Project Description: The proposed conference center hotel project (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 Project will be designed and constructed by KUD International, LLC, (the “Owner”). The Owner is an experienced developer with net assets worth over $3.0 billion, and has developed much larger projects than the one proposed, including a 1500 room hotel in Orlando. The University of Central Florida (“UCF” or “University”) will enter into a 52-year ground sublease (including the construction period) with the Owner to design, construct, finance, operate and maintain the Project on the UCF campus. The ground sublease is subject to the approval of the Board of Trustees for the Internal Improvement Trust Fund, which holds title to the property on behalf of the State of Florida. UCF’s lease expires in 2073, and should the State of Florida renew UCF’s lease, the Owner has the option to extend the original 52-year lease an additional 10 years.

The Owner retains ownership of the hotel throughout the term of the ground sublease, which is effectively 62 years as it will automatically renew for additional 10 years if the State of Florida renews its lease of the property to UCF. Ownership of the hotel will revert to UCF after the expiration of the lease. The University should consider including the option to require the Owner to demolish the Project at its own expense at the end of the lease term.

The Project is included in the master plan of the University. However, the Project does not support the core mission of the University to educate and matriculate students in the most cost effective and timely manner.
**Project Site Location:** The Project will be located at UCF’s main campus entrance in Orlando located on the northeast quadrant of the intersection of North Alafaya Trail and University Boulevard. The site is currently undeveloped.

The proposed location on the edge of campus provides no parking, is not adjacent to any other university facilities, and is separated from the rest of campus by the main campus loop road. As future development for academic facilities is undesirable, UCF considered several alternatives for the land including a grocery store and ultimately concluded the proposed Project represents the best way to utilize the land.

(See Campus Map from UCF Master Plan)

**Projected Start and Completion Date:** It is anticipated that construction will commence in March 2016 with completion scheduled in January 2018.

**Project Cost:** *The total cost of the Project is estimated at $35.0 million,* which includes construction costs of approximately $21.3 million, furniture and equipment of $4.4 million, permits, insurance and other soft costs of $4.8 million (including a developer fee of about $1.2 million), financing costs of $2.9 million, and contingency costs of $1 million.

(See estimated Sources and Uses of Funds.)

**Quantitative Demand for Project:** *The Owner commissioned PKF Consulting USA, A CBRE Company ("PKF") to study the possibility of an on-campus hotel and conference center.* The study is primarily based on demand for a Four Star hotel relative to the limited service hotels in the nearby market. To be competitive, PKF recommended a boutique, luxury hotel with guestrooms numbering between 110-140. PKF also recommended that the hotel have conference rooms, dining facilities, and other amenities.

*UCF and the Owner expect that university business partners and visitors will use the Project when doing business with UCF,* and the Project will provide needed conference room space for various University events and user groups. Over the past three years the University has spent an average of $170,000 per year for guest stays.
and anticipates this trend will continue. The hotel is expected to primarily benefit by demand from groups who meet at the University that need housing including BOG meetings and other professional groups such as purchasing officers, finance officers and others who rotate meetings at the different state university campuses. **UCF estimates that it will use the Project’s conference space for approximately 50 events a year, and that other entities will use the space for approximately 2,000 other events.**

PKF projects an occupancy rate starting in 2018 of around 65%, and rising to 77% by year 10, in 2027. Based on a comparison of the competitive market and the location of the proposed hotel, PKF believes that the hotel will have sufficient demand for operational profitability and be an efficient use of the site.

**P3 Justification:**

UCF proposes to have the Owner construct, finance, operate and maintain the Project under a public-private partnership ("P3"). While numerous limited service hotels surround UCF, 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 a hotel and convention center 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 auxiliary operations such as housing or parking. As a result, there is no loss of control over a traditional auxiliary or foregoing of revenues that would be generated by existing auxiliary systems. The resulting benefits to the University by using the P3 model include transferring construction, operational and demand risk to a private operator. Additionally, 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.

In exchange for the long-term ground lease, the University will receive base rent payments from the Owner starting at $140,000 per year when the Project is expected to open in 2018 (the University will not receive any base rent during the two-year construction period).
Base rent payments will increase annually by the consumer price index ("CPI") for urban areas. Once the Project operations stabilize 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. It is anticipated that starting in the eighth year of operations, UCF expects to receive the base rent payment plus a variable rent payment equal to 3% of gross revenues in excess of $11 million. Based on a revised lower initial base rent amount of $140,000 (excluding any catch up provision in a later year), **UCF projects it will receive combined base rent and variable rent payments of approximately $24 million over the 52-year lease period.** UCF plans to use all rental payments received from the Owner for scholarships. Rent payments will be made by the Owner prior to payment of debt service or equity distributions.

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 $11.3 million. Actual CPI could positively or negatively impact projected base rent and variable rent payments.

(See Financial Projections).

**Financing Structure:**

*The Project will be privately financed by the Owner.* Based on the submitted pro-forma, the Owner currently intends to finance the Project with an interim construction loan of $22.8 million (65%) and equity of $12.3 million (35%). An interest rate of 6.5% has been assumed for the interim construction loan and will require interest only payments for the first three to five years of operations. Once the Project stabilizes, the Owner plans to refinance the construction loan with a 25 - 30 year amortization at an assumed interest rate of 6%. The Owner must preserve the rights of UCF under the terms of the ground sublease; however, UCF has imposed no other conditions on the Owner’s financing structure. The specific financing model actually adopted will be dictated by market conditions; however UCF’s base rent and variable rent payments are the same no matter the final form of the financing.

The proposed loan structure is not in compliance with the P3 Guidelines due to the interest only payments during the first three to five years, potential 35 year repayment period and ascending debt service once the construction loan is refinanced into permanent debt with principal and interest payment requirements. **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.

The Owner may finance, refinance, and sell all or a portion of its ownership interest in the Project. The Owner stands to earn an unlimited return or lose up to 100% of the cost of the Project, including any sums borrowed to fund construction if the Project is not successful. The information provided by the Owner has been reviewed by Board staff; however, Board staff make no assertions to the validity of the information.

Should the Owner default on any debt associated with the Project, the lender could assume control of the Project, subject to all the terms and conditions of the ground sub-lease.

**Security/Lien Structure:** Project revenues consist of guest room rates, food and beverage service, and parking. Debt service payments will be made from net Project revenues after payment of operating expenses and other expenses, such as taxes and management fees and base rent payments to UCF. The Owner’s return on equity is projected to be 14.9% and is paid last from available net excess cash flow. Non-payment of the base rent and any required variable rent are considered a default under the lease agreement.

The commercial lender will have a leasehold interest in the Project and can assume control of the Project in the event the Owner defaults on the loan repayment.

**Taxable Debt:** A portion of the Project will be financed by the Owner with taxable debt. No tax-exempt debt will be utilized.

**Project Guestroom Rates:** The average room rates are projected to start at $157/night and rise 3% a year, subject to market conditions. UCF has no role in the rate-setting process.
Return on Investment: UCF and the Owner will enter into a 52-year (including the construction period) ground sublease. Assuming UCF’s lease with the State of Florida is extended for a new 99-year term, the Owner has the option to extend the sublease for an additional 10-year period. Thus, the lease is effectively for a 62-year time frame.

The term is in excess of the P3 Guidelines that allow for a 40-year term. The Guidelines allow a University to enter into a 50-year term upon justification provided by the University. The justification for the 62-year term including construction is that the pool of investors for hotel construction financing is limited since equity distributions and excess cash flow available to repay investors are subordinate to the terms of UCF’s ground sublease and the commercial loan. (See letter from KUD Consultant CBRE to KUD dated 09/13/2015). Thus, the Owner indicates the 62 year term is necessary to achieve the target equity return necessary to incentivize investors.

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 made 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 a 62-year lease agreement.

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/financial performance of the hotel.

There is no purchase option in the ground sublease for UCF, however, the university will own the Project outright at the end of the lease term (or after the 10-year extension period).

University Support of Project:

Under the ground sublease, the Owner will be permitted to connect to UCF’s chilled water, potable water, and sanitary sewer systems. The Owner will be required to purchase those utilities from UCF at cost. The Owner will also be allowed to utilize UCF’s storm retention
system pursuant to permitting and regulations. UCF is not legally obligated to pay the debt service or maintain the Project. It is unlikely that it would be in UCF’s interest to provide support to the Project beyond its own needs to provide rooms for visiting faculty, students and guests and holding meetings and conferences.

Analysis and Conclusion:

Staff of the Board of Governors and the Division of Bond Finance has reviewed the information provided by the University with respect to the request for Board of Governors approval for the Project. The demand for the Project appears adequate given the results of the study performed by PKF and development of the Project on the main campus of a large and established University. Insufficient demand could result in the Owner’s inability to operate and maintain the Project. Should the Owner be unable to operate the Project or pay all obligations, UCF could take title to the project under the ground sublease conditions of default. 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.

The pro-forma cash flow information shows the Owner anticipates receiving an IRR of 14.9% while UCF anticipates receiving approximately 9.0% based on a 52-year lease with the Owner.

The proposed term of the ground lease does not comply with the P3 Guidelines. As previously mentioned, the effective ground lease is potentially 22 years in excess of the 40-year limit. However, it appears the longer lease term is reasonable given the Owner’s inherent risk of operating and maintaining a full-service, luxury boutique hotel. 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 Debt Guidelines or P3 Guidelines. 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. As a result, justification for the longer lease term and
The proposed financing structure are not as important from a debt management perspective as for P3 projects that finance university facilities or involve the aforementioned characteristics.

It appears the P3 model for this Project is appropriate with limited negative outcomes for the University.

Accordingly, Board of Governors’ staff recommendation is adoption of the resolution.