SUBJECT: A Resolution of the Board of Governors Approving the University of Central Florida to enter into a ground sublease with a vendor for the construction, financing, operation and maintenance of a hotel and convention center on UCF’s main campus.

PROPOSED COMMITTEE ACTION

Adoption of a resolution approving the University of Central Florida (“UCF” or “University”) entering into a ground lease for the construction, financing, operation and maintenance of the Project with KUD International, LLC, or its affiliate (“Owner”). If approved, UCF will enter into a 52-year ground sublease (including the construction period) that the Owner has the option to extend for an additional 10 years.

Staff of the Board of Governors, State University System of Florida, and the Division of Bond Finance, State Board of Administration of Florida, have reviewed this resolution and all supporting documentation for compliance with Florida law and the Board of Governors P3 Guidelines. The proposed Project appears to be in compliance with applicable Florida law but does not comply with the P3 Guidelines in all respects. Staff note that effective lease term of 62 years is 22 years in excess of the 40-year limit in the Board’s P3 Guidelines. Additionally, the anticipated financing structure comprised of interest only payments during the construction period, potential 35-year repayment period once the initial loan is refinanced into permanent debt, and ascending debt service payments does not comport with the BOG’s Debt Guidelines or P3 Guidelines. However, the debt structure and lease length are less important from a debt management perspective because the development and operation of the Project is not a University facility, does not impact traditional University auxiliary enterprises or operations, and does not affect the cost to students. As such, the proposed transaction is more like commercializing an undeveloped parcel of land to generate revenue for student scholarships than a financing mechanism for University facilities.

AUTHORITY FOR BOARD OF GOVERNORS ACTION

Article IX, Section 7, Florida Constitution; Section 1013.171, Florida Statutes
The University of Central Florida Board of Trustees has reviewed a proposal and adopted a resolution authorizing the President to execute a 52-year ground lease (including the construction period and an Owner’s option for a 10 year extension) for the construction and operation of a boutique hotel (the “Project”) utilizing a public-private partnership arrangement. The Project will consist of a 135 guest room four star hotel and will include such amenities as a swimming pool and fitness center, a 2,500 sq. foot restaurant, a snack bar, a 500 sq. ft. faculty lounge, a 200 sq. ft. lobby bar, a 5,000 sq. ft. ballroom, and 2,000 sq. ft. of other meeting room space.

The University is interested in a full-service hotel similar to what exists at the University of South Florida (Embassy Suites) and the University of Florida (University Hilton) primarily to assist with faculty and student recruitment. Although the P3 model makes sense from a business standpoint, it is difficult to discern how the Project supports the core mission of the University of educating and matriculating students in the most cost effective and timely manner.

UCF cited several reasons for choosing the P3 model including the lack of interest and experience in owning and operating a hotel. Additionally, hotel operations do not infringe on traditional University or auxiliary operations such as housing or parking. As a result, there is no loss of control over traditional auxiliary enterprises or foregoing of revenues that would be generated by existing auxiliary operations. The resulting benefits to the University by using the P3 model include transferring construction, operational and demand risk to a private operator. Additionally, the P3 is not being used to finance University facilities, the University is not obligated to financially support the Project or debt service associated with the Project, and anticipates receiving rent in return for leasing the parcel of land to the Owner.

The Project cost of $35,166,447 million will be financed by the Owner, who is proposing the use of equity in the amount of $12,307,906 (35%) and a construction loan in an amount not greater than $22,857,541 million (65%) of all of the cost of design, development and construction of the Project. The equity portion will be split between Owner (15%) and the Owner’s investment partner (85%). The Owner will grant a leasehold mortgage to the lender to secure the loan. The specific financing model adopted will be dictated by market conditions and may vary in the future.

The Owner will pay UCF a base rent of $140,000 annually beginning in 2018 (first year of operations), which will escalate by 2% annually. Once the Project operations are stabilized in 2023, the Owner is expected to pay UCF the difference between $140,000 and $200,000 as if $200,000 were the starting base rent in 2018. Additionally, beginning in year 8 of operations, UCF will receive variable rent payments equal to 3% of gross operating revenues generated from the Project exceeding $11 million annually. Over
the life of the 52-year lease, **UCF projects it will receive combined base rent and variable rent totaling approximately $24 million.** UCF plans to use all rental payments received from the Owner for scholarships. Base rent payments are required to be paid by the Owner prior to payment of debt service or equity. Assuming current urban area CPI levels, the value of the 10 year sublease extension to UCF through additional base rent and variable rent payments is projected to be $11.3 million. Actual CPI could positively or negatively impact projected base rent and variable rent payments.

**UCF commissioned an appraisal of the land parcel indicating the value is approximately $2.3 million.** When considering the projected base rent and variable rent payments due to UCF under the ground lease, it is estimated that **UCF’s internal rate of return (“IRR”) for the Project is 9.0%** when considering a 52-year lease and nearly 9.2% based on the 10 year optional lease extension. The **Project pro-forma projects the Owner will receive $35.5 million in revenues** if ownership is retained for the lease term. The **Owner’s investor is projected to receive $199.3 million** if ownership is retained for 50 years resulting in an **IRR to the Owner of 14.9%**. However, as stated previously, the Owner and any investors have the potential to make greater returns, or suffer losses depending upon the operating performance of the hotel.

Taken as a whole, approval of the Project is recommended by Board staff.

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**Supporting Documentation Included:**
1. Requesting Resolution
2. Project Summary
3. Estimated Sources and Uses of Funds
4. Financial Projections
5. PFK Feasibility Study
6. Letter from CBRE to KUD dated 09/13/2015
7. Campus Map

**Facilitators/Presenters:** Mr. Chris Kinsley