



December 10, 2014

TO: Members of the Board of Trustees

FROM: John M. Biancamano
Interim Executive Vice President for Administration and Chief Financial Officer

Richard F. Orr, Esq.
General Counsel

RE: Acquisition of Nathan Hale Inn

RECOMMENDATION:

That the Board of Trustees approves the Administration to enter into a Purchase & Sale Agreement to acquire the Nathan Hale Inn.

OVERVIEW:

The University of Connecticut ("UConn") currently owns the land under the Nathan Hale Inn ("NHI"), but not the building or other improvements.

In late September 2014, the owners of the NHI received an offer from a private hotel company to purchase the NHI for \$8,372,333. Included in the lease of the land for the construction of the NHI, UConn has a Right of First Refusal ("ROFR") to purchase the NHI for the same price and on the same material terms as a private buyer. On November 24, 2014, UConn exercised that ROFR and began negotiating a Purchase & Sale Agreement ("P&S") with the seller.

The intent of the purchase is to acquire 98 dorm rooms (to accommodate approximately 280 students); however, in the short term UConn will need to manage a mixed-use hotel of 48 rooms and 50 dorm rooms.

UConn's acquisition will be a cost-effective way of meeting some of UConn's short- and long-term student housing needs. UConn will retain the existing hotel manager to minimize the financial and other risks associated with operating a hotel during the transition period. The intent is to convert the NHI into a full UConn dormitory.

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The purchase of the NHI allows UConn to control the use of the property in the future without needing to negotiate with a private owner.

Exercising the ROFR did not irrevocably commit UConn to purchasing the NHI. As explained more fully below, exercising the ROFR was a prerequisite to negotiating a P&S with the seller. Entering into the P&S only occurs if the Board accepts this recommendation. UConn will not actually acquire the property pursuant to the P&S until all contingencies have been addressed to UConn's satisfaction.

At the time this memorandum was prepared for the Board's December 10, 2014 meeting, negotiations were still in progress. If needed, additional or updated information will be provided in advance of, or at, that meeting.

BACKGROUND:

Existing Contractual Relationship and the ROFR

Two primary agreements govern the relationship between UConn and Campus Associates Limited Partnership d/b/a/ Nathan Hale Inn and Conference Center (the "**Seller**"). The first is a Ground Lease that terminates in 2050. Under the Ground Lease, UConn has a ROFR when presented with a bona fide purchase offer to buy the NHI. Separately, the Ground Lease provides that UConn is prevented from developing or "promoting" development of a hotel on or within 15 miles of campus. That restriction continues to 2050.

Article 34 of the Ground Lease grants UConn a ROFR, which must be exercised no later than 60 days after the receipt of a "Sale Notice" from the Seller. The Sale Notice was received by UConn on Monday, September 27, 2014. It included a P&S with FM Storrs Hospitality, Inc. (the "**Private Buyer**") containing a purchase price of \$8,372,333. UConn's 60 days to exercise the ROFR expired on Friday, November 28, 2014 (the day after Thanksgiving), so UConn exercised the ROFR on Monday November 24, 2014 by sending the Seller a required "Acceptance Notice."

Under the Ground Lease, UConn must agree that it will "purchase the Leasehold Estate on the terms and conditions set forth in the Offer." Since the Sale Notice included an executed P&S with the Private Buyer, UConn's Acceptance Notice noted that UConn's P&S would have to reflect UConn's status as a State agency, while retaining the price and fundamental terms of the Private Buyer's transaction.

The second agreement is a Joint Use Agreement that governs, among other items, booking of function rooms for UConn events held at the NHI. This agreement also terminates in 2050.

Current Operational Framework

The Seller is a partnership of individual investors. The NHI is operated, for the Seller, by a hotel management company, Interstate Hotels & Resorts, Inc. ("**Interstate**"). UConn – with the

permission of the Seller – has been negotiating an agreement with Interstate to ensure the terms on which Interstate will remain as manager in the short term, until such time as the building is used exclusively as a dormitory. At this time, the Administration does not see any obstacles to concluding an acceptable management agreement.

UConn's Student Housing Need

UConn guarantees on-campus housing to newly admitted freshmen, returning undergraduate residents who meet all deadlines, undergraduates returning from an off-campus program, and students changing campuses. To assist UConn in meeting these housing needs, the Board of Trustees, last year, approved UConn to enter into a Room Reservation Agreement (“**RRA**”) with the Seller under which UConn has reserved 50 rooms in the NHI for the current (2014-2015) academic year with an option for two additional years. Each hotel room houses three students or a resident advisor and a roommate.

UConn has exercised its option for 2015-2016 and expects to do so for 2016-2017; the cost for the 2015-2016 academic year will be \$1,085,250.

UConn currently has no agreement to use the NHI for students after the spring of 2017.

The need for additional student housing is described fully in the material prepared by Dr. Michael Gilbert, Vice President for Student Affairs, attached as Exhibit A. As set forth there, the need to continue to rely on the NHI to house students continues well beyond the 2016-2017 expiration of the RRA.

Demand for on-campus housing has surpassed the designed capacity (11,116 beds) of UConn's residential facilities in each of the past 13 years. The Department of Residential Life has accommodated this strong demand by converting some single and double rooms to house additional students. These efforts have created approximately 900 additional spaces, and increased the total of available on-campus beds for assignment to 12,000. As demand has grown in the past five years, Residential Life has also converted spaces originally designed as floor lounge and study spaces to accommodate an additional 400 – 700 students annually, as reflected in the 12,711 on campus residents in August 2014. Accordingly, as the chart appearing in Exhibit A describes, existing student housing is currently well over 100% of designed capacity.

Further detail on occupancy percentages, projected enrollment growth, and the suitability of the NHI for undergraduate student housing is found in Exhibit A. As shown there, the need for these beds for student housing will continue into the foreseeable future.

Operational Considerations

If UConn were to acquire the NHI, the expectation is that UConn would operate it as it is now: a mixed use hotel and dormitory. UConn will be able to adjust the relative proportion as between dorm rooms and hotel rooms to meet UConn's needs without requiring consent of a private

owner. Absent the acquisition, there is no assurance of being able to use the NHI for student housing after spring 2017 or the cost to do so.

A critical aspect of this model is management of the hotel. As explained above, at the time this memorandum was prepared, UConn was in negotiations with the incumbent management company, Interstate, to continue as the management company.

The Administration recognizes that an independent management company must have owner oversight. UConn will identify a senior administrator to be accountable for performance by the management company and for the operation of the hotel.

Financial Viability

Determining the financial viability of acquisition and operation is a multivariate complex task. There are two aspects to this analysis: acquisition costs and operational costs.

Acquisition Cost

Under the ROFR, UConn cannot renegotiate the purchase price established between the Seller and the Private Buyer. That price is \$8,372,333. Based on the information available, there is no indication that the Private Buyer's offer is other than an arms-length transaction. The purchase price and deal structure appear to have been negotiated between a willing buyer and willing seller.

Although the ROFR requires UConn to purchase the property at the same price and on same material terms as the Private Buyer, UConn obtained an appraisal of the value of the leasehold interest with the assumption that the RRA is in place for 10 years. That value is \$8.7 million.

Fletcher Thompson performed a building conditions assessment. The total potential cost for replacement of all identified short- and long-term items was \$3.3 million. The estimated cost of items need at time of turnover-- such as code compliance improvements, deferred maintenance, and furniture and fixtures -- is \$648,000.

Accordingly, in addition to the purchase price of \$8,372,333, there are immediate costs of approximately \$648,000, for a total acquisition cost of approximately \$9.1 million. This cost is very favorable when compared to the cost of new construction. A rough estimate of the cost of dormitory new construction is approximately \$100,000 per bed. This estimate is based on UConn's recent experience in the market including the new STEM dormitory. The NHI has a capacity of approximately 280 beds, so the cost of new construction of equivalent capacity would be roughly \$28,000,000.

Operational Cost

A detailed five-year pro forma income statement for UConn's ownership is presented in Exhibit B. That five-year financial projection indicates both a positive operating profit and positive cash flow.

The NHI has operated at a loss for Calendar Year ("CY") 12 and 13 and is budgeted to lose \$204,000 in CY 14. Upon UConn's acquisition in CY 15, this situation improves to profitability in CY 15 and beyond. There are several reasons for this improvement.

- The full impact of the RRA occurs in CY 15 because that is the first year where there are two semesters of dormitory revenue. That continues in subsequent years.
- Almost \$300,000 in fees paid by the Seller to the general partner and for legal fees do not continue.
- Approximately \$34,000 per year in ground rent paid to UConn does not continue.
- After the existing debt is extinguished in December 2016, the annual interest expense of \$418,000 is no longer required.

The result is a projected profit of \$293,000 in CY 2015, increasing in the out years.

Transactional Issues

UConn would purchase from the Seller the leasehold interest and the building, including its furnishings and equipment, from the Seller.

As noted above, although UConn will negotiate its own P&S, UConn must accept the price and fundamental terms in the P&S between the Private Buyer and the Seller. As presented in that P&S, the transaction contemplates either: the assumption of the existing leasehold mortgage; or prepayment of an existing leasehold mortgage with a prepayment penalty that is currently \$688,000.

UConn has been exploring an alternative financing structure with the existing mortgage holder, Webster Bank, and the Office of the State Treasurer. At the time this memorandum was prepared, the negotiations with Webster and discussions with the Treasurer's office were ongoing but the Administration does not see insurmountable hurdles to being able to finance the entire transaction through Webster or the State, or some combination, on financially reasonable terms. Webster has provided preliminary approval to release the mortgage lien on the NHI. This was a critical issue to the assumption of the existing promissory note by UConn.

More detailed information will be provided before or at the December 10, 2014 Board meeting. The Administration is working to define the precise nature of the financial structure by that meeting to secure BOT approval. In the event the financing is not finalized by December 10, then, at a later time when the financial structure has been finalized, the Administration will seek Board approval for any necessary UConn expenditures to finance the transaction.

Moreover, as noted above, the P&S that the Board is being asked to approve will not irrevocably commit UConn to purchase. UConn can walk away in its discretion if satisfactory financing cannot be obtained or for other reasons.

Other Hotels in Storrs

Under the current Ground Lease, UConn cannot promote a competing hotel on campus or within 15 miles, nor can UConn build a hotel of its own until 2050. If UConn acquires the NHI, those restrictions would be extinguished and UConn could choose to build its own hotel, promote a new hotel through some collaboration with a private party or simply sit back and see what the market produces.

Those possibilities have not been fully explored, nor will they be within the time available. Acquiring the NHI will give UConn control over that facility for use as a hotel or dorm in such proportion that meets UConn's needs.

EXHIBIT A
Housing Needs Analysis

NEED FOR ADDITIONAL ON-CAMPUS HOUSING

A. On-Campus Housing Capacity/Occupancy

The University of Connecticut guarantees on-campus housing to newly admitted freshmen, returning undergraduate residents who meet all deadlines, undergraduates returning from an off-campus program, and campus change students.

Demand for on-campus housing has surpassed the designed capacity (11,116 beds) of the University's residential facilities in each of the past 13 years. The Department of Residential Life has accommodated this strong demand by converting some single and double rooms to house additional students. These efforts have created approximately 900 additional spaces, and increased the total of available on-campus beds for assignment to 12,000. As demand has grown in the past five years, Residential Life has also converted spaces originally designed as floor lounge and study spaces to accommodate an additional 400 – 700 students annually, as reflected in the 12,711 on campus residents in August 2014.

The chart below documents total on-campus housing assignments and occupancy percentages, against system design capacity (11,116), and the modified capacity (12,000) at the start of each academic year since 2010.

Year	August Demand	Percentage Housed to Modified Capacity 12,000	Percentage Housed to Design Capacity 11,116
2014-2015	12,711	106%	114%
2013-2014	12,668	106%	114%
2012-2013	12,469	104%	112%
2011-2012	12,716	106%	114%
2010-2011	12,546	105%	113%

B. Projected Enrollment Growth

In January 2014, the University embarked on a master planning process to define a 20-year vision for the campus and further the goals of Next Generation Connecticut, which includes growing undergraduate student enrollment on the Storrs campus. UConn's Master Plan anticipates incremental enrollment growth in the range of 1,000 – 5,000 students, over the next 10+ years.

Two new residence halls are currently in the planning and design phases for the Storrs campus. The first residence hall will be a new Science, Technology, Engineering and Math (STEM) Living Learning Community and will have approximately 725 beds. The current target completion date for the project is

fall semester 2016. The second facility, an Honors Residence Hall, will provide housing for first-year Honors students and have approximately 650 beds. It is expected that UConn's undergraduate student enrollment will increase incrementally, in 2016 and 2017, and apace with on and off-campus housing growth.

If enrollment growth precedes or surpasses University targets, the current 149 Nathan Hale Inn beds will continue to be critical in meeting student demand. If enrollment growth lags, Residential Life will adjust policy to accommodate more upper-division transfer students and more graduate students – neither of which is currently guaranteed housing - to ensure strong occupancy.

C. Nathan Hale Inn's (NHI) Suitability For Undergraduate Student Housing

The NHI is located in a distinctly residential neighborhood with close proximity to several dining halls, Storrs Center and the academic core of campus. Students assigned to the NHI have expressed satisfaction with their experience. The residential floor design supports social interaction and community development, and students enjoy special amenities including more private bathrooms, a pool and fitness center. One measure of their satisfaction with the NHI is 41 the 48 students assigned to that facility in 2013 – 2014 continue to live on campus, with 20 returning to the NHI this year.

If the University acquires the NHI the residential floors will not require significant structural changes to accommodate students. The public areas on the first floor of the facility will provide ample study, recreation, and social space. In addition, the potential 200+ NHI bed spaces will lessen the total count of new beds that may be required if Next Generation Connecticut enrollment goals are actualized.

EXHIBIT B
Five Year Pro Forma Income Statement

University Of Connecticut
Budget Office
Pro Forma Income Statement - Fiscal Year End 12/31- Nathan Hale Inn
November 25, 2014

Calendar Year	FY12	FY13	FY14 - Budget	FY15	FY16	FY17	FY18	FY19
Revenue								
Occupancy Rate	70.50%	70.40%	71.50%	76.50%	76.50%	76.50%	76.50%	76.50%
Market Lodging Revenue	2,810,871	2,854,273	2,008,278	2,300,665	2,381,188	2,464,530	2,550,788	2,640,066
RRA Lodging Revenue	3,984	4,889	996,306	1,059,900	1,096,997	1,135,391	1,175,130	1,216,260
Misc. Lodging Revenue	5,349	2,934	5,708	4,500	4,624	4,751	4,882	5,016
Food Revenue	921,689	890,017	966,608	885,430	909,779	934,798	960,505	986,919
Beverage Revenue	298,272	292,845	303,172	300,000	308,250	316,727	325,437	334,386
Other Income	76,722	74,518	82,774	90,000	92,475	95,018	97,631	100,316
Total Revenue	\$ 4,116,887	\$ 4,119,476	\$ 4,362,846	\$ 4,640,495	\$ 4,793,313	\$ 4,951,215	\$ 5,114,373	\$ 5,282,963
Expense								
Desk & Housekeeping	460,360	456,752	504,309	450,128	464,951	480,268	496,094	512,447
Laundry	63,981	78,742	71,259	74,248	76,693	79,219	81,830	84,527
Room Supplies & Services	89,751	110,836	112,113	106,731	110,246	113,878	117,631	121,508
Movies & Miscellaneous	5,774	5,775	6,293	4,328	4,471	4,618	4,770	4,928
Food & Food Service Costs	896,604	887,333	922,108	886,233	915,418	945,574	976,734	1,008,931
Beverage & Tavern Costs	176,334	176,526	183,389	186,120	192,249	198,582	205,126	211,888
Admin. & General	659,568	594,817	644,240	653,584	675,107	697,347	720,326	744,071
Sales & Marketing	349,816	284,787	253,176	255,227	263,632	272,317	281,291	290,563
Operations & Maintenance	245,618	237,384	244,096	278,430	287,599	297,073	306,862	316,978
Energy & Utilities	205,946	223,920	239,331	278,430	287,599	297,073	306,862	316,978
Telephone (Communications)	19,221	18,867	12,500	23,202	23,967	24,756	25,572	26,415
Management Fee - 3%	104,757	123,584	130,000	139,215	143,799	148,536	153,431	158,489
Other Operating	398,022	394,229	399,640	23,202	23,967	24,756	25,572	26,415
Sub Total Operating Expense	\$ 3,675,752	\$ 3,593,552	\$ 3,722,454	\$ 3,359,079	\$ 3,469,698	\$ 3,583,998	\$ 3,702,101	\$ 3,824,137
Taxes: Personal Property	19,281	22,240	23,204	27,000	27,324	27,652	27,984	28,320
Taxes: Real Estate	61,694	62,124	65,082	105,000	106,260	107,535	108,826	110,131
Insurance	14,252	42,740	50,007	50,000	50,600	51,207	51,822	52,444
Sub Total Fixed Expense	\$ 95,227	\$ 127,104	\$ 138,293	\$ 182,000	\$ 184,184	\$ 186,394	\$ 188,631	\$ 190,895
Replacement of FF&E	-	-	-	72,500	74,888	77,354	79,904	82,537
Capital Reserve & Replacements	-	-	-	35,300	36,462	37,664	38,905	40,187
Interest / Amortization	403,210	397,308	427,190	418,617	418,617	-	-	-
Deprecation	279,187	279,187	279,187	279,078	279,078	279,078	279,078	279,078
Sub Total Reserves, Interest and Depr	\$ 682,397	\$ 676,495	\$ 706,377	\$ 805,494	\$ 809,044	\$ 394,096	\$ 397,886	\$ 401,802
Total Expense	\$ 4,453,376	\$ 4,397,151	\$ 4,567,124	\$ 4,346,573	\$ 4,462,926	\$ 4,164,488	\$ 4,288,618	\$ 4,416,834
Earnings after interest, taxes and Depr	\$ (336,489)	\$ (277,675)	\$ (204,278)	\$ 293,921	\$ 330,386	\$ 786,727	\$ 825,755	\$ 866,129