University of Toronto

OFFICE OF THE VICE-PRESIDENT – BUSINESS AFFAIRS

TO: Business Board

SPONSOR: Felix Chee, Vice-President, Business Affairs

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DATE: February 7, 2003 for February 11, 2003

AGENDA ITEM: 1

ITEM IDENTIFICATION:
Real Estate Acquisition

JURISDICTIONAL INFORMATION:
In accordance with Section 4.3(b) the Business Board approves the acquisition of real estate.

PREVIOUS ACTION TAKEN:
Presented to the Executive Committee on February 3rd, 2003 for procedural direction.

HIGHLIGHTS:

- Currently the demand for student residences exceeds the University's ability to supply appropriate number of rooms to (i) fulfill the first year guarantee, (ii) address the housing needs of the Professional Faculties, and (iii) provide sufficient rooms for non-first year students.

  The shortfall in the number of rooms is approximately 1,000 and growing.

- An opportunity has presented itself to purchase The Colony Hotel to address the University's pressing residence problem.

- The Colony Hotel is a full service hotel with the following features:

  ✓ 721 rooms including 18 suites
  ✓ 27,000 square feet of meeting rooms and conference/function space
  ✓ 326 parking spaces on 5 underground levels
  ✓ Total gross floor area of 496,000 square feet plus 177,000 square feet in the parking garage
  ✓ Land area of 41,000 square feet
  ✓ Located directly north of Toronto City Hall
  ✓ Restaurant and retail stores at grade

HIGHLIGHTS(Con't)

- The University of Toronto has a tentative agreement to purchase the Hotel for $72 million inclusive of capital improvements.

- Subject to Governing Council approval by February 14, 2003, the University would take ownership of the property on May 30, 2003.

- On September 1, 2003, 496 rooms able to accommodate 814 students would be available on floors 11 through 26.

FINANCIAL AND/OR PLANNING IMPLICATIONS:

TOTAL PROJECT COST:

Purchase Price	=	$66.4 million
Capital Improvements	=	$4.6 million
PST & land transfer tax	=	$1.0 million
		$72.0 million

TOTAL FUNDING:

1. The property will be 100% mortgage financed with an annual debt service of $6.3 million.
2. The $72 million will be financed either externally or internally from the expendable funds investment or via a combination thereof.
3. The projected breakeven is Year 4 with recovery of the cumulative deficit projected by Year 7.
4. The Business Affairs Department will commit up to $1 million per year for 8 years (present value of $5.3 million) to provide the start up equity.

RECOMMENDATION:

That the Vice-President, Business Affairs be authorized, subject to Business Board review and recommendation, to:

- Expend up to $72 million for the acquisition of the Toronto Colony Hotel, to be used primarily as a student residence.
- Arrange 100% interim and long-term financing in an amount up to $72 million, either externally or internally from the Expendable Funds Investment Pool, or via a combination thereof.
- Establish a residence ancillary to contain the residence operation and its associated activities.
- Subsequent to the approval by Governing Council the acquisition will be presented to the University Affairs Board to review the proposed operation and structure of the residence operations.

REPORT ON THE PROPOSED ACQUISITION OF THE TORONTO COLONY HOTEL

Felix P. Chee
Vice-President, Business Affairs

February 7, 2003

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EXECUTIVE SUMMARY

The University of Toronto, in collaboration with the federated universities, has a proud tradition of the residence experience within our on-campus college environment. Beginning in 1996, all first year students entering the University of Toronto have been guaranteed a place in residence. This guarantee, while an attractive recruiting tool, has placed considerable pressure on the availability of residence beds, resulting in a current shortage of about 1,000 beds. This shortage has been met by placing students in hotels at a net cost of about $3.5 million this year, and estimated at $5 million annually going forward.

An opportunity has presented itself to acquire the Toronto Colony Hotel to address this pressing problem. This is a full service hotel located at 89 Chestnut Street in the heart of downtown Toronto, about a 15 minute walk from campus. This hotel has 721 rooms, 27,000 square feet of meeting rooms and conference/function space, and 326 parking spaces. It could be configured as a pure residence, with conference, banquet and parking operations, or as a hybrid hotel/residence.

The hybrid hotel/residence alternative would cost $70 million while the residence only alternative would cost $72 million, with the difference reflecting contract termination and severance costs with respect to the pre-existing hotel operation. Both alternatives were carefully considered. In summary, based on conservative assumptions:

- The hybrid hotel/residence alternative is estimated to break even in Year 4 and recover the initial cumulative deficit by Year 8. The projected net present value is $20 million over 25 years.

- The residence only alternative is estimated to break even in Year 10 and to recover the initial cumulative deficit by year 19, without the injection of any start-up equity, with a projected net present value of negative $0.6 million. Addition of start-up equity of $900,000 per annum for 8 years improves the break-even to Year 4, recovery of the cumulative deficit by Year 7 and net present value of $4.8 million.

From a student experience perspective, it is the administration's judgement that a pure residence is better. From an operating perspective, the University has considerable experience in running residences. It has no experience running a hotel. While the modelling, including sensitivity analysis, indicates that the hybrid alternative is viable, our operating experience gives us greater confidence regarding the residence only alternative. The pure residence alternative, however, is viable only with start-up capital.

The hybrid hotel/residence alternative was recommended to the Executive Committee of Governing Council primarily to avoid putting in start-up capital. To proceed with the residence only alternative, the focus therefore, has to be whether start-up equity can be found.

The Vice-President, Business Affairs has agreed to commit up to $1 million per year for eight years to provide the start-up equity needed. This will be found from the existing budget. Ancillary Services division of Business Affairs will be the unit accountable for running this operation. Given the lag associated with building residences on campus, the Colony is the only practical solution to the problem.

Recommendation:

That the Vice-President, Business Affairs be authorized, subject to Business Board review and recommendation, to:

- Expend up to $72 million for the acquisition of the Toronto Colony Hotel, to be used primarily as a student residence.
- Arrange 100% interim and long-term financing in an amount up to $72 million, either externally or internally from the Expendable Funds Investment Pool, or via a combination thereof.
- Establish a residence ancillary for the residence operation and its associated activities.
- Subsequent to the approval by Governing Council, the acquisition will be presented to the University Affairs Board to review the proposed operation and structure of the residence operations.

BACKGROUND

Introduction

The University of Toronto, in collaboration with the federated universities, has developed a proud tradition of the *residence experience* within our on-campus college environment. In recent years, commencing in 1996, all first year students entering the University of Toronto were offered a residence guarantee. The guarantee, while an attractive recruiting tool, has placed considerable pressure on the availability of residence beds. The percentage of first year students within any of the residents has increased and now is approximately 50- 60% of the total student body. This has also resulted in the displacement of upper year students.

At the present time and certainly for the foreseeable future, given the tremendous increase in student enrolment, there will be a shortage of student residence accommodation on the St. George campus for undergraduates, graduates and family housing. The current shortage of residence beds is approximately 1,000. The obvious solution is to build new residences, but such decisions have to be considered in the light of a very limited number of building sites, the current high cost of building university residences and the speed of designing and constructing these facilities ready for occupancy.

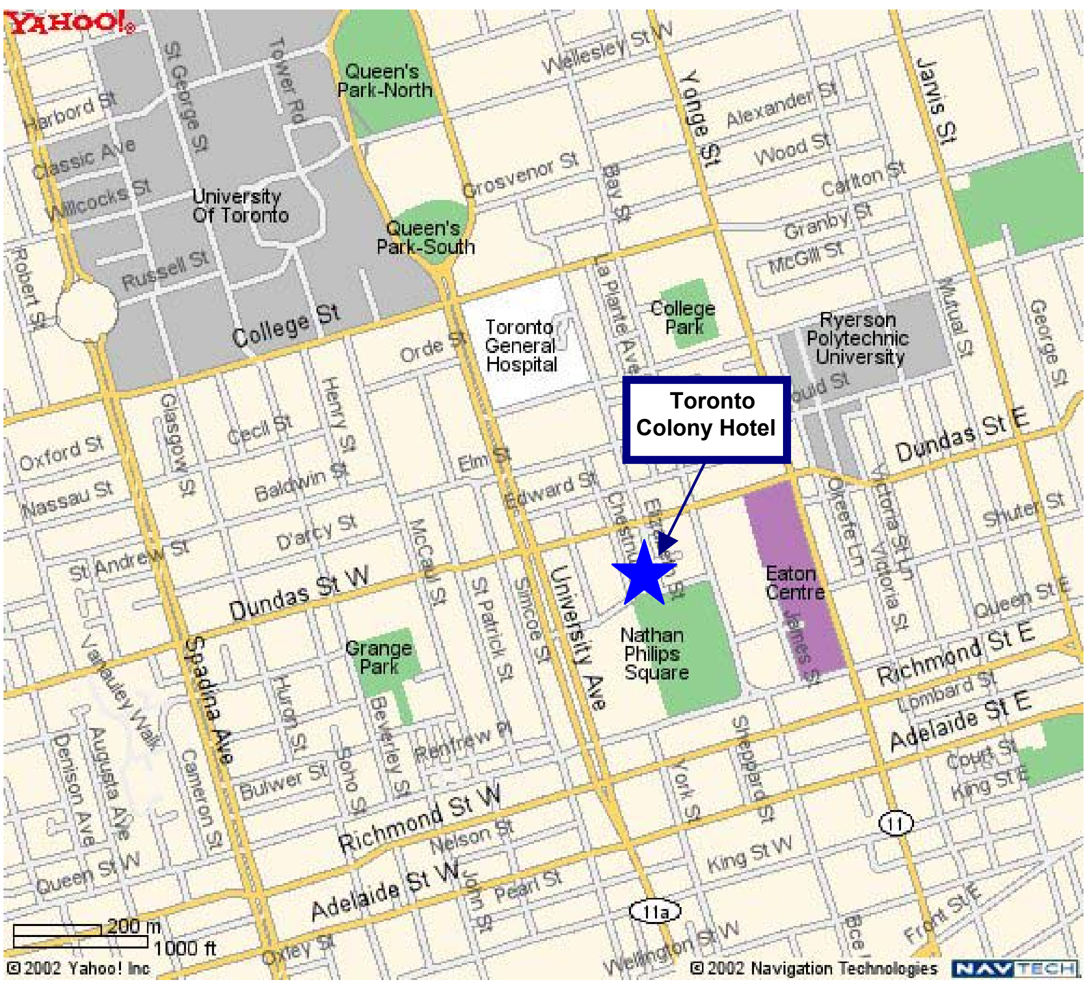
An alternate approach is to increase the off-campus residence experience. In recent years as a result of high residence demand induced by the first year residence guarantee, the University has been obligated to lease residence space at the Primrose Hotel and the Delta Chelsea where in 2002/03 the student population at these locations rose to 490 students. The financial impacts of these alternatives are substantial and require the University of Toronto to provide an annual subsidy of about $3.5 million this year. This subsidy is expected to grow to about $5 million in 2003/04. The above facilities are not deemed desirable over the longer term and are not financially sustainable.

The University therefore requires an immediate cost effective solution. An opportunity has presented itself to acquire the Toronto Colony Hotel to address this pressing problem.

The Toronto Colony Hotel

An opportunity has presented itself for the University of Toronto to purchase the Toronto Colony Hotel. This is a full-service hotel located at 89 Chestnut Street in the heart of downtown Toronto. The Hotel is located on the east side of Chestnut Street, just south of Dundas Street West, and backs onto Elizabeth Street. The north side abuts an apartment building. Along the south side an open pedestrian walkway separates the Hotel from Toronto City Hall. The map below highlights the location of the Hotel.

Toronto Colony Hotel
Site Location



The Toronto Colony Hotel is a fifteen minute walk to the south end of the St. George Campus and is also on the University Avenue subway line. It is close to a number of public amenities, including Nathan Phillips Square, Allan Gardens, College Park, Eaton Centre, Pantages Theatre, Elgin and Wintergarden Theatres, Chinatown, and the numerous shops and services situated along Yonge Street. Nearby is the multi-million dollar Yonge Street Regeneration Project between Queen and Dundas streets, which is designed to establish the area as Toronto's leading shopping, dining and entertainment district. This property represents a unique opportunity for The University of Toronto. It has recently undergone a refurbishment program, which has included the renovation of guest rooms, lobby and reception, ballroom, corridors and elevators

Highlights of this property include:

- Constructed in 1972
- Total gross floor area of 496,000 square feet plus 177,000 square feet in the parking garage
- 721 rooms including 18 suites
- 27,000 square feet of meeting rooms and conference/function space
- 326 parking spaces on 5 underground levels
- Land area of 41,000 square feet
- Located directly north of Toronto City Hall
- Restaurant and retail stores at grade
- Close to St. Patrick's subway station
- Located next to Toronto City Hall, which is connected to Toronto's underground Path pedestrian system
- Excellent complement of facilities
- Approximately $8.4 million has been invested into the Hotel interior since 2000, which has included a refurbishment of the lobby and reception area, ballroom, corridors and elevators

ACQUISITION COSTS

A. Hotel/Residence Model

The estimated capital cost of acquiring the Toronto Colony Hotel and undertaking necessary improvements to convert it into a 219 room hotel and 814 bed student residence is $70 million.

The breakdowns of the costs are as follows:

A.	Purchase Price	$64 million [1]
B.	Capital Improvements	$ 5 million [2]
C.	Taxes - PST & land transfer	<u>$ 1 million</u>
		$70 Million

[1] *The purchase price amount reflects the credit given for the number of staff the University of Toronto expects to retain from The Colony's existing complement.*

[2] *The capital improvements include $4,000,000 to undertake renovations and upgrades including completion of exterior façade rehabilitation, security system enhancements, internet connectivity, parking garage repairs, HVAC improvements and the purchase of furniture and fixtures for the residence component. An additional $1,000,000 will be used for carrying costs over the initial three month conversion period immediately after acquisition.*

B. Residence Only Model

The estimated capital cost of acquiring the Toronto Colony Hotel and undertaking necessary improvements to convert it entirely into a student residence of approximately 1,172 beds is $72 million.

The breakdowns of the costs are as follows:

A.	Purchase Price	$66.4 million [1]
B.	Capital Improvements	$ 4.6 million [2]
C.	Taxes – PST & land transfer	<u>$ 1.0 million</u>
		$72.0 Million

[1] *The purchase price amount increases to reflect the breakup cost of long term contracts to supply hotel rooms. The purchase price amount reflects the credit given for the number of staff the University of Toronto expects to retain from The Colony's existing complement.*

[2] *The capital improvements of $3,600,000 reflect a reduction due to less complex security requirements. An additional $1,000,000 will be used for carrying costs over the initial three months conversion period immediately after acquisition.*

Proposed Hotel Conversion

The facility has 27 floors, a first basement comprising some commercial activities and five additional underground levels of commercial parking. The first to fourth floors comprise common facilities including a large ballroom and commercial space on the 2^{nd} floor, meeting rooms on the 3^{rd} floor and a pool and guest rooms on the 4^{th} floor. Floors 5 to 25 are essentially the standard with approximately 34 guest rooms per floor. The 26^{th} floor comprises 10 guest rooms, some in suite configuration, a revolving restaurant, roof garden and kitchen with a bar/lounge on the 27^{th} plus the mechanical equipment.

The existing Hotel may be re-configured in one of the following arrangements:

A. Hotel/Residence Model

i. An 814 bed residence in 496 rooms.
ii. Provision for one Don's Room, one Study and 2 adjoining Common Rooms on each floor.
iii. A reduced commercial hotel operation of 219 rooms.
iv. Continuance of the current Conference, Banquet and Parking operations.

OR

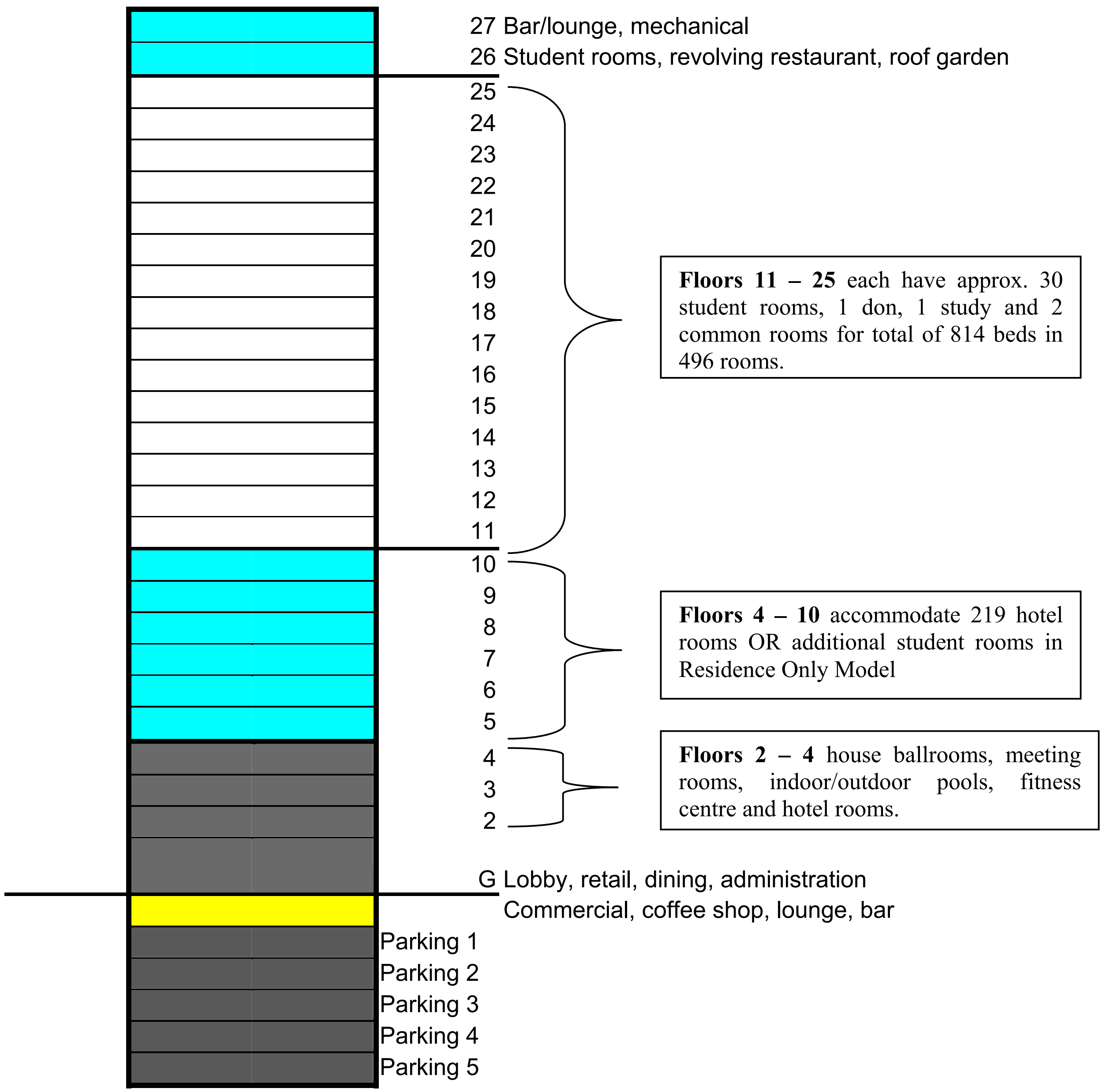
B. Residence Only Model

i. A 1,172 bed residence with approximately 78 single rooms and 547 double rooms (i.e. 1,094 beds) with meal facilities.
ii. Provision for one Don's Room, one Study and 2 adjoining Common Rooms on each floor.
iii. Continuance of the current Conference, Banquet and Parking operations

The preferred alternative is for a residence only model. A hybrid configuration reduces the flexibility to create a unique off campus residence facility. In addition it carries over the negative perception of the Primrose. The hybrid alternative was considered primarily because it generated income from the existing hotel operation to substitute for start up capital required (e.g. Woodsworth is de facto funded by 25% equity).

A Stacking Chart of the facility is presented below. The availability of the indoor pool, gym and other facilities offer interesting marketing opportunities as does the proximity of the location to the theatre and business districts of the city.

STACKING CHART



Residence Operation

The facilities will include space for residence office and dean, residence council, residence dons, double accommodation in large rooms, single rooms, study space, common rooms, laundry facilities as well as the possibility of a residence indoor pool and gym, a dining hall/study space with a view from the 27th floor, prayer space, music rooms, and bicycle storage.

In addition, other amenities may be available within the conference centre to support in-house residence activities and related academic events that will bring other University activities to this location. This includes:

Space for University Visitors
University Conferences
University Functions
Professional Masters Courses
Rotman School of Business study programs requiring accommodation
Student Functions and Events

These activities also support the parking operation.

A residence house committee has been established to discuss and refine the concepts of this new off-campus residence. Its current membership is:

- Professional Faculties
    - Faculty of Applied Science & Engineering
    - Faculty of Music
    - Faculty of Physical Health & Education
- International Exchange Office
- New College Residence
- Student Affairs
- Vice-Provost – Students
- Facilities Management [services provided to the Residence]

Acquiring the Toronto Colony Hotel will enable the University of Toronto to develop a community that reaches out within a great city while providing a new type of quality residence experience.

FINANCIAL ANALYSIS

Two alternatives have been analyzed to determine sensitivity. They include:

A. Hotel/Residence Model
- Option 1 = Base case
- Option 2 = Reduced occupancy
- Option 3 = Reduced occupancy, reduced hotel rates

B. Residence Only Model
- Option 4 = Base case
- Option 5 = Equity contribution
- Option 6 = Lower residence rates, reduced summer occupancy

HOTEL/RESIDENCE MODEL

Option 1 (Base Case)

The following assumptions have been applied to the **Hotel/Residence Model** Base Case:

General

i. The acquisition cost is $70 million.

ii. Debt financing of 100% is assumed with a 25-year mortgage at 7.25% (based on current rates).

Hotel

i. The Hotel component consists of 219 rooms

ii. Hotel room occupancy is estimated at 80% for 12 months based on current contracts.

iii. Operating costs are included which reflect the existing operations plus a factor for escalation.

iv. Additional summer revenues assume 60% occupancy of the residence rooms. (The Primrose experiences an 80% occupancy rate).

Conference/Banquet/Parking

i. Based on existing operations.

ii. Conference and Banquet revenues assumed at 50% of current levels.

iii. Parking revenues at current level.

Option 1 (Con't)

Residence

i. Total number of student residence beds is 814 with 54 single rooms at \$750/month and 760 double rooms at \$650/month or \$1,300/double room.

ii. Operating costs are modeled after current New College residence expenses.

iii. A capital maintenance charge of 1 % of capital cost (net of land value) for Years 1 thru 5 and 1.5% for future years escalating at 3% per annum. This amounts to \$550,000 in Year 1. Currently, all new recently approved residences waive this charge until Year 6.

iv. An additional residence allowance of \$200,000 per year, escalating at 3% per annum, over and above the current maintenance reserve requirement is included.

v. Residence rooms are estimated at 100% occupancy from September 1st to April 30th each year.

The results of Option 1 indicate breakeven in Year 4 with recovery of the cumulative deficit by Year 8. The projected net present value of the annual cash flows over 25 years is approximately \$20 million.

Detailed assumptions and financial modelling are provided in Summary Table1 and Appendix 1

Option 2 (Reduced Occupancy)

A more conservative scenario was modeled with the following modified assumptions:

i. Lowered Hotel Occupancy Rate to 70%

ii. Lowered Hotel Summer Occupancy Rate to 50%

iii. Lowered Conference, Banquet and Parking revenues by 10%

The results of Option 2 indicate breakeven in Year 8 and recovery of the cumulative deficit by Year 14. The projected net present value of the annual cash flows over 25 years decreases significantly to just under \$9 million. This scenario results in a reduction of \$11 million, or 55%, from Option 1.

Detailed assumptions and financial modelling are provided in Summary Table 1 and Appendix 2

Option 3 (Reduced occupancy, reduced hotel rates)

This scenario was modeled on Option 2 with a further reduction to the following assumptions:

i. Summer room rate reduced by 18% to $99 per night.

The results of Option 3 indicate breakeven in Year 11 and recovery of the cumulative deficit by Year 19. The projected net present value of the annual cash flows over 25 years decreases to a deficit balance of approximately $700,000. This scenario results in a reduction of $20.8 million or 103% from Option 1.

Detailed assumptions and financial modelling are provided in Summary Table 1 and Appendix 3

RESIDENCE ONLY MODEL

Option 4 (Base Case)

The following assumptions have been applied to the **Residence Only Model** Base Case:

General

i. The total acquisition cost increase to $72 million

ii. Debt financing of 100% is assumed with a 25-year mortgage at 7.25% (based on current rates).

Hotel

i. No Hotel operation resulting in residence rooms increasing to 1,172 beds.

Conference/Banquet/Parking

i. Conference and Banquet revenues assumed at 25% of current levels.

ii. Parking revenues assumed at 50% of current levels.

Option 4 (Con't)

Residence

i. Total number of student residence beds is 1,172 with 78 single rooms at $750/month and 1,094 beds in double rooms at $650/month.

ii. Operating costs are modeled after current New College residence expenses.

iii. A capital maintenance charge of 1 % of capital cost (net of land value) for Years 1 thru 5 and 1.5% for future Years escalating at 3% per annum. This amounts to $550,000 in Year 1. Currently, all new recently approved residences waive this charge until Year 6.

iv. An additional residence allowance of $200,000 per year, escalating at 3% per annum, over and above the current maintenance reserve requirement is included.

v. Summer revenues assume 35% occupancy which represents 30% of winter revenue.

vi. Residence rooms are estimated at 100% occupancy from September 1st to April 30th each year.

The results of Option 4 indicate breakeven in Year 10 and recovery of the cumulative deficit by Year 19. The net present value of the annual cash flows over 25 years is a deficit of approximately $545,000. This reflects the need for initial startup equity akin to what was required by Woodsworth. The hotel alternative requires no such contributions because it is an on going concern and not a startup.

Detailed assumptions and financial modelling are provided in Summary Table 1 and Appendix 4

Option 5 (Equity Contribution)

A more conservative scenario was modeled with the following modified assumptions:

i. Start up equity contribution of $900,000 per annum for Years 1 through 8. This level of contribution results in a similar breakeven to the base case for the hotel.

The results of Option 5 are an annual breakeven in Year 4 and recovery of the cumulative deficit by Year 7 which is similar to the base hotel case. The present value of the annual cash flows over 25 years is about $4.8 million.

Detailed assumptions and financial modelling are provided in Summary Table 1 and Appendix 5

Option 6 (Lower residence rates, reduced summer occupancy)

This scenario was modeled on option 5 with a further reduction to the following changes:

i. Single room rate reduced by 13% to $650/month and Double Room Rate reduced by 15% to $550/month or $1,100/double room.

ii. Summer revenues assume 30% occupancy.

iii. Equity contribution of $900,000 per annum for Years 1 through 25.

The results of Option 6 extend the breakeven in Year 17 and recovery of the cumulative deficit by Year 27. The net present value of the annual cash flows over 25 years is negative $9.1 million. An equity contribution of $900,000 is required every year until all the borrowing has been repaid. The PV number is $10.3 million which implies a requirement to double the equity contribution to compensate for lower rent.

Detailed assumptions and financial modelling are provided in Summary Table 1 and Appendix 6

Comparison with Woodsworth College

To provide some perspective, a comparison was made with the Woodsworth College Residence ancillary under construction. This comparison is the most relevant since the Woodsworth residence is also a startup i.e. there is no previous residence ancillary. The comparison is detailed in the table below. The following should be noted:

a) The break even years and recovery of initial deficit are similar

b) The startup equity contribution is lower in the Colony case (PV $5.3 million for Colony versus $7 million for Woodsworth)

c) The percent of equity funding is lower, 7.4% for the Colony versus 25% for Woodsworth

d) The equity contribution per bed is lower, $4500 per bed for the Colony versus $19,400 per bed for Woodsworth.

This reflects the lower capital cost per bed for the Colony relative to Woodsworth.

Comparison of Residence Only Options 5 to Woodsworth

	OPTION 5	WOODSWORTH
Capital Costs	$72 million	$28 million*

Annual Breakeven	Year 4	Year 5
Cumulative Deficit	Year 7	Year 8
Equity Required	$900,000 for 8 years	$1,200,000 for 8 years
PV of Equity	$5.3 million	$7.0 million
PV of Equity on a Per Bed Basis	$4,500/bed	$19,400/bed

*(*Residence portion of total construction cost of $32 million)*

RESIDENCE VERSUS HOTEL

The preferred option is to have a pure residence from a student experience perspective. The hybrid hotel/residence alternative was analyzed to avoid putting in start up capital. The modeling indicates that the residence alternative is viable only with start up capital.

From an operating perspective the University has considerable experience in running residences. It has no experience running a hotel. This can be mitigated by outsourcing to a hotel management company but this will further dilute the economics. The focus therefore, is whether start up equity can and or should be found to be able to proceed with the residence only alternative. In this regard it is important to note that the Colony is the only practical solution available. If the University continues with the Primrose/Delta Chelsea arrangement it faces a continuing subsidy. The current subsidy is about $3.5 million for 2002/03 and projected to be $5 million in 2003/04. The appropriate perception is that the start up equity contribution of $900,000 per annum avoids $5 million annual expenditures in bed subsidies at commercial hotels.

Overall the administration's judgement is that a pure residence operation should be pursued. Ancillary Services division of Business Affairs will be the unit accountable for running this operation and the VP Business Affairs has agreed to commit up to $1 million per year for eight years to provide the start up equity required. This will be found from the existing budget. Management within Business Affairs made this proposal which reinforces ownership of the facility and accountability for results.

CONCLUSION

In return for an investment of $900,000 per year for 8 years or PV of $5.3 million the acquisition of the Toronto Colony Hotel will:

- ✓ Make significant gains in helping to fulfill the first year guarantee
- ✓ Address the housing needs for the professional faculties
- ✓ Contribute to addressing the problem of rooms for non-first year students
- ✓ Eliminate the annual subsidy of $ 5 million that would have been needed for future years.

TIMELINES

It is anticipated that the Purchase & Sale Agreement will be signed by February 10th and be conditional upon the approval of Governing Council.

The confidential real estate details will be submitted to Governing Council for approval at the next meeting, currently scheduled for February 14, 2003.

The transaction will close and the University of Toronto will take possession of the property on May 30, 2003.

The conversion to residences will take place during the period of June through to August for student occupancy for Tuesday, September 2, 2003.

RECOMMENDATIONS TO THE BUSINESS BOARD

That the Vice-President, Business Affairs be authorized, subject to Business Board review and recommendation, to:

- Expend up to $72 million for the acquisition of the Toronto Colony Hotel, to be used primarily as a student residence.

- Arrange 100% interim and long-term financing in an amount up to $72 million, either externally or internally from the Expendable Funds Investment Pool, or via a combination thereof.

- Establish a residence ancillary to contain the residence operation and its associated activities. Subsequent to the approval by Governing Council the acquisition will be presented to the University Affairs Board to review the proposed operation and structure of the residence operations.

Acquisition will be presented to the University Affairs Board to review the proposed operation and structure of the residence operations.