PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 5b

Date of Meeting October 8, 2013

DATE: September 30, 2013

TO: Tay Yoshitani, Chief Executive Officer

FROM: Melinda Miller, Director Portfolio & Asset Management
Rebecca Schwan, Real Estate Manager

SUBJECT: Term Lease with Fishing Vessel Owners Marine Ways, Inc. at Fishermen's Terminal

Revised October 4, 2013

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute a lease for a **ten** year term with two additional five year options according to the terms laid out in this memorandum at a fair market rate, with Fishing Vessel Owners Marine Ways, Inc. at Fishermen's Terminal.

SYNOPSIS

Fishing Vessel Owners Marine Ways, Inc. (FVO) is a marine vessel repair and dry dock operation established in 1919, with a work force of 35 to 48 employees, most of which are union wage jobs. In addition to providing dry dock services, FVO has a machine shop, welding shop, wood shop, sand blasting and painting operation and a parts supply store. They also provide ancillary services to other ship repair operations in the Pacific Northwest. They were the first tenant of the Port of Seattle and have been serving the commercial fishing fleet for 95 years, supporting the Port's mission to promote the maritime industry.

A large portion of the Alaska halibut fleet was built and repaired at the facility. The business relies on railways and century-old winch equipment to pull boats from the water for dry-dock repairs. FVO has one 300 ton and one 600 ton marine rail. They can haul out up to a 250 foot vessel. Only two other shipyards in the area have marine rails.

The FVO lease is currently on holdover status. Port staff has negotiated a **ten**-year lease with two additional five-year options. The rates are based on the response from a recent request for proposal that is addressed later in this memo. The lease requires no investment by the Port.

BACKGROUND

The Port entered into a lease with FVO in 1919 to manage and operate a commercial shipyard. The lease was renewed and extended many times throughout the years. In 1978 FVO signed a 25-year lease with the Port. At that time they built what is known as the I-3 Building and the M-

4 building, which housed their office, warehouse, and machine shop. The lease stated that at the end of the 25-year term, ownership of the two buildings would revert to the Port.

The lease was amended several times over the years, renegotiating the rent and expanding the lease premises. In 2003, FVO signed a five-year lease. At this time the Port had started Phase 3 of the South Wall Construction Project and acknowledged that the impacts of the project would be extremely difficult and impracticable to ascertain, so the Port agreed to reduce the rent to represent a reasonable estimate of the amount of damages that the lessee would suffer as a result of the project. FVO in turn released the Port from any loss or damages relating to the project.

In 2007, the Port amended the lease and extended the term through September 2009. The lease then went into holdover status and in 2010 FVO entered into a two-year lease that took into account the impacts of Phase 4 of the South Wall Construction Project, which would encumber a portion of their yard for approximately two years. The project was completed in 2012 and the lease went into holdover.

The following is a list of improvements and upgrades that were performed by FVO over the past 40 years:

- 1974 – Replaced the old wooden haul out ways and constructed a new steel haul out on the east side of the dock.
- 1979 – Replaced the wooden west cradle with steel.
- 1983 – Installed the electrical system and air system in the yard, building way and dock 3.
- 1987 – Installed the side track system.
- 1987 – Installed the overhead crane system in the machine shop.
- 1989 – Installed new fence around the perimeter of the property ending at the first bridge column on the south east side of the property. FVO installed the portion that is on its lease premises.
- 1990 – Graded yard area and installed asphalt.
- 1994 – Removed tracks and underwater wood timbers. Installed new piling and installed underwater steel I-beams and new tracks on east haul out ways.
- 1995 – Installed more steel cross beams, diamond steel plates and sump pump for water containment for National Pollutant Discharge Elimination System permit.

MARKET CONDITIONS

In 2012, the Real Estate Division obtained an appraisal for the FVO lease site. The Port entered into negotiations based on the appraisal. The Port was unable to come to terms with FVO on the rent. Division Management decided to send out a request for proposal for a long-term lease for a commercial shipyard or boatyard to see what the market reflected as market rate rents for a commercial shipyard or boatyard. The request for proposal was published on January 26, 2013, and the deadline for submittals was April 26, 2013. FVO was the only entity that submitted a proposal. FVO proposed a monthly rental of $15,071 per month. FVO is currently paying

$14,178 per month. Their proposal asks for zero investment by the Port over the term of the lease and no free rent. In addition, there are no commission fees associated with this lease.

TERMS OF PROPOSED LEASE

The major elements of the proposed term lease are outlined below:

Term:	**Ten** years plus two additional five-year options.
Rent Commencement Date:	November 1, 2013.
Premises:	Premises consists of multiple industrial buildings located on approximately 43,866 square feet of uplands and 136,138 square feet of submerged land.
Base Rent:	2,800 square feet of office @ $10.00 per square foot per year = $2,333.33 per month. 15,683 square feet of warehouse @ $5.00 per square foot per year = $6,534.58 per month. 28,183 square feet of improved land @ $1.58 per square foot per year = $3,710.76 per month. 136,138 square feet of submerged land @ $0.22 per square foot per year = $2,495.86 per month. Total Monthly Rent of $15,074.53. Annual Rent of $180,894.36. Plus Leasehold Tax.
Rent Increases:	Base rent shall be subject to annual adjustments in proportion to the percentage change in the Consumer Price Index for all Urban Consumers. In addition, rent shall be subject to renegotiation at the end of the 60th month following the commencement of this lease and every 60 months thereafter.
Rent Abatement:	None.
Operating Expenses:	Lessee is responsible for the utilities and all the repairs and maintenance within their premises. Port of Seattle has no maintenance responsibilities whatsoever.
Port Improvements:	None.
Security:	Lessee shall provide a cash deposit, corporate surety company bond or irrevocable stand-by letter of credit in the amount of $95,000, which is equal to six months' base rent over the term of the lease.
Insurance/ Liability:	$2 million General Liability.

Assignment/Sublease: Conditioned on the Port's prior written consent.

FINANCIAL IMPLICATIONS

Financial Analysis and Summary

<table>
<tr><td>CIP Category</td><td>N/A</td></tr>
<tr><td>Project Type</td><td>N/A</td></tr>
<tr><td>Risk adjusted discount rate</td><td>7.0%</td></tr>
<tr><td>Key risk factors</td><td>Risk of tenant default, which is partially mitigated by:
$95,000 Security deposit (6 months base rent)
Good standing status as an existing tenant of the Port</td></tr>
<tr><td>Project cost for analysis</td><td>N/A</td></tr>
<tr><td>Business Unit (BU)</td><td>Portfolio Management, Real Estate Division</td></tr>
<tr><td>Effect on business performance</td><td>No incremental expense is generated. Incremental revenue is as follows:
<table>
<tr><th>NOI (in $000's)</th><th>Year 1</th><th>Year 2</th><th>Year 3</th><th>Year 4</th><th>Year 5</th></tr>
<tr><td>Revenue</td><td>$181</td><td>$186</td><td>$192</td><td>$198</td><td>$204</td></tr>
<tr><td>Expenses</td><td>$0</td><td>$0</td><td>$0</td><td>$0</td><td>$0</td></tr>
<tr><td>NOI</td><td>$181</td><td>$186</td><td>$192</td><td>$198</td><td>$204</td></tr>
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<tr><td>IRR/NPV</td><td>
<table>
<tr><th>NPV (in $000's)</th><th>IRR (%)</th><th>Payback Years</th></tr>
<tr><td>$1,421</td><td>NA</td><td>NA</td></tr>
</table>
The NPV is based on incremental net cashflows generated by the lease and does not factor in the underlying value of the land and improvements. The basis for establishing the rate for the lease is described in the memo under "Market Conditions."</td></tr>
<tr><td>CPE Impact</td><td>N/A</td></tr>
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ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Not enter into a lease with FVO. Port staff could reissue another request for proposal for a commercial shipyard or boatyard. Judging from the results of our recent request for proposal for this use, it is likely we would get the same outcome. Even if we did receive proposals from submitters other than FVO, they could be at less attractive terms for the Port and we could end up having to invest Port dollars for improvements, which is not the case with the proposed lease with FVO. In addition, the request for proposal process can take months to complete and demands a significant amount of time and resources from Port staff. There is also the issue of environmental clean-up should the shipyard vacate the premises and a new shipyard or boatyard take its place. Although the current lease addresses this issue, it is likely that this could fall on the shoulders of the Port. FVO has an Industrial National Pollutant Discharge

Elimination System (NPDES) Permit with the Department of Ecology. A new shipyard or boatyard would be required to obtain their own permit, which could have more stringent requirements than the one held by FVO and make it difficult for another shipyard or boatyard operator to conduct business at the site. This is not the recommended alternative.

Alternative 2) – Not enter into a new lease with FVO. Port staff could advertise through a request for proposal and pursue a non-shipyard tenant for the premises. In doing so the Port would lose its longest standing tenant and an amenity that attracts and retains many of our commercial fishing customers. FVO would have to find another location, which we know from our dealings with the Monorail in 2004 would be extremely difficult, if not impossible. There is also the issue of environmental clean-up should the shipyard vacate the premises. Although the current lease addresses this issue, it is likely that this could fall on the shoulders of the Port. The premises could remain vacant for an unknown time period resulting in loss of revenue to the Port. Should the Port receive submittals to the request for proposal, these submittals could be at less attractive terms for the Port and we could end up having to invest Port dollars for improvements, which is not the case with the proposed lease with FVO. In addition, the request for proposal process can take months to complete and demands a significant amount of time and resources from Port staff. This is not the recommended alternative.

Alternative 3) – Execute the proposed lease with FVO. Proceeding with the execution of the proposed lease would secure a maritime tenant that directly supports the commercial fishing industry for at least another five years. FVO was the first tenant of the Port of Seattle. They provide living wage union jobs to dozens of highly skilled shipwrights, millwrights, machinists, metal workers and other skilled workers. By going through the public process of a request for proposal for a commercial shipyard, the Port has confirmed that the rates in this lease are at market for this specific property and use. From an environmental perspective it benefits the Port to have a continuous use and tenant with knowledge and expertise in the ship repair business on this site, Ship yards are highly regulated by multiple agencies and requires in-depth knowledge of such regulations to operate in an environmentally responsible manner. If the Port does not execute this lease, we could risk losing commercial fishing moorage tenants who have been loyal customers of FVO for many years, some for generations. Fishermen's Terminal is the homeport of the North Pacific Fishing Fleet, the hub of the maritime industry on the Lake Washington Ship Canal and a significant economic engine for Puget Sound and the region. Fishermen's Terminal generates jobs and helps the Port to achieve one of its Century Agenda goals of doubling the economic value of the fishing and maritime sectors. The execution of this lease is in line the Port's commitment to the maritime industry. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- Computer slide presentation.
- Signed Lease.

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- None.