PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6d

Date of Meeting November 5, 2013

DATE: October 25, 2013

TO: Tay Yoshitani, Chief Executive Officer

FROM: James R. Schone, Director, Aviation Business Development
D. Michael Ehl, Director, Aviation Operations
James Jennings, Manager, Aviation Properties

SUBJECT: Thirteenth Amendment to Air Cargo Building Site Lease Agreement with Federal Express Corporation

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute a Thirteenth Amendment to Air Cargo Building Site Lease Agreement with Federal Express Corporation, substantially in the form attached, to reflect a 15-year extension of the lease term in exchange for FedEx leasing additional premises and committing to invest $3 million in capital improvements to the facility during the extended term.

SYNOPSIS

FedEx's current lease with the Port is a land lease that will expire on December 31, 2013. At the end of the current lease term, FedEx's building improvements would revert to the Port. FedEx has expressed an interest in extending the lease under its present terms for an additional 15 years. In consideration for extending the land lease, and forgoing a future rental stream for building rent, Port staff has negotiated with FedEx to lease an additional 60,001 square feet of land, as well as invest no less than $3 million dollars in capital improvements to the premises.

BACKGROUND

FedEx, a global courier delivery service company headquartered in Memphis, Tennessee, provides next-day air cargo service within the United States, and time-definite international service to more than 375 destinations in nearly every country each day. FedEx Express, the cargo airline subsidiary, operates the world's largest cargo airline fleet and is the world's largest airline in terms of freight tons flown. FedEx is Seattle-Tacoma International Airport's largest cargo airline with 47.5% total market share in 2012.

FedEx, as successor in interest to The Flying Tiger Line Inc., has had a lease for the cargo building located at 2450 S. 161st Street at the Airport since 1974. Under this lease, FedEx has built a substantial building to process the cargo and mail that they carry as part of their business. Subsequent to the transfer of the building from The Flying Tiger Line, FedEx has expanded the building's footprint, added office space square footage, and installed a sophisticated system of automated package tracking, sorting and racking infrastructure that allows for a very high throughput of a variety of sizes of packages to and from multiple destinations. Upon the expiration of the lease, ownership of the improvements reverts to the Port. This facility is highly customized to FedEx's operations, and as such, when the Port receives the building at the expiration of the lease, it is anticipated that significant capital investment will be required to make the building usable by another tenant.

FedEx desires to continue their operations at the Airport while also continuing to maintain control and ownership of their facility. Port staff has been engaged with FedEx for close to two years in trying to understand and address their interests associated with their facilities and lease. As part of this negotiation, staff developed an analysis of pros and cons related to multiple Port goals, considering the proposed lease extension, negotiation of a new lease, as well as a potential re-lease of the facility. Considerations included both the associated revenues the Port would receive, as well as the associated capital expenditures that would be required in each scenario. In this analysis, we also considered the uncertainty surrounding the time it would take to convert and lease the specialized facility to another user, as well as any revenue impacts to the Port. The Port's conclusion was that a lease extension with FedEx was the best approach to balance the Port's risk, revenue and tenant relationship. The additional rent for the expanded premises and the $3 million investment to which FedEx is committing by executing this Thirteenth Amendment is fair and reasonable compensation for the extended lease term being granted.

LEASE SUMMARY COMPARISON

	Current Lease Terms	**Proposed Amended Lease Terms**
Term	1/1/1974-12/31/2013	1/1/1974 – 12/31/2028
Premises (Square Feet)	592,545	652,546
Monthly Rent	$75,370.35	$84,370.50
Capital Investment Requirement	0	$3M before 12/31/2026

All other terms and conditions of the current lease will remain including an adjustment in the land value every five years based on appraisal, which will be documented by future amendments to the lease.

FINANCIAL IMPLICATIONS

The lease in its present condition contributes $904,444.20 in annual rent to the Port. The proposed Thirteenth Amendment to Air Cargo Building Site Lease Agreement will increase this to $1,012,446 in annual rent.

STRATEGIES AND OBJECTIVES

FedEx is the Airport's largest cargo customer by far in terms of tonnage and flight frequencies, and, as such, is expected to contribute significantly to the Port's Century Agenda goal of tripling air cargo volume to 750,000 metric tons. In 2012, FedEx's cargo volumes grew by more than

6%, compared to overall airport cargo growth of 1.4%. With the airline's newest wide body aircraft, the Boeing 777 freighter, deployed on routes to Seattle, FedEx is poised to continue growth at the Airport. Although their current route network at the Airport is purely domestic, the airline estimates that international volumes comprise 10 to 20% of their total volume here. FedEx has recently entered into partnership agreements with several of the Airport's international carriers to move cargo overseas directly from Seattle, boosting opportunities for the Airport's existing international carriers to grow. The extended lease term represents FedEx's commitment to Seattle to continue their operations here for the next 15 years, which means additional revenue from landing fees that help reduce overall airline costs per enplanement.

In addition, this amendment ensures FedEx is committed to its cargo operation at the Airport, maintaining an important rental revenue stream from the premises to the Port for the next 15 years. The premises under this lease are part of the Airport's Airfield Commercial Area, a compensatory aeronautical cost center.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

During the course of this negotiation, Port staff developed multiple scenarios with varying assumptions and analyzed the financial implications of each scenario. The scenarios can best be summarized in 3 alternatives.

Alternative 1) – Negotiate a lease that has the building reverting to Port ownership on December 31, 2013. FedEx would then pay rent on the building as well as the land around the building that they are currently leasing. This would require the Port to take responsibility for the structural maintenance of the building. This alternative had the highest financial return to the Port but does include some elements of risk that include FedEx's reducing the size of the premises from what they are currently leasing or choosing to relocate their operations to another airport in the region as well as the required maintenance expenditures being higher than forecasted.

Alternative 2) – Negotiate a lease that has the building reverting to Port ownership on December 31, 2013, but FedEx chooses to leave the Airport. In this scenario, substantial capital investment would be required to make the facility suitable for re-leasing and there would likely be a significant amount of time before the facility could be re-leased, two years or longer, with no rental income during that period. The Port would take on the responsibility for structural maintenance of the building. This alternative represents the worst financial return to the Port.

Alternative 3) – Negotiate a lease that allows FedEx to retain ownership of the building for an additional 15 years but that also requires FedEx to invest no less than $3 million in the facility during that term as well as pay rent on an additional 60,001 square feet of hardstand that they would otherwise not have to lease. The responsibility for structural maintenance of the facility remains with FedEx. This alternative had a financial return that was less than Alternative 1 but substantially higher than Alternative 2. And this alternative guarantees a significant revenue stream to the Port while assuring that FedEx, the Airport's largest cargo customer, remains a tenant for the next 15 years. The assumptions analyzed in this alternative are reflected in the 13th Amendment to the Air Cargo Building Site Agreement. This is the recommended alternative.

ATTACHMENTS TO THIS REQUEST

- Attachment 1 - Draft Thirteenth Amendment to Air Cargo Building Site Lease Agreement
- Attachment A – Site Exhibit

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

December 17, 2010 – In accordance with the delegation of authority, staff executed the Twelfth Amendment to reflect an increase in leased premises effective December 1, 2010

August 12, 2009 – In accordance with the delegation of authority, staff executed the Eleventh Amendment to reflect an increase in rental rate effective June 1, 2009

November 14, 2006 – Commission authorized staff to execute the Tenth amendment to increase the leased premises effective December 1, 2006 and extend the lease expiration date to December 31, 2013; the amendment was fully executed November 27, 2006

April 12, 2005 – Commission authorized staff to execute the Ninth amendment (as part of the overall land rental rate adjustment at the airport) to reduce the leased premises effective May 15, 2002 and document the rental adjustment effective June 1, 2004; the amendment was fully executed December 28, 2005

October 27, 1998 – Commission executed the Seventh Amendment to waive FedEx's right of first refusal

December 10, 1996 – Commission executed the Sixth Amendment to increase the leased premises and extend the expiration of the lease to December 31, 2008

May 5, 1994 – Commission authorized the Executive Director to execute amendments implementing the land rental rate adjustments effective June 1, 1994; the Fifth amendment, which documented the land rental rate adjustment effective June 1, 1994 was executed on September 30, 1994

June 26, 1990 – Commission executed the Consent to Assignment of Lease to FedEx, as well as the Fourth Amendment which authorized a reduction in leased premises at a future date to be determined, increased the leased premises effective September 1, 1989 and documented the rental rate adjustment effective June 1, 1989. The Eighth amendment to reduce the leased premises effective August 1, 1999 (as authorized under the Fourth Amendment) was executed on October 22, 2001.

September 23, 1986– Commission authorized execution of the Third Amendment to reflect a reduction in the lease premises effective November 1, 1986; the amendment was fully executed on January 5, 1987

July 24, 1984 – Commission executed the Second Amendment documenting the rental rate adjustment effective June 1, 1984

November 11, 1980 – Commission executed the First Amendment which documented a rental rate adjustment effective January 1, 1980, as well as changed the dates of future rental rate adjustments to June 1, 1984, June 1, 1989 and every five years thereafter

March 4, 1976 – Commission executed Consent to Assignment of Lease for Security Purposes

March 26, 1974 – Commission executed the Air Cargo and Building Site Lease with Flying Tigers