

STATE UNIVERSITY SYSTEM OF FLORIDA
BOARD OF GOVERNORS
Facilities Committee
August 31, 2017

SUBJECT: A Resolution of the Board of Governors approving Florida International University to enter into a sublease for the construction, operation and maintenance of a hotel, conference center and associated parking on the Modesto Maidique Campus of the Florida International University.

(Note: The bold and italicized language represents analysis by the Division of Bond Finance that it wishes to emphasize.)

PROPOSED COMMITTEE ACTION

Adoption of a resolution approving of Florida International University (“FIU”) entering into a sublease for the construction, operation and maintenance of 150 bed hotel and conference center (the “Project”) with the Project owner, Concord Benchmark, LLC (“Owner”). If approved, FIU will enter into a 40-year agreement and sublease with the Owner. The sublease will also require Owner to construct an alumni center on the land which will be owned and operated by FIU. FIU also intends to enter into an agreement with Benchmark Management Company for operation of the hotel and conference center.

Staff of the Board of Governors, State University System of Florida, and the Division of Bond Finance, State Board of Administration of Florida, has reviewed this resolution and all supporting documentation for compliance with Florida law and the Board of Governors’ P3 Guidelines. The Board of Governors’ staff has determined that the Project is within the guidelines, though it does not meet the core mission of the University, and while demand for the hotel is not solid, because of FIU and Owner’s intent to aggressively address demand, recommends adoption of the resolution and authorization of the Project. *The Division of Bond Finance has raised issues regarding the conclusions reached in the three market demand studies prepared for the Project and potential problems arising from the physical attachment of the University’s alumni center to the hotel, which are outlined in more detail in the Project Summary attached hereto.*

AUTHORITY FOR BOARD OF GOVERNORS ACTION

Sections 1013.171 and 1010.62, Florida Statutes; and Article IX, Section 7(d), Florida Constitution

BACKGROUND INFORMATION

The Florida International University has reviewed a proposal for entry into a sublease for the construction of a hotel and conference center (the "Project") utilizing a Public-Private Partnership arrangement. The proposed project is to be located on the Modesto Maidique Campus, the main campus. The Project will be a 150 bed hotel, approximately 154,000 gross square foot building with amenities such as a pool and restaurant with approximately 300 parking spaces.

The Project cost of \$59.3 million will be financed by the Owner, who is proposing the use of equity in the amount of 40% and a construction loan for 60% of all of the cost of design, development and construction of the Project. The Owner will grant a leasehold mortgage to the lender to secure the loan. The Owner will receive a development fee of 3.5% of total costs or approximately \$2.3 million. The Owner will also construct an alumni center on the property at a cost of approximately \$8 million, which will be paid for by FIU. The alumni center will be owned and operated by FIU.

For use of the land, the Owner will pay FIU a base rent of \$210,000 annually, which will escalate by 5% every 5 years. FIU will also receive additional payments as part of profit sharing starting at 6%, once the cash return on the Project reaches 10%. The Owner will be required to reserve 2% of gross revenue, escalating to 4% by year four of operations, for maintenance and repair of the Project.

The Florida International University Board of Trustees, at its June 1, 2017 meeting, approved the Project and the sublease.

The Division of Bond Finance has raised issues regarding the conclusions reached in the three market demand studies prepared for the Project and potential problems arising from the physical attachment of the University's alumni center to the hotel, which are outlined in more detail in the Project Summary attached hereto.

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

Supporting Documentation Included:

1. Requesting Resolution
2. Project Summary
3. Estimated Sources and
Uses of Funds
4. Historical and Projected Pledged
Revenues and Debt Service
Coverage

Facilitators/Presenters: Mr. Chris Kinsley

STATE UNIVERSITY SYSTEM OF FLORIDA
BOARD OF GOVERNORS
Project Summary
Florida International University
Hotel, Conference Center, and Associated Parking

(Note: The bold and italicized language represents analysis by the Division of Bond Finance that it wishes to emphasize.)

Project Description:

The proposed project (the "Project"), is a seven-story, 150 guest room hotel of approximately 154,000 gross square-foot, located on FIU's main campus, the Modesto Maidique Campus ("MMC"). The Project will be designed to host small conferences and will include associated infrastructure and amenities, such as restaurants, meeting rooms, a pool and fitness center, and 300 parking spaces. The Project (the hotel and conference center) will be financed, designed, and constructed by Concord Benchmark, LLC ("Concord" or "Owner"), and will be operated by the Benchmark Management Company, LLC (the "Operator" or "BMC"). FIU will enter into an operating agreement and a 40-year ground sublease with the Owner to construct and operate the Project. The sublease will also require the Owner to enter into a design-build agreement for the alumni center, adjacent to the hotel. The sublease contains two optional 5-year renewal periods, exercisable by FIU, for operation of the hotel and conference center. The Alumni Center, which will not be financed under this Project, will be a separate building with almost 14,000 gross square foot. A separate ground sublease will be entered into between the FIU Foundation and FIU for the operation of the alumni center. Consent to enter into the agreements and subleases will need to be given by the Board of Trustees for the Internal Improvement Trust Fund.

The Owner retains ownership of the hotel and conference center throughout the term of the 40-year ground sublease, which may be extended for an additional 10 years at FIU's option. FIU will own the hotel free and clear after the expiration of the 40-year lease. However, after 40 years, the Project may be obsolete or worthless and be a liability for FIU.

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 graduate students.*

Project Site Location: The Project will be located on FIU's main campus. The proposed site is 5.21 acres on the northwest part of campus, along the 8th Street boundary.

Projected Start and Completion Date: It is anticipated that construction will commence in March of 2018, and the Project is expected to open in June 2019. The Owner will be responsible for any developmental delays or cost overruns except in the situation where FIU has requested a change.

Project Cost: *The total cost of the Project is \$59.3 million, approximately \$300,000 per room.* Total hard costs for the hotel and conference center are estimated at \$46.9 million, with planning, equipment and other estimated soft costs of \$12.4 million.

(See estimated Sources and Uses of funds.)

Financing Structure: *The Project will be privately financed by the Owner.* Based on the submitted pro-forma, the Owner intends to finance the Project using a structure of 40% equity provided by Owner and 60% debt. *The Owner will receive a development fee of 3.5% of total costs or an estimated \$2.3 million.* The 60% debt portion will be in the form of a construction loan, which would be refinanced into permanent debt sometime between 12-24 months after completion. The permanent debt will be financed over thirty years, in compliance with the P3 Guidelines. The Owner is assuming a cost of debt of 4%.

The alumni center will be constructed by Concord at a cost of \$6.8 million. However, it will not be part of the P3 financing, and will not have any associated debt. The FIU Foundation will make a \$5.5 million investment with cash, and the remaining \$1.3 million from donations received by the foundation in support of the FIU Alumni Association.

Feasibility Studies: *FIU commissioned three studies to determine the demand for the Project, but none of the studies show strong demand for the Project.* One study conducted by PKF Consulting USA (PKF), concluded in December of 2013, that there was *insufficient demand to support the development of a large-scale hotel and conference center at MMC,* based on the following:

1. *University conference centers do not produce significant or consistent levels of conferencing demand.*
2. *FIU had no conference planning division.*
3. *National competition for conferencing is very strong.*
4. *FIU's distance from beach areas or tourist attractions.*
5. *Lack of current development in Sweetwater, just north of MMC. Sweetwater was found to be a more attractive location for hotel development due to its close location to amenities.*
6. *FIU enrollment showed a majority local population with little demand for lodging.*
7. *The MMC area already had an abundance of hotel types in the vicinity. The PKF study analyzed 17 hotels within 7 miles of the proposed Project site, and noted that 6 more were under construction during the time of the study in 2013.*

The study found that 74% of FIU's needs for conference space were already being met on-campus. However, the study did find that a smaller scale hotel with 95 beds, a restaurant and bar could operate successfully in the future.

PKF updated its study in June 2015 and found an increase in demand when it focused on demand created by the MMC specifically. PKF surveyed FIU departments to determine demand for lodging and meeting space needs. From this survey PKF found FIU-generated lodging demand of 23,300 rooms per years (versus its estimate of 14,100 rooms per year in the 2013 study). With this updated room demand estimate which equated to a 67% occupancy rate for a 95 room hotel, PKF still points to a gap of 8,000 to 10,400 rooms per year which would need to be filled by external sources to operate at a successful level.

FIU also hired JLL to conduct a market demand study along with financial projections and cost estimates, which was completed in October 2015. The JLL study found sufficient demand for a 150-bed hotel, and believes a smaller hotel would eliminate benefits received from economies of scale. JLL based their findings on current market demand and the trend in the area for increasing lodging demands. JLL's study also assumed that the hotel would be branded and operated by a well-known operator, which tends to increase occupancy. JLL's study indicates that by 2020, the hotel would stabilize at 73% occupancy. JLL estimated that with FIU leadership implementing incentive policies to drive demand, the hotel could achieve 75% occupancy, but if the hotel relied solely on the FIU

demand, occupancy would only reach 48%. This places a demand on FIU to create executive programs to ensure the success of the project.

JLL did find a gap between the estimated development costs of \$37.2 million versus an estimated market value of \$23.2 million. JLL recommended ways to close the gap including donations to FIU, surface parking over a structured facility, and potential rental income from the Alumni Center.

FIU does not believe there will be a gap, and notes that the PKF assessment did not take into account the impact of having the alumni center co-located with the hotel, and that local hotel occupancies are trending well above the PKF findings. FIU also believes the Owner will address any concerns by increasing FIU demand, as well as marketing to non-FIU business demands. One strategy proposed by the Owner was to form partnerships with local companies to use the hotel conference center for events and trainings. In addition, the Owner intends to build 300 revenue generating surface parking spots, rather than the more expensive 100 space structured garage.

P3 Justification:

FIU has chosen to utilize a public-private partnership (“P3”) to finance the Project. *The primary benefit of a P3 is the transfer of demand risk to the Owner.* By using a P3, FIU contends it is able to mitigate risk. In addition, FIU will not be required to manage or maintain the Project, which is outside of its area of expertise. Owner will be required to have funds for operations and maintenance, as the lease will require an annual reserve starting at 2% of gross revenue escalating to 4% by year four of operations.

FIU points to impediments if the university were to pursue the Project without a partner, and would not pursue the hotel and conference center without an outside partner. The partner chosen for hotel operation, BMC, has global experience in management and marketing of independent resorts, hotels, and conference centers.

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 and profit sharing to FIU. Owner’s return on equity (15.0%) is paid last from available net excess cash flow. Non-

payment of the base rent and any required profit sharing are considered a default under the lease agreement.

The Owner will have a leasehold interest in the Project, which may provide security for a mortgage. Should the Owner default on any debt associated with the Project, the lender could assume control of the Project, subject to the terms and conditions of the ground sublease. *Foreclosure or repossession of the leasehold interest may prove problematic for FIU, particularly with the alumni center attached.*

Taxable Debt:

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

University Support of Project:

Debt will not be a legal obligation of FIU or a Direct Support Organization. FIU has not pledged its credit towards the Project and is not legally obligated to pay debt service or maintain the Project. However, the University has stated they view the Project as a partnership, and *if the Project does not meet projections, the university may be pressured to provide financial assistance. Because of location of the Project and the integration of the alumni center and associated parking with the Project, the Project may be considered in FIU's debt profile by the rating agencies.*

The parties have not made a final decision, however, the agreements provide that *Owner may connect to chilled water, potable water, and sanitary sewer utilities and may purchase chilled water, potable water and sewer services from FIU* reimbursed at Owner's cost, including capital recovery.

Ten of the 300 Project parking spaces will be reserved for the alumni center. FIU will be responsible for the upkeep for those 10 spaces.

In addition, the Owner intends to provide opportunities for paid student internships, opportunities for jobs for graduates, and coordinate with the university regarding opportunities to expand curricula. Owner will also provide an annually-negotiated discount on rooms for FIU, and negotiate preferential conference center rates when possible. The University anticipates using the ground rent and profit participation revenue to support instructional and research activities and student scholarships.

The average room rates are projected to start at \$152.76/night and rise 3% a year for the first three years, subject to market conditions. FIU has no role in the rate-setting process. The occupancy rate is projected to be 66% in year 1. Stabilization of the Project is projected in year 8 with an occupancy rate of 74.5%.

FIU's police department will be responsible for law enforcement and security on the Project. The University's business services personnel will also be used to monitor hotel operations and services.

Return on Investment:

Under a 40-year ground sublease, which may be extended by FIU, FIU will receive an annual payment for rent starting at \$210,000, which will increase by 5% every 5 years. The default terms are still being finalized, however, the failure to pay rent will be a default which, if left uncured, will accumulate a penalty.

If the Project is successful, the University is entitled to a share of the profits. In addition to the ground rent, attached chart, and beginning in year one of operations, if the cash-on-cash return of the Project is between 10.0% to 12.5%, then the University would receive 6.0% of profits. If return is between 12.5% to 15.0%, the University would receive 8.0% of profits and if the cash-on-cash return is greater than 15.0% then the University would receive 10.0% of profits. Failure to pay profit sharing will also result in a default if money is owed.

FIU intends to use the funds generated from the Project to support scholarships, strategic hires, and other endeavors, including strategic hiring of new faculty members and recruitment of quality students outside of the South Florida area. The goal is to remain flexible to react to current conditions, but for all of the proceeds to support its academic and research mission. The anticipated return to the University over the first ten years of the project is \$5.2 million. The intent is for the University President and Leadership to direct the funds to their best use on an annual basis during the budget process.

The total site for the Project is 5.21 acres, with 4.60 allocated for the hotel, conference center, and parking. FIU conducted a review of the Project land, comparable sales and other sources, and believes the rent payments will be more than fair market value.

At the end of the 40-year sublease, unless renewed, the Project will revert to FIU. FIU justifies the two five-year renewal terms (exercisable at FIU's option) by the increased profit sharing to the University once outstanding debt is satisfied and by the industry norm of 50 to 99 years for hotel ground leases. At the end of 40 years the hotel may be worthless or obsolete and a liability for FIU. Demolition and removal may be problematic since the alumni center is attached to the hotel.

The parties are also negotiating a termination right that will be an option 10 years after the Project opening. The termination right would allow FIU to purchase the Project for a price to be determined by an independent appraisal.

**Analysis and
Recommendation:**

Staff of the Board of Governors and the Division of Bond Finance has reviewed the information provided by Florida International University with respect to the request for Board of Governors approval for Project. *The Project is not part of the University's core mission to educate students; however, it serves an identified University need and purpose. The University is committed to using the funds strictly for academic enhancements which is part of the core mission. The three studies provided did not indicate strong/sufficient demand for the Project; however there was robust vendor interest in the Project, as well as several hotel projects underway in the study area. Insufficient demand could result in the Owner's inability to operate and maintain the Project. If the Project does not meet projections, FIU may be pressured to provide financial assistance.* Any failure would be handled by the default provisions of the Owner's loan, and there are provisions in the lease which provide protections for FIU. However, *foreclosure or repossession of the leasehold interest may prove problematic for FIU, particularly with the alumni center attached.*

The lease term with renewals would create up to a 50-year lease term, but because the renewals are at FIU's option rather than the Owner's, the 40-year limit in the P3 Guidelines is effectively met. *At the end of the lease, the Project reverts to FIU but it may be obsolete or worthless and a liability for the University.*

Board staff recommends approval of the Project.

DBF has several concerns about the Project outlined below. The three market studies do not seem to support demand for the size and scope of the Project. The 2013 PKF market demand study concluded that there was not sufficient existing demand to support development of a hotel and conference center at FIU. The 2015 PKF market study update found somewhat higher demand for lodging demand and meetings that would potentially support a 95-room hotel with 3800 square of meeting space at FIU. The final 2015 JLL market study, which focused primarily on financial projections, indicated that the estimated cost of \$37.2 million exceeded the projected market value of \$23.2 million but that steps could be taken to resolve the gap. In any case, the JLL market study noted weakness/threats of limited demand (other than FIU), potential new lodging supply pressuring occupancy rates and increasing construction costs. Lastly, the JLL demand study suggests a 150-room hotel is “appropriate” because a smaller hotel would reduce economies of scale and increase room rates.

The Project is essentially a commercial venture unrelated to the University’s core mission of student education. Although unrelated to student education or services, *the Project will utilize FIU resources and personnel, including 5 acres of land that is part of or adjacent to the core campus. The Project will combine the hotel with university facilities (the alumni center and meeting space) which could potentially put pressure on FIU to provide financial assistance if projections are not met* and/or cause the debt to be included in FIU’s debt profile. Currently, the need for lodging and conference/meeting space is accommodated by on-campus meeting spaces or off-campus private sector alternatives available in the area.