

**Working Together or Going it Alone:  
How Should Universities Develop Real Estate?**

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## **Abstract**

This case study has been prepared as part of the Lincoln Institute's program on "The City, Universities, and Land." It has been written by Wim Wiewel (University of Baltimore), based on presentations at a workshop held at the Lincoln Institute for Land Policy on September 18-19, 2005, by Joseph T. Maguire, Jr., John P. McQuaid, and Michael K. Owu (MIT); Gayle Farris (Forest City Enterprises); John Myers (Spaulding & Slye); and Michael Cantalupa (Boston Properties). While every effort has been made to present all relevant information accurately, neither the presenters nor the Lincoln Institute of Land Policy is responsible for any statements or claims made in this case study.

## About the Author

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# **Working Together or Going it Alone: How Should Universities Develop Real Estate?**

## **Introduction**

This case presents three real estate development projects at the Massachusetts Institute of Technology (MIT), each undertaken in a different way. These projects illustrate the various options that universities (and other institutions) have in structuring their role, depending on such factors as internal ability and resources, degree of risk, and expectations about rewards. The information presented on how MIT chose to approach each of these projects, the associated advantages, disadvantages, and trade-offs, and the actual results, may help other institutions decide under what conditions they might want to choose one or the other of these approaches. Specifically, the case discusses:

1. University Park at MIT, where MIT owned the land and leased it to Forest City, a large privately owned developer of commercial and residential real estate, which took full responsibility for the project.
2. Technology Square at MIT, where MIT purchased the land and existing buildings from a developer and built out the project itself, and hired Spaulding and Slye as development manager.
3. Broad Institute, where Boston Properties, a publicly-traded Real Estate Investment Trust which owns and has developed many projects, owns the land and the building and leases it to MIT for use by a collaborative of several institutions.

For each of these projects, MIT faced different opportunities and constraints, and therefore chose these differing approaches. Other institutions will similarly have the option of acting as the developer with the assistance of consultants as needed; taking a more passive approach and simply leasing the land to a developer; or meeting space needs by working with a developer on a “build-to-suit” deal and leasing the space back from the developer for its own use. This case will first present some background on MIT’s real estate investment approach, and then provide detailed information about the three projects, allowing a comparison of key factors distinguishing them, and suggesting general guidance about the conditions under which the various approaches would best serve institutional needs.

## **Background on MIT’s real estate investments**

MIT has two offices dealing with real estate. The Facilities Department deals with projects on the campus itself and buildings strictly for academic needs. This entails some 160 acres, with 11 million square feet of buildings, and an approximate value of \$1.6 billion. All of the projects discussed here, however, have been handled by the Real Estate Office, the group within the MIT Investment Management Company which deals with investment real estate. Most of this is also in Cambridge, Massachusetts, where MIT owns some additional 80 acres, with 6 million square feet of space, and an approximate value of \$870 million. While investment return is the primary goal of any

project handled by the MIT Real Estate Office, additional goals include strategic land banking, providing support for academic operations, and improving the surrounding community. However, all projects have to meet an investment return hurdle, regardless of the other benefits they may provide. Because of its significant non-academic real estate holdings, MIT is the largest property tax payer in the city of Cambridge. In 2004 MIT paid over \$22 million in property tax, more than 10% of total property taxes levied in the city—three times more than the next biggest taxpayer, Boston Properties. (In comparison, Harvard University paid just over \$3 million in property taxes to the City of Cambridge).



Source: University Park at MIT by Forest City Commercial Group, Boston

During the 1960s, MIT was involved in a modest way in several real estate development projects. They were a limited partner in the first phase of the redevelopment of Technology Square, an older industrial area close to campus. They also started land acquisition in another industrial and warehouse area, which later became the University Park project. However, a more active approach did not start until the early 1980s. We will now discuss each of the three projects, focusing on five key points:

- a) Motivation
- b) Return on investment
- c) Town-gown issues
- d) Flexibility
- e) Expertise and staffing.

## University Park at MIT: Land Leases

University Park is a 27 acre area, originally consisting of factories and warehouses, most of which became vacant and were acquired by MIT in the 1960s, 1970s, and 1980s. The area is along Massachusetts Avenue, adjacent to MIT itself (see map). In 1983, MIT entered into a development agreement with Forest City Enterprises, Inc., an 80-year old, privately held real estate development and holding company, with over \$7.8 billion in market capitalization. The company's Science and Technology Group at present owns and manages 2 million square feet of space, and has another 2.5 million square feet under development. The basic structure of the agreement is that Forest City is responsible for all planning, financing, and development activities for the area, and leases land from MIT as it is needed. At present, the project is fully developed as a mixed use development.



Source: University Park at MIT by Forest City Commercial Group, Boston

**Motivation.** MIT's reasons for taking on this project were primarily to improve a derelict community adjacent to the campus. It was an area where MIT knew it would likely develop new academic buildings, including student housing, at some point in the future, and it was important to begin the lengthy process of improving the neighborhood. In addition, with many vacant warehouse buildings, neighbors were concerned about rising crime and drug use, a concern that was shared by the MIT community. Secondary reasons for the project were to generate investment returns and to create opportunities for economic development through technology transfer. At the time (early 1980's)

leadership of MIT did not feel they had the institutional expertise to take on a development project of this magnitude. Also, MIT had already invested \$16 million in acquiring the property—this constituted about 5% of the MIT endowment at that time, and they did not want to invest any more. Thus, an approach which limited investment and required little in-house effort was desirable.

Forest City saw this as an opportunity to partner with a major land holder, which they realized was the driver of demand for land in the area, and which would give them access to long-term value creation opportunities in a technological and intellectual mecca. It dovetailed with Forest City's strategy of being a long-term investor.

Return on investment. Over the past twenty years, the project has been fully built out, with 1.5 million square feet of lab and office space occupied by major biotechnology and pharmaceutical companies, 674 rental apartments, a luxury hotel, supermarket, restaurants, health club, and child care center, as well as 2600 parking spaces and a 3-acre urban park. However, development has only recently been completed, many years later than was anticipated, and at several points in time Forest City was unsure whether the project would really succeed.

MIT accepted the lower return of a land lease compared to the equity appreciation and other income of being the developer, in exchange for the very low risk. Over time, other forms of participation have been added, with percentages of the building rent being paid by tenants, equity participation by MIT in some of the buildings (such as the hotel), and various fees. In fact, MIT owns 50% of the hotel; it made this investment at a time that development in University Park appeared stalled, and needed a major boost. Since 1998, the market value of the ground leases has gone up from about \$20 million (which is also the book value) to about \$50 million. The annual return on the ground leases now averages above 10% of market value, or \$5 million per year (see chart). Most importantly from MIT's perspective, the development has turned an area of abandoned and marginal buildings into a first-class office and residential community, at a minimal investment of the institution's capital.

Forest City has invested about \$24 million in infrastructure and master planning, and has also been an equity investor in the \$800 million worth of development that has taken place. The average unleveraged return is about 12.5% on the commercial development, and 8% on the residential development. In addition to the financial returns, the project has allowed the development of a new business unit in the company, which is now working on half a dozen similar projects around the country.

Town-gown issues. This development took place in a climate that was quite contentious. During the 1960s and 1970s, the strong manufacturing base located on the east side of Cambridge, where MIT is, had been declining rapidly. At the same time, housing prices were rising. Cambridge had a high proportion of renters, and along with several other Massachusetts cities it had passed a strong rent control law. By the mid-1970s, rent control was constantly under attack by landlords and real estate developers, who claimed that it deterred construction of new rental housing. Strong tenant and community

organizations were very active, and had significant influence on city government in opposing new developments that could be seen as “gentrification.” The universities were widely seen as part of the local “growth machine” that wanted to make Cambridge’s traditional blue-collar neighborhoods more attractive for white-collar professionals.

One of the advantages MIT expected to reap from bringing in Forest City was to remain somewhat isolated from the community opposition and contentiousness that had accompanied other MIT projects. This did not turn out to be the case. Community organizations and residents opposed several aspects of the development over the years, and generally lumped Forest City and MIT together. The community succeeded in obtaining increases in the number of housing units being built, the number of those that would be at an affordable level, and the amount of open space. Because of these issues, as well as negotiations with city government, the development process took more time from MIT staff and leadership than had been anticipated, especially during the first 5-7 years when most rezoning took place, and rent control was still in place in Cambridge. (Nevertheless, at times it did work out for Forest City to be the lead organization in dealing with city government, providing some shield for MIT which frequently had other priority issues on which to negotiate with the City).

Since the early years, and now that all decisions regarding rezoning, traffic, and greenspace have been made, the contentiousness with the community of the early years has disappeared. City government made significant traffic and streetscape improvements along adjacent Massachusetts Avenue, and in general is quite conscious of the \$11 million in annual real estate taxes the project generates—about 5% of the city’s total real estate taxes.

Flexibility. By partnering with Forest City, MIT had to cede most control over the specifics of the development that would take place. At the same time, it minimized the use of MIT assets (other than requiring some staff time). By retaining ownership of the land, MIT is capturing the rising land values, and retains the ability to reprogram its utilization 50-75 years from now—which is the soonest they expect to need the space. Other advantages of getting the property developed now, rather than just land banking it, are the annual financial return it generates; the fact that its current use protects against down zoning, which has taken place in other parts of Cambridge; and that in fact a successful new community has been created.

Expertise and staffing. As noted, the MIT Real Estate Office was only a small operation at the time this project started, and did not have the expertise required for this project. While Forest City was very experienced, MIT still found that it had to add some expertise of its own, and that its senior staff had to spend time on the project, both regarding issues with city government, and related to an understanding of what kinds of tenants would find proximity to the university most attractive. Now that the project is fully developed, it takes relatively little time and effort from either of the parties, beyond what one would expect from a 2.3 million square feet development.

MIT staff admit that in hindsight it would have been advantageous to have been more of an equity partner, given how successful the project is. However, they feel that given what was known at the time, and the constraints regarding staffing and available capital, the decision to proceed as they did made sense. Forest City also has no regrets, since the project has been profitable and has allowed them to develop a new business unit. However, in retrospect they feel that they took on too much risk and would not want to do that again, even though it worked out well in this particular case.

Questions:

1. What particular features of this case made leasing to a private developer a viable option?
2. What other model of developing real estate, would have mitigated risks and/or increased profitability for the university?
3. What other model of developing real estate would have mitigated risks and/or increased profitability for the private developer?
4. Could the university and/or the private developer deal with town-gown issues any differently?
5. What lessons does this case provide for developers dealing with institutions responsible for multiple stakeholders such as universities?

### **Technology Square: MIT as developer**

Technology Square is located along Main Street in Cambridge, adjacent to the northwest corner of the MIT campus. It includes the former site of the Polaroid Company's headquarters and several other companies, which all closed in the 1970s and 1980s. MIT participated as a limited partner in the initial development phase of the area. By the late 1990s, the development area consisted of 10 acres, with office space in four buildings, owned by Beacon Capital (see site map). Beacon Capital is a privately-held Real Estate Investment Trust, whose general strategy is to add value to projects and then sell them. In 2000, as part of the process of adding value, Beacon had demolished one low-rise office building and was building four new office buildings, containing 600,000 square feet of space, and an addition to the garage, on the site. At that time, MIT was restructuring its real estate office to take on a larger role in pursuing investment opportunities. In October 2000, MIT retained the real estate development and consulting firm of Spaulding & Slye (now part of Jones Lang LaSalle) to act as its advisor, and wound up purchasing the Technology Square project as a long-term investment in early 2001. By 2005, the project contained 600,000 square feet of biotech R&D laboratories, 540,000 square feet of office and retail space, and 1600 parking spaces.



Tech Square site plan

Motivation. MIT has a continuing interest in the nature of development along its boundaries. Over the years, it purchased properties as they became available, often without changing anything about their use. The Technology Square development is immediately across the street from a part of the campus that was experiencing significant new development during the late 1990s. The Stata Center, a large research facility, was under construction, and in general the entire Kendall Square corridor, extending north of campus, was undergoing rapid development. The University Park development was finally doing well, and MIT could see that its limited role there was keeping it from reaping the full benefit of the rapid increases in real estate values in the area. A new director of the MIT Real Estate Office, Steven Marsh, was hired and took the lead in having the institution actively pursue real estate investment. Thus, it was natural to look at opportunities in this area.

In pursuing real estate investment opportunities, MIT uses a “hurdle rate” that all investments have to meet. However, strategic considerations also play a role. Given that 75% of its real estate investments are local, obviously MIT gives a priority to projects that may possibly serve other institutional needs, such as using the buildings or land for its own purposes at some time in the future, or neighborhood stabilization and improvement.

Return on investment. MIT purchased the site and existing buildings for \$278.8 million early in 2001, primarily as an investment opportunity. Initially it was an all-cash deal;

later they put some long-term, low cost debt on the buildings in order to get some of the equity out. The land is held in a separate legal entity, so that MIT's ownership of the land is protected even if the buildings were to turn unprofitable. (The ground leases are not subordinated to the financing of the buildings). At the time, there were three existing buildings which were fully leased, while four other buildings were under construction. Beacon Capital had planned these as office buildings, but during the year 2000 office rents declined from a high of about \$56 per square foot per year, to around \$47; but simultaneously, rents for lab space were rising from around \$44 to \$48. MIT was able to capitalize on its reputation and its presumed attractiveness for bio-tech firms to locate close by. Therefore, when MIT took over the development, it changed the building plans for three of the buildings to construct lab space instead (Tech 100, 300, and 500). However, it retained the services of the original owner, Beacon Capital, and its architect, Sasaki Associates, and construction company, Beacon Skanska, to complete the buildings according to the new plans.

According to Spaulding & Slye, MIT, like other institutional clients, does take a different perspective regarding expected returns than a corporate client. While cash flow calculations are still done on a standard 10-12 year time period, payback expectations are in the range of 6-7 years, rather than the three years more typical for a corporation. Because of this, investments in infrastructure and building quality tend to be higher for institutional investors.

Town-gown issues. Since the area was already under development with large office buildings, and there were no residents in the immediate vicinity, the project did not raise any community issues. However, the City of Cambridge was quite concerned about MIT's intended purchase. At the time, the project's annual real estate taxes constituted 2.8% of all city real estate taxes. The city administration and city council feared that MIT would start using the buildings for its own purposes, and take the property off the tax rolls.

At that time, MIT and the City of Cambridge had already been negotiating about an agreement regarding Payments In Lieu of Taxes (PILOT). The impending purchase of the Technology Square project provided the impetus for finalizing this agreement. It specifies that, above a certain threshold, if MIT were to use any of the space for academic (tax-exempt) purposes, it will make PILOT payments. The payment-in-lieu-of-tax would be equal to the tax payment in the year the property was removed, increasing at 3% per year, for a 40-year period.

Flexibility. The Tech Square acquisition provided MIT with immediate flexibility in meeting some of its own space needs. MIT took 100,000 square feet of lab space, and 80,000 square feet of office space. In addition, its pre-existing lease of one of the buildings (200 Tech Square) was extended when completion of the Stata Center was delayed. All of this space remained on the tax rolls. Beyond these immediate needs, the project obviously provides a large inventory of both office and lab space for future uses, depending on the terms of the leases with tenants. In addition, the lab space has attracted users which collaborate with MIT faculty and hire MIT students. Indeed, the major

tenant, the Novartis Institutes for BioMedical Research (NIBR), chose this location over other ones a few miles away, even though costs were \$10-15 per square foot higher, in order to be adjacent to the campus.

Expertise and staffing. This project inaugurated a new, more aggressive phase in MIT's real estate investment activities, coinciding with the arrival of Steven Marsh as the new managing director, and a doubling of the staff size. Marsh reports directly to MIT's Chief Investment Officer and Treasurer, and has considerable freedom to pursue real estate investment deals that are projected to have an attractive return on investment.

MIT used Spaulding & Slye for due diligence analysis prior to the purchase, continuing with development management, including property management, construction services, manager for tenant improvement, research and marketing, and project accounting. Once the project was completed, Spaulding & Slye continued on as property manager.

Since the project has only recently been completed, it is too early for a full assessment. However, so far it has exceeded expectations. The conversion of office space to lab space turned out well, and virtually all space is leased at rates that provide MIT with the returns it was expecting. Currently, MIT is in the process of seeking an equity partner for the leasehold improvements. This decision is based on the "frothy" investment climate. Results of the equity sale won't be known until the summer of 2006. Unlike University Park, though, the project makes less of a contribution to the vitality of the area from an urban design perspective. This is due in part to the fact that three of the buildings were existing at the time MIT acquired that property, limiting what could be done to improve the area. The pre-existing buildings are set back from the street, without any street-level activity, and have large wind-swept plazas between them. To help improve the urban experience, the new buildings are built to the street edge, and contain retail and service uses on the ground level. In addition, MIT is in the process of adding more retail areas in front of two of the older buildings, extending their footprints to the street edge.

Questions:

1. What particular features of this case acted in favor of MIT developing this project on its own?
2. What other model of developing real estate, would have mitigated risks and/or increased profitability for the university?

## **The Broad Institute: MIT as tenant-partner**

The Broad Institute is a new research collaboration between MIT, Harvard, several hospitals, and the Whitehead Institute for Biomedical Research. Its mission is to create comprehensive tools for genomic medicine, making them broadly available to the scientific community, and to apply these tools to propel understanding and treatment of disease. The Institute also is intended to enable collaborative projects that cannot readily be accomplished with the traditional setting of individual laboratories. Funded by an initial \$100 million gift from Eli Broad, the Institute builds primarily on the work of the Whitehead Institute/MIT Center for Genome Research and the Institute of Chemistry and Cell Biology at Harvard.



The Broad Institute of MIT and Harvard

The Broad Institute, located in multiple buildings in Boston and Cambridge, was looking for a single building to house all its programs and initiatives. Boston Properties, a publicly-traded Real Estate Investment Trust, is the designated developer for the 2.7 million square foot Kendall Square Urban Renewal Project, which includes most of the Kendall Square area. This means that it has the right to purchase land that has been cleared by the City of Cambridge under the federal urban renewal program, as development opportunities come up. A site next to the Whitehead Institute was the last major site available in the area, and Boston Properties successfully marketed it to the MIT Real Estate Office. (The MIT Real Estate Office considered at least 6 other sites, including ones with existing lab space, but ultimately preferred the proximity to the Whitehead Institute, the MIT campus, and Tech Square). The deal that was agreed upon has Boston Properties as the owner-developer, and MIT will lease the new building from them for the Broad Institute. The building was completed early in 2006.

Motivation. For this project, it did not make sense for MIT to act as owner-developer. Since the Broad Institute is a collaborative effort between several institutions, too dominant a role by any one of them would not be appreciated by the others. Also, the site that was chosen, immediately next to the Whitehead and in the MIT-related bio-tech

corridor, was owned by Boston Properties, which, as a REIT, was very interested in long-term ownership and cash flow. Thus, owning the site was not an option for MIT.

Since this is a building intended for (joint) academic use, it actually is not an investment case. Indeed, the only reason the MIT Real Estate Office, rather than its Facilities Department staff is involved relates to capacity and staffing issues. Also, MIT already carried significant debt for academic buildings, and needed its resources for other academic initiatives, rather than this joint one. MIT also was not interested in taking on all the development risk for a joint venture with other organizations. Therefore, the arrangement with Boston Properties was very attractive.

The deal was interesting for Boston Properties, since this was their last major site in the urban renewal area, and MIT was considered a very good credit risk. Also, the office market was declining at the time, and lab space presented a viable alternative.

Return on investment. This project required limited upfront investment from MIT. Boston Properties is responsible for the construction of the building, while the specific fitout is also paid for in part by them as part of tenant improvement allowances at \$200 per square foot. (Total development costs exceed \$500 per square foot). Rent will be partially offset by the research funding (including the federal Facilities and Administration rate) generated by the researchers.

From Boston Properties' perspective, MIT's participation was critical. While the Broad Institute is well-funded, it has a limited track record. However, Boston Properties trusted MIT's credit, enabling it to get financing for the project. Boston Properties would have preferred a longer lease than the 10-year term agreed upon, but probably would have been unable to get any other tenant for a longer term. If the lease is not renewed after 10 years, the Broad Institute is responsible for undoing some tenant-specific aspects of the building in order to make it more marketable to another tenant. This includes shifting the main entrance from the side (where it now immediately connects with the Whitehead Institute) to the front; changing the location of an elevator; and eliminating the mezzanine, which primarily has a ceremonial and esthetic purpose.

Town-gown issues. As with Technology Square, the City of Cambridge was concerned about this development since the user would be non-profit organization. However, since the owner is a for-profit corporation, real estate taxes are being paid. With the PILOT agreement in place, the city also has assurance that if at some future point one of the nonprofit partners purchases the building, there will still be payments to the city.

Another city issue was the requirement that there be a street-level retail use. Obviously, retail on the first floor was not considered as a very compatible use with the laboratory purpose of the building. Instead, agreement was reached that the first floor would have a publicly accessible hands-on museum/learning space related to bio-technology. Since the entire front of the building has a glass façade, this space will be very open to passing pedestrians. Indeed, the idea behind the glass façade for all spaces, including the laboratories, is to symbolize the purpose of the Broad Institute: to make research and research tools publicly available, rather than use them for private profit or benefits.

On all of these issues it helped to have Boston Properties as the owner-developer, rather than MIT. As the designated developer for the urban renewal area, Boston Properties had very good relations with the Cambridge Redevelopment Authority and other city government staff. Also, MIT probably would have been held to higher design standards than a private developer.

Flexibility. The fact that MIT is not the owner somewhat limited its flexibility regarding the design. Boston Properties sought to make sure it would have a leasable building if the Broad Institute ever moves out. Nevertheless, because of the specialized requirements, the Broad Institute and MIT, rather than Boston Properties, oversee the internal work in the building, using the same architect and construction firm as was used for the basic structure. This created opportunities for flexibility—for instance, midway through construction, a large part of one floor was completed redesigned, requiring tearing out and replacing all the duct and utilities work in that area. On the whole, the project has moved much more quickly than a typical campus construction project.

Expertise and staffing. Both MIT and Boston Properties feel they benefited from the expertise of each other's staff. Indeed, MIT's Real Estate Office, rather than its Facilities Department, was assigned this project because of its expertise with public-private collaborations.

Questions:

1. What particular features of this case made leasing from a private developer a viable option for MIT?
2. What other model of developing real estate, would have mitigated risks to the university?
3. What other model of developing real estate would have mitigated risks to the private developer?
4. Could the university and/or the private developer deal with town-gown issues any differently?
5. What lessons does this case provide for developers dealing with multiple institutions each responsible for different and multiple stakeholders?

## Conclusion

These three projects exemplify three different approaches for a university to undertake real estate development. In University Park, MIT's main role was as owner of the land, leasing it to a private developer for development. In Technology Square, MIT purchased the land, existing buildings, and some buildings under development, and subsequently completed the development project. In the Broad Institute project, MIT is only one of the participants in a partnership that is leasing a building.

However, the distinctions between these models are, in practice, not entirely neat and tidy. In University Park, MIT became a co-investor in several of the projects, most notably the Hotel@MIT, both to gain an opportunity at equity appreciation, as well as to give new energy to a development process that appeared to be stalled. In Technology Square, MIT had had an earlier role as a limited partner in the first phase of the development, and wound up renting a considerable amount of space in a project that was initially conceived as a pure investment deal. Finally, for the Broad Institute, MIT played a much larger role than a typical tenant, with its expertise, credit, and direct involvement in overseeing an important part of the construction. Thus, in analyzing the advantages and disadvantages of each model, it must be borne in mind that some attenuation of each model is possible.

The MIT staff feel that for each project the right approach was chosen, given what was known at the time. While at some level acting as owner-developer may be seen as the most attractive approach, representing a culmination of staff expertise and opportunity for rewards, in reality any of the models may be used in the future. The key variables in choosing an approach will be the availability of capital, given all other project needs at that time; the availability of staff time and expertise, depending on what other projects MIT Real Estate is engaged in; and organizational/political reasons that may suggest a more or less prominent role. Thus, all of these models, along with mixed versions, are likely to be used again.

### General questions

1. Based on your experience, how generalizable are MIT's experiences with the different development models?
2. What was most valuable to you about each of the case studies and across all the case studies?