The Development, Ownership and Operation Models for Private Sector Schools in the GCC

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The price of oil has challenged governments across the GCC to find new ways of balancing their budgets. Having the private sector involved in providing “public” type services such as education is one strategy which may assist with this challenge. Private sector school operators already have a strong foothold in the region. In this article we look at some of the issues surrounding the private sector school industry and in particular their real estate requirements.

The Stakeholders

A private sector school operation is generally made up of the following stakeholders:

- the Operator;
- the School Owner (either freehold or leasehold);
- in the case of leasehold a Land Owner;
- the Financiers;
- the Master Developer or other planning entity;
- the Regulators; and
- the Consultants.

We consider the role of each stakeholder briefly below:

The Operator

The Operator is the entity that is specialised in providing the range of services necessary for a school including the curriculum, resourcing, licensing and often consultative services such as financial modelling and design.

Typically such Operators will specialise in a particular type of curriculum (ie: International Baccalaureate, British or Indian curriculum) though there are examples of Operators providing a variety of curricula.

Generally Operators would prefer to take an occupational lease of the school (not to be confused with a ground development lease or ‘musataha’ discussed later) rather than commit large amounts of capital to such infrastructure.

Often however they want to be involved in the design process in order to ensure that the school meets their specifications. In order to achieve their objectives there may be joint venture elements with a School Owner who wants to hold the school asset as an investment.

The School Owner

The School Owner is the party who undertakes the planning and development of the school. School Owners tend to be attracted by the diverse nature of a school from an investment perspective. For this reason Real Estate Investment Trusts (or “REITs” as they are commonly referred to) are showing an interest in school properties as a means of balancing their portfolios. Ownership may be freehold but is often pursuant to a long-term ground-development lease or musataha.

The Land Owner

Schools are a low-density land use and the land is often in a strategic location set aside by the Master Developer or planning entity to meet that specific community's needs. Other land uses may be more profitable and in order to keep control of the land, the land is often leased by the Land Owner (often a Master Developer or public authority) to the School Owner on a long-term ground-development lease basis or musataha.

The Financiers

Financing may be through equity contributions often involving incorporated joint ventures. Participants in such joint ventures may include the Operators and Master Developers. It is becoming more common however for funds or specialist investors to provide such equity funding. In addition to the equity funding, school projects may also require debt funding. Debt funders require adequate security and accordingly the ability to register any leasehold interest and grant a mortgage may assist.

The Master Developer or other planning entity

As referred to above, many Master Developers now recognise the value a school can bring to their master planned communities and will specifically set aside land for such schools and advertise this as part of their Master Plan. If such Master Developers are able to sell freehold land then they would have the option of selling the freehold interest (subject to land use restrictions) though for the reasons set out above, it is more likely that the Master Developer would sell the land on a leasehold basis.

The Regulators

The applicable regulators will be the relevant ministry or government authority in charge of education and also the relevant municipal or planning authority in charge of construction and planning matters.

The Consultants

Many Operators have built up knowledge on the design, planning, regulatory and financial aspects of putting together a school project. In addition however there are specialist consultants who can assist with such projects.

A Favourable Private Sector Regulatory Environment

Planning Regimes

Fundamental to establishing a private sector school will be having suitable land set aside for such developments. If designations are set out in master plans or the urban plans of the planning entities, the value of such land may adjust to that reasonable for a school development rather than a more profitable land use. In addition, Master Developers and the planning entities may want to retain such land and make it available through long term lease for development as a school.

Land Ownership Regimes

For the private sector to involve itself in schools and educational initiatives, they require profit and also certainty that any funds invested are secure. In this regard, having a land titles regime that allows foreign ownership or investment and the registration of long-term leases and mortgages over such interests will support private sector involvement.

Regulatory Regimes

The regulatory requirements for private sector schools need to be clear and reasonable. Such requirements include: foreign ownership rules (whether in land or the equity in the business), planning and construction requirements and operational requirements such as licensing and curriculum content. In addition, schools face international competition for teachers. Having an environment that facilitates the recruitment of foreign teachers and makes it attractive for them to move to the region will benefit this industry.

Typical Private Sector School Models

A private sector school investment model will usually involve variations on the following:

- the relevant land may be identified by the Master Developer or planning entity as suitable for a school;
- the Operator may themselves or in conjunction with their Consultants assess the viability of the school on the land and assess an appropriate development and investment model;
- the Operator or their Consultants may approach Financiers with their development and investment model; and

- the Operator and Financiers will agree the form of the investment which will usually comprise:

(a) investigating the underlying title to the land or the terms of the long term lease or musataha;

(b) the establishment of a Special Purpose Vehicle ('SPV') as a School Owner to hold the land or long term lease and complete the construction;

(c) if the School Owner is an incorporated JV then agreement as to the terms of the shareholders agreement and equity contributions;

(d) generally debt arrangements will be arranged with a Bank and mortgage or conditional assignment put in place;

(e) the terms of the occupational lease between the Operator (or its SPV) and the School Owner thereby giving security to the School Owner as to its return; or

(f) as an alternative to the occupational lease, the Operator may prefer to grant a franchise to or have an operating agreement with the School Owner ('Management Agreement'). Such an arrangement may have advantages where there are foreign ownership or other regulatory restrictions in the relevant jurisdiction; and

(g) once the investment model is agreed, the arrangements would be closed and the design consultants and contractors appointed.

Variations on the above may include the Operator completing the project then transferring this to an investor or fund or the Master Developer or other partner completing the development through a consultancy then entering into an occupational lease or Management Agreement with the Operator.

Conclusion

Many private sector schools operators already have operations in certain regions of the GCC and Middle East. Governments seeking to move more services from the public sector to the private sector may wish to specifically target these private sector school operators. This industry can be further facilitated by building a favourable regulatory environment. Operators and other private sector stakeholders may need to be flexible with their investment models having regard to the regulatory environments of each GCC or Middle East jurisdiction.