools for every child in the state's *Abbott* districts, while in many cases, enhance the quality of the educational program and the benefit of the new schools to the community.

Major obstacles, however, block the creation of mixed-use school facilities and the use of public-private school development initiatives in New Jersey. The threshold problem is a legal one, in that features critical to such initiatives are either not permitted under state law, or permitted under severe limitations, or discouraged in practice even where, strictly speaking, they might be permitted. Furthermore, even if legislation is enacted to change those laws, significant procedural obstacles would remain which would have to be resolved before either public-private initiatives or mixed-use school development became anything other than rare exceptions. How the local regulatory process – which becomes relevant as soon as one moves away from conventional school development practices – will interact with the state school regulatory process is a critical issue, which must be addressed if a smooth and timely system for review and approval of projects is to be ensured.

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<sup>21</sup> The other two Paterson sites studied as part of this project offer stronger mixed-use potential. The Panther site, because of its proximity to the train station and its opportunities for high density development, is likely to meet many of the criteria for mixed-use development. Similarly, if Barnert Hospital were to re-open, the development of a facility adjacent to the hospital that combined a health careers academy with medical-related uses that would logically locate close to the hospital, would clearly be appropriate.

As will be discussed further below, the ramifications of decisions made about school projects, particularly with respect to mixed-use development, go far beyond the school district, affecting the development of the community and its quality of life. Those directly affected, whether in local government or among neighborhood residents and their organizations, must be part of the process by which decisions regarding public-private initiatives and mixed-use projects are made. In all, three areas must be addressed:

- Removing legal constraints
- Ensuring a consistent and efficient review and approval process
- Establishing a sound planning and decision-making process.

The scope of this paper does not permit an extensive examination of these areas, or the framing of detailed recommendations. The discussion here will outline the key areas, and provide a framework for a more detailed investigation of each area.

### ***Removing legal constraints***

Existing provisions of state statutes governing the SDA as well as local school districts do not permit the sorts of contractual agreements and uses of public funds that are needed to create public-private initiatives and mixed use school development projects. In some cases explicit language prohibits certain agreements, such as the limitation on school lease-purchase agreements to 5 years.<sup>22</sup> In other cases, the absence of explicit language permitting certain agreements has nearly the same effect as a prohibition. This appears to be the case where certain actions may be permitted in the general state law governing school property matters (N.J.S.A.18A:20-1 et seq.) but are not explicitly authorized under the Educational Facilities Construction and Financing Act with respect to the use of funds by the SDA (N.J.S.A.18A:7G-1 et seq.).<sup>23</sup>

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<sup>22</sup> For reasons that are unclear, state statutes permit leases of up to 50 years, but prohibit lease-purchase agreements (which typically need to be long-term in order to be economically feasible) to five years. Moreover, any lease of greater than 5 years must be approved both by the Commissioner of Education and the Local Finance Board (N.J.S.A.18A:20-4.2)

<sup>23</sup> This point is stressed for two separate reasons. First, experience has shown that it is the natural tendency of attorneys, particularly, it would appear, deputy AGs representing state agencies, to argue that the absence of explicit authority is tantamount to a prohibition, whatever the context or public policy considerations might suggest. Second, even if it is possible from time to time to navigate the process of gaining approval for something that is not explicitly permitted, such 'one-shot' efforts have little value. The point is not to see one or two experiments take place after many years with great difficulty, but to institutionalize a process whereby public-private initiatives and mixed-use school development are seen as normal transactions.

Instead of prohibiting alternatives to conventional school development, the law should be rewritten to provide the greatest possible flexibility in both contractual agreements and use of public funds, along with criteria to ensure that inappropriate or abusive contracts or uses of funds are kept to a minimum. Without specifying legal language, the areas in which legal changes are needed include the following:

**(1) *Provide clear language not only authorizing, but encouraging, mixed-use school development.***

School districts should be required to consider mixed-use options, and the SDA should have the authority to initiate and pursue mixed-use development options where such options clearly meet either economic or community benefit criteria.<sup>24</sup>

**(2) *Provide clear language permitting schools to be developed by qualified private for-profit or non-profit entities, and permitting SDA funds to be provided to such entities.***

The statutory language regarding use of SDA funds should clearly authorize their use in conjunction with other funding sources for mixed-use school development, and reasonable standards for phasing SDA funds with other funds in such projects.

**(3) *Provide clear language permitting flexible contractual agreements between the SDA, school districts, developers and non-school users in mixed-use school projects.***

Both public-private initiatives as well as the long-term arrangements that are inherent to mixed-use projects require that the parties have great flexibility in framing ownership and contractual relationships. The law needs to permit the widest possible variety of formats to govern the development of school projects as well as long-term leasehold and ownership agreements. These should include turnkey, purchase of air rights, lease-purchase, shared-use, condominium and similar options. The statutory language should, moreover, be drafted so that it will include future legal frameworks and contractual relationships that cannot be explicitly anticipated at this point.<sup>25</sup> Long-term capital leases

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<sup>24</sup> Language under which this can take place under certain circumstances appears in the general statute, N.J.S.A.18A:20-4.2(g).

<sup>25</sup> The legal framework for property ownership and organization of complex corporate entities is constantly evolving. The condominium as a form of ownership effectively did not exist until states passed laws creating it. More recently, the development of LLCs represents a new way in which companies can organize themselves. As laws and practices change, the SDA and school districts need to maintain the ability to change with them.

and lease-purchase agreements should be explicitly permitted.

**(4) Provide for clear public benefit criteria for alternative uses of SDA funds and flexible contractual agreements needed for public-private initiatives and mixed-use projects.**

In order to protect the public interest, prior to using the flexible alternatives that should be permitted in the state statutes, the SDA would be required to make a series of findings. The first must be that *the proposed approach will not conflict with or undermine the educational goals to be furthered by the school construction project*. Additional findings would include:

- For all public-private initiatives:
  - That the development entity has the technical and financial qualifications to carry out the project
  - That development of the project through a public-private initiative will benefit the public either through cost savings, time savings, mitigation of risk or other salient considerations.
- For mixed-use initiatives
  - That the development entity has the technical and financial qualifications to carry out the project
  - That the proposed uses are consistent with the development plans and strategies of the municipality
  - That the financial structure of the project (the manner in which SDA and other funds will be combined in the project) adequately protects the public interest
  - That the project meets at least one of the following criteria:
    - Land or buildings for schools or for other needed development are in short supply in the municipality, and mixed-use development enables the project to use available land or building resources more efficiently.
    - Mixed-use development will generate capital revenues or cash flow to offset school development costs;
    - Mixed-use development will result in creation of a facility which provide greater benefits to the neighborhood than the school will provide alone.
    - Mixed-use development will make possible synergies between the non-school uses and school activities and educational programming.

The statute or regulations should explicitly provide that net financial benefit to the public through cost savings is not the only criterion for either public-private initiatives or mixed-

use development, and that in exceptional cases, significant public benefit may justify a project even though the cost may exceed that of a conventional school project.

### ***Ensuring a consistent and efficient review and approval process***

A significant problem arises with both public-private initiatives generally and mixed-use projects in particular because of the existence of two parallel, and sometimes inconsistent, regulatory systems in New Jersey. Conventional school projects are regulated by state agencies, and are not subject to any municipal regulation with respect to either land use or construction plan review and approval. School plans are reviewed by the Department of Education, while actual construction and engineering plans are approved by the Division of Codes & Standards in the Department of Community Affairs. Non-school projects developed by private entities are subject to land use regulation by the municipality through the planning board or zoning board of adjustment, as well as construction plan review by the municipality's buildings or inspection department.<sup>26</sup>

A clear process needs to be established with respect to both public-private initiatives and mixed-use projects which prevents both duplication and undue delay. Duplicative review procedures, and delays in approval, can undo a significant part of the time and cost savings that might otherwise be possible. The matter is further complicated in mixed-use projects, since local zoning ordinances are often written in ways that preclude mixed-use development, whether or not a school is involved. The process of obtaining the necessary variances or zoning changes needed may be difficult and time-consuming.

In addition to rationalizing the division of state and local responsibilities, it will also be necessary to establish efficient standards and procedures within state government for these projects. State school construction standards do not address the design issues that may arise with respect to mixed-use developments, while no template exists within the state for a long-term lease between a school district and a developer/owner, or for any of the other contractual agreements that may arise in the course of framing public-private initiatives and mixed-use school developments.

Creating a single, efficient regulatory process for public-private initiatives and mixed-use school development projects is likely to require legislative action, while changes in state practice are likely to require regulatory changes. The following

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<sup>26</sup> While the code used by municipalities in reviewing construction plans is a uniform statewide code, the individuals responsible for administering the code are municipal employees.

practices should be incorporated into legislative amendments to the SDA statute, and to changes to state regulations:

**(1) Provide that schools developed by private developers through public-private initiatives, where there are no non-school elements and the school will be either owned by the school district or subject to a long-term lease after completion, be exempt from local land use approval.**

Since, from a land use standpoint, there is no difference between such a project and a conventionally-constructed school project, there is no substantive rationale for requiring such approvals. This is not inconsistent with a greater municipal role in the *planning* of school projects, as discussed further below.

**(2) Create an expedited process for municipal approval of mixed-use school development projects.**

The SDA should be given the power to over-ride municipal denial or undue delay in taking action with respect to both land use approvals and tax abatement where the SDA finds that (1) the project is not inconsistent with the municipal master plan and (2) the mixed-use development will result in significant public benefit.

**(3) Provide for one-stop review and approval of construction and engineering plans for mixed-use projects.**

Local code officials and DCA staff have the same training and administer the same codes. One or the other, not both, should be responsible for review and approval of construction plans for mixed-use projects, as well as ongoing inspection during construction. We would suggest that use of local code officials be seen as the default option, with the municipality given the option of deferring to DCA and the SDA retaining the power to require state review of projects (including the non-school elements) in communities where significant deficiencies in local review and inspection capacity exist.

**(4) Revise Department of Education design and space standards for school projects to ensure that cost-efficient mixed-use development is possible consistent with sound educational requirements.**

**(5) Develop model standards and templates for the full range of potential agreements between the SDA, developers and school districts, including turnkey agreements, leases, and the like, to facilitate expeditious negotiation and execution of such agreements.**

Construction of schools through the conventional public sector process is slow and expensive, but is a known quantity. All of those involved, school superintendents, architects, state DoE personnel and others, understand the process and know their role in that process. If public-private initiatives and mixed-use school development projects are to achieve their potential, the process by which they take place must become as clear and unambiguous as conventional school construction.

Wherever possible, the SDA should be prepared to delegate their responsibility under any of the above scenarios to local school districts as provided in the 2007 amendments to the EFCFA, where the school district meets the criteria developed by the SDA for delegation. Management of the project at the local level should in most cases facilitate communication, and make it simpler to resolve the jurisdictional issues that may arise.

***Establishing a sound planning and decision-making process.***

All urban school development projects, and mixed-use projects in particular, exist within a larger community framework. Where a school is located, how it is configured on its site, and what facilities it might offer in addition to the school, all have important consequences for the neighborhood in which it is situated, and often for the community or municipality as a whole. For that reason, the involvement of local officials and neighborhood residents in needs to be central to the process by which school sites are chosen, decisions about complementary uses for the property are made, and the schools are planned and designed. In the past, in the absence of either clear requirements that school districts engage either local officials or community residents in planning or state policies to encourage such efforts, wider engagement of the community in school planning has been limited, erratic and inconsistent from one school district to another.

Failure of many school districts and the former School Construction Corporation to engage in joint site selection and planning efforts with local officials, CDCs and other community stakeholders has led to innumerable missed opportunities for valuable synergies between school development and neighborhood revitalization, not to mention shared use and mixed use opportunities that would have benefited the school district's educational programs as well as the larger community. If, as this paper recommends, school districts and the SDA should actively explore opportunities for mixed-use school development wherever such projects meet the criteria set forth earlier, the engagement

of the community becomes even more important. *School districts are not always the best qualified entities to judge whether a mixed-use project indeed meets the criteria for success, both educationally and otherwise.* Local officials and community leaders may be able to see the potential benefits of mixed-use developments more clearly.

While the SDA may have the authority to adopt the following recommendations by regulation or other administrative action, it would nonetheless be desirable to include their principal features in the legislation that would be needed to create the contractual and legal framework for public-private initiatives<sup>27</sup> and mixed use school development, in order to ensure that community engagement is institutionalized as a fundamental part of the school development process.

**(1) *Adopt a school site selection process that provides a formal role for local government and community representatives, and which incorporates community improvement as well as educational and financial criteria.***

While school sites must reflect the educational needs of the school district and the distribution of its present and future student body, the process of site selection should also take into consideration how potential school sites further neighborhood revitalization, and create mixed-use (and shared use) opportunities. These are considerations that local officials and others in the community may well understand better than the school district.

**(2) *Adopt a mixed use ‘screen’ to evaluate future school projects.***

Although not every school project should be a mixed use project, a strong case can be made that the potential of mixed-use development should at least be *explored* for every school project involving a new facility or a large-scale expansion of an existing facility. To that end, a process known as a ‘screen’ should be followed for all such projects, in which the potential non-school uses of the site or building are evaluated against each of the criteria previously identified. This is illustrated in Table 6 on the following page, which applies such a screen to the Kroll site.

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<sup>27</sup> Public-private initiatives for development of school projects without mixed use features, from the standpoint of basic site selection and planning issues, are no different than other school construction projects, and would be subject to any community engagement provisions generally applicable to all projects. The analysis of the financial pros and cons of developing a school through a public-private initiative versus conventional school construction is more a matter for the financial professionals.

The screen does not determine that the project should be a mixed-use project. It identifies, however, which uses should be considered for inclusion in the project, and what considerations need to be further evaluated before a firm decision can be made whether or not to include specific uses – and to what extent – in the project. As with the selection of school sites, the process of evaluating mixed-use options needs to be one in which local government and community representatives are actively at the table with the school district and SDA.

**(3) *Ensure the ongoing involvement of local government and community representatives in the planning and design of the school or mixed-use development.***

The role of the community does not end when a school site is chosen, or the mixture of uses on the site is established. It needs to be built into the process of planning and designing the school, in way that permits not only input into the school design itself, but the opportunity to identify synergies with other community goals, such as housing improvement projects or open space projects. Ongoing community engagement is particularly important where the school is being developed in an area that has been designated a redevelopment area by the municipality, or where it is the subject of a neighborhood revitalization plan developed by a CDC and approved by the Department of Community Affairs.<sup>28</sup>

## ***Closing note***

The foregoing discussion has shown that construction of schools through public-private initiatives can offer significant benefits to the public, by speeding the process of school construction, mitigating the risks to the public sector, and potentially reducing the cost of many schools and allowing limited public resources to go farther. It has also shown that under many – although not all – circumstances, the combination of schools with non-school facilities through mixed use development can also provide significant public benefits. In some cases these benefits may be financial, while in others they may

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<sup>28</sup> Under the Neighborhood Revitalization State Tax Credit Act, N.J.S.A.52:27D-490 et seq. (P.L.2001, c.415), a procedure is established under which CDCs prepare neighborhood revitalization plans, and submit them to DCA for approval; once the plan is approved, the CDC is eligible to receive up to \$1 million per year in corporate contributions to carry out the projects in the plan, in return for which the corporation receives a state tax credit for the amount of the contribution.

be educational or take the form of other social and economic benefits to the neighborhood in which the school is located.

These benefits will not accrue without significant changes in both legal requirements and administrative practices. In order for New Jersey, the city of Paterson and the other thirty *Abbott* school districts to take advantage of these benefits, major changes are needed in the manner in which the Educational Facilities Construction and Financing Act defines both the powers and responsibilities of the School Development Authority and the local school districts, and in the way the school development process takes place. These changes, spelled out in this paper, will require legislative amendments, regulatory changes and changes in the practices of state and local bodies. They will not come easily or quickly. The benefits of making these changes, however, vastly outweigh the difficulty of pursuing them.

**TABLE 6: APPLICATION OF MIXED-USE SCREEN TO KROLL SITE**

| POTENTIAL USE                   | POTENTIAL MIXED-USE BENEFIT CRITERIA  |   |   |  | PLANNING ACTION   |
|---------------------------------|---|---|---|--|---|
|                                 | Further better site utilization and better planning   | Offset school development costs   | Add community benefits  | Enhance educational programs   |   |
| Commercial (retail) development | Yes, but only with respect to small area along 21 <sup>st</sup> Avenue. Can strengthen that commercial corridor.  | No. Retail rents likely to be equal or less than school lease payments for same amount of space.                        | Yes. Can provide additional retail services to community        | No   | Consider setting aside $\pm$ 10,000 SF for commercial development along 21 <sup>st</sup> Avenue site frontage |
| Office development              | No. No evidence of unmet need for office space in area or lack of other options to create office space.   | No. Office rents likely to be equal or less than school lease payments for same amount of space                         | No. No evidence of unmet need for office space in area.         | Yes, but only if office space is utilized by firm offering specific synergies with high school academy program | Consider only if firm commitment from suitable firm is available.   |
| Residential development         | Uncertain. Site is suitable for housing, but use of part of site for housing reduces area available for school use. Alternative housing sites are likely to be available. | No. Housing market will not support housing costs at level where return could generate revenues to offset school costs. | Probable. Additional housing of good quality is needed in area. | No.  | Consider only if evidence shows that reduced area for school use can be readily made up in alternative sites. |