PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 5c

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 Kirby Offshore Marine Pacific LLC at The Maritime Industrial Center

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute a lease for a five-year term with two additional five-year options according to the terms laid out in this memorandum at a fair market rate, with Kirby Offshore Marine Pacific LLC at the Maritime Industrial Center.

SYNOPSIS

Kirby Offshore Marine Pacific LLC (Kirby), headquartered in Staten Island, New York, is a leading provider of marine transportation, distribution, and logistics services in the United States. They are a water-dependent commercial maritime tenant. Kirby operates the nation's largest fleet of inland tank barges and towing vessels. Kirby's service area spans America's inland waterway network to include the Gulf Intracoastal Waterway, the Mississippi River System, the Illinois River, the Ohio River and numerous other waterways. Kirby is a proven industry leader in safety, customer service and environmental protection. Petrochemicals, refined products, black oil products, and pressurized products are transported efficiently and safely from producers to intermediaries to end users.

Kirby operates 887 active inland tank barges, 161 active towing vessels and five fleets. They currently employ 1,530 mariners with over 1,000 being on a boat at any given time. Their training program is unique in the industry, and they take pride in the fact that they “grow their own” wheelmen. They support the Port’s mission to promote the maritime industry.

In 2000, in efforts to curb an industry-wide employee shortage, they instituted the Kirby (Mate) Pilot Program, which walks their own Tanker Men through the process of attaining their Master's Licenses in the shortest amount of time. In 2005, they began to incorporate graduates of maritime academies in their Pilot Program.

Kirby has been a tenant at the Maritime Industrial Center since 1998. This lease is a five-year lease with two five-year options. There is an annual CPI increase and language for renegotiation of rent every five years. The lease consists of 8,640 square feet of office space, 9,047 square feet of warehouse space, 21,250 square feet of improved land, and 356 lineal feet of moorage. Rates are based on comparable lease rates for Class C office space, warehouse space and land in the Ship Canal and surrounding sub-markets.

BACKGROUND

Purchased from the Coast Guard in 1993, the Maritime Industrial Center was redeveloped in 1998 to accommodate marine-related tenants and tenants that support the commercial fishing fleet. This facility is comprised of 6.39 acres, 4.03 of which are landside. The Maritime Industrial Center has several mixed use buildings, along with outside fenced storage. The main building is the A-1 Building and houses our anchor tenant Kirby. In addition to the office space that they lease in this building, they also lease warehouse space, yard space and moorage at the facility.

MARKET CONDITIONS

Office Market

In speaking with local brokers at Cannon Commercial RE and CB Richard Ellis, what we are seeing is more of a demand for high quality space and less for Class B and C office space. According to reports from CBRE and Cannon Commercial RE, tenants had been lured away by low rates and concessions in the Central Business District. Until recently, rates had been dropping but are now beginning to stabilize. It is difficult to retain tenants in the Ship Canal submarket unless they are maritime related or reside in the area.

Although most of the quarterly reports do not report on Class B and C rent in this submarket, we have confirmed with local brokers that Kirby's office rate of $15.25/sf/year, triple net (NNN) is on the high end of the range of what landlords are getting to fill Class C office space. We have also taken a look at asking rates in surrounding submarkets such as Ballard and Queen Anne. CoStar reporting confirms that this rate is within the range for comparable buildings. We recently amended a lease with InnerSea Discoveries in the Nordby Building at Fishermen's Terminal effective February 1, 2013, and are getting $14.75/sf/year/NNN for the additional office space. At the Wharf Building across the street from Fishermen's Terminal a recent comparable showed a Class C office lease done at $16.00/sf/year, Gross. (Operating Costs @ $5.00/sf/year)

This submarket has taken a hit in recent years but is slowly bouncing back. With rents dropping and landlords offering concessions in the Central Business District, many non-maritime tenants have left this area for nicer space downtown.

Industrial Market

In the Seattle Industrial Market, most of the tenant activity is occurring in the south end. In general, the Ship Canal submarket, Ballard in particular, is an extremely tight market. Many of the buildings are owned and occupied by businesses that have been there for decades. In addition, the increased development in the submarket in recent years has resulted in a decline in industrial inventory. According to brokers in the area, rates for warehouse space in the 5,000-10,000 square foot range are getting deals done around $6.00 -$7.80/sf/year. Land is ranging from $1.80 - $3.00/sf/year. Although there is no clear broker reporting on industrial properties in the Ship Canal/Ballard market, local brokers confirm that warehouse space and vacant land are scarce.

We recently had an appraisal done by McKee & Schalka on the FVO Marine Ways Shipyard at Fishermen's Terminal. Land came out at $2.40/sf/year and warehouse ranged between $6.00 - $7.80/sf/year. The rates we are getting for this lease for warehouse and land are at/above market according to the appraisal done in late 2012. We are getting $7.00/sf/year for the warehouse and $3.33/sf/year for the land. This falls in line with what local brokers are reporting for this submarket. There is no free rent or broker fees associated with this lease. The Port will be contributing $20,000 in tenant improvement work.

TERMS OF PROPOSED LEASE

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

Term:	Five years plus two additional five-year options.
Rent Commencement Date:	November 1, 2013.
Premises:	Premises consists of 8,640 square feet of office space in the A-1 Building, 9,047 square feet of warehouse space located in the A-1 Building and in three smaller warehouse buildings in the yard, 21,250 square feet of improved land and 356 lineal feet of submerged land.
Base Rent:	8,640 square feet of office @ $15.25 per square foot per year = $10,980.00 per month. 9,047 square feet of warehouse @ $7.00 per square foot per year = $5,277.41 per month. 21,250 square feet of improved land @ $3.33 per square foot per year = $5,896.88 per month. 356 lineal feet of moorage @ $155.25 per square foot per year = $4,605.75 per month. Total Monthly Rent of $26,760.04. Annual Rent of $321,120.48. 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, with the exception of the roof, foundation and structure of the A-1 Building.
Port Improvements:	Port will 1) Provide for hook up for washer and dryer in A-1 office space, 2) Repair roof leak in warehouse outbuilding in yard area and 3) Repair splitting bull rail in submerged area for a total of $20,000.
Security:	Lessee shall provide a cash deposit, corporate surety company bond or irrevocable stand-by letter of credit in the amount of $142,000, 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

Budget/Authorization Summary	Capital	Expense	Total Project
Original Budget	$0	$0	$0
Previous Authorizations	$0	$0	$0
Current request for authorization	$0	$20,000	$20,000
Total Authorizations, including this request	$0	$20,000	$20,000
Remaining budget to be authorized	$0	$0	$0
Total Estimated Project Cost	$0	$20,000	$20,000

Project Cost Breakdown	This Request	Total Project
Tenant Improvement Allowance	$20,000	$20,000
Leasing Broker Commission	$0	$0
Other	$0	$0
Total	$20,000	$20,000

Budget Status and Source of Funds

The 2013 Operating Budget included a $30,000 budget for Kirby Tenant Improvements. The proposed funding of $20,000 will result in a favorable operating expense variance in 2013.

The source of funds for these tenant improvements will be the Real Estate General Fund.

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:
• Security deposit in the amount of $142,000
• Good standing status as a current tenant of the Port</td></tr>
<tr><td>Project cost for analysis</td><td>$20,000</td></tr>
<tr><td>Business Unit (BU)</td><td>Portfolio Management, Real Estate Division</td></tr>
<tr><td>Effect on business performance</td><td>The impact to Net Operating Income (NOI) and NOI After Depreciation resulting from this lease is shown below.
<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>$339</td><td>$349</td><td>$360</td><td>$371</td><td>$382</td></tr>
<tr><td>Expenses</td><td>($38)</td><td>($19)</td><td>($19)</td><td>($20)</td><td>($20)</td></tr>
<tr><td>NOI</td><td>$301</td><td>$331</td><td>$341</td><td>$351</td><td>$361</td></tr>
<tr><td>Depreciation</td><td>$0</td><td>$0</td><td>$0</td><td>$0</td><td>$0</td></tr>
<tr><td>NOI After Depreciation</td><td>$301</td><td>$331</td><td>$341</td><td>$351</td><td>$361</td></tr>
</table>
Revenue is inclusive of estimated operating expense reimbursements collected from the tenant.

Expenses are inclusive of both estimated recoverable operating expenses and a tenant improvement allowance.</td></tr>
<tr><td>IRR/NPV</td><td>
<table>
<tr><th>NPV (in $000's)</th><th>IRR (%)</th><th>Payback Years</th></tr>
<tr><td>$1,418</td><td>NA</td><td>1</td></tr>
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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 market rate for the lease is described in the memo under “Marketing Conditions.”</td></tr>
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ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Not enter into a lease with Kirby. Port staff could advertise through a request for proposal for a water dependent, maritime user. This would be risky, as it is difficult to know if another user would want the same configuration of space that Kirby currently uses and we could end up with no submitters. Even if we did receive proposals from submitters other than Kirby, they could be at less attractive terms for the Port and we could end up having to invest Port dollars for more extensive improvements than the Kirby lease requires and other possible concessions. The rates for this lease are at or above market and it is not recommended that the

Port risk getting less revenue. The Kirby lease provides annual revenue of $321,000 and the Port's investment is $20,000. This is not the recommended alternative.

Alternative 2) – Not enter into a new lease with Kirby. Port staff could advertise through a request for proposal and pursue a non-maritime tenant for the premises. In doing so the Port would lose its anchor tenant that supports the Port's mission of promoting and supporting the maritime industry. Kirby would have to find another location, which would be extremely difficult as industrial space with adjacent moorage is scarce in this submarket. Should the Port not receive submittals for a non-maritime user, 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, and other concessions. The Kirby lease provides annual revenue of $321,000 and the Port's investment is $20,000. This alternative is also at odds with the original mission when the Port developed the facility in 1998, which was to accommodate marine related tenants and tenants that support the commercial fishing industry. This is not the recommended alternative.

Alternative 3) – Execute proposed lease with Kirby. Proceeding with the execution of the proposed lease would secure a long-standing Port customer and commercial maritime tenant for at least five years. Kirby directly supports the maritime industry by providing thousands of maritime jobs and a customized training program that brings a new generation of workers into the industry. By executing this lease the Port is avoiding the time and cost associated with sending out a request for proposal, which from experience can take months to complete and demands a significant amount of time and resources from Port staff. Execution of this lease falls in line with the purpose of the development of the Maritime Industrial Center in 1998, which was to accommodate and support marine-related tenants. The rates are at or above market, and the lease provides the Port annual revenue of $321,000 with a nominal Port investment of $20,000, no broker fees and no free rent. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- PowerPoint presentation.

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- None.