PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6f

Date of Meeting November 5, 2013

DATE: October 28, 2013

TO: Tay Yoshitani, Chief Executive Officer

FROM: Patricia Spangler, Real Estate Manager
Melinda Miller, Director, Portfolio and Asset Management

SUBJECT: New Ten-Year Term Lease at Terminal 34 with Masters, Mates and Pilots Maritime Advancement Training, Education, and Safety Program d.b.a. Pacific Maritime Institute

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute a lease for a ten-year term with one five-year option substantially as drafted in Attachment 1 and according to the terms laid out in the memorandum at a fair market rate, with Masters, Mates and Pilots Maritime Advancement Training, Education, and Safety Program d.b.a. Pacific Maritime Institute at Terminal 34.

SYNOPSIS

Pacific Maritime Institute provides advanced education and training for masters, mates and pilots supporting the mission of the Port to promote the maritime industry. Pacific Maritime Institute is a current tenant with the Port occupying industrial flex space that includes 15,084 square feet of industrial flex space and 29,545 square feet of improved land at Terminal 34. Pacific Maritime Institute wishes to enter into a new lease with the Port at the expiration of their current ten-year lease term, expiring March 31, 2014. Port staff has negotiated a new ten-year lease that includes one five-year option to extend; terms discussed later in this memo. Port staff determined an initial market rate of $9.40 per square foot for the industrial flex space and $2.90 per square foot for the improved land. The total rent received over the term of the lease is approximately two million dollars. This lease obligates the Port to $85,000 of tenant improvement allowance and a broker commission fee of $93,602 for a total amount of $178,602.

BACKGROUND

The building and improved parking lot on Terminal 34 was constructed in 1950 and consists of a 15,084 square foot single-story masonry commercial building and a 29,545 square foot improved parking lot. In 1993, the Port purchased Terminal 34, located at 1727 Alaskan Way, from Flint, Inc. The facility remained vacant for several years. In 2003, the Port signed a ten-year lease with Pacific Maritime Institute (PMI). At that time the facility was in very poor condition. Prior to occupancy the building was substantially renovated with PMI contributing $350,000 and the Port funding $400,000 toward the improvements.

PMI's importance to the maritime industry should not be understated. It is a leader in maritime training and education and helps mariners maintain and advance their qualifications, assists individuals who would like to enter the maritime profession, and provides operational research services for the maritime industry. PMI also provides sophisticated simulation services with specialties in the areas of simulation databases and operational research models. PMI's full mission ship simulator is one of only three on the West Coast. For many of the courses offered, there are no equivalent alternatives north of the San Francisco Bay Area.

MARKET CONDITIONS

Port staff met with PMI early in the first quarter of this year to discuss their interest in negotiating a new lease at the end of their current term. PMI decided to work with a tenant broker and issued a request for proposal to the brokerage community. At that time, Port staff contacted the United States Coast Guard (USCG), occupying the west parcel on Terminal 34 adjacent to the PMI parcel. The USCG was interested in the property; however, to enter into a purchase or lease was not an option due to the current sequester limiting federal funds. The USCG referred Port staff to the Exchange. The Exchange is a supplemental department of the military funded by their retail sales and not reliant on federal funding. The Exchange supports the Seattle USCG currently located on the USCG base on Terminal 34. The Exchange was looking to expand the size of their current facility and considered the PMI parcel an option to relocate. Ultimately, the Exchange decided their current location would work for their expansion plan.

In order to establish the market rate for Terminal 34 industrial flex space, Port staff engaged the services of a real estate appraisal firm through an existing IDIQ contract. The appraisal evaluated recent lease transactions of other similar office and industrial properties in the Seattle area and concluded that the market rate for the office building was $7.95 per square foot per year, triple net and $2.40/sf./yr. triple net for the improved yard area. The Port negotiated rates in line with the appraisal rates of $9.40/sf./yr. triple net for the office building and $2.90/sf./yr. triple net for the improved yard with annual two and a half percent (2.5%) increases and renegotiated rent commencing the sixth year.

TERMS OF PROPOSED LEASE

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

Term:	Ten years commencing April 1, 2014
Use:	Administrative office and classrooms providing the education and training for the maritime industry and parking for approximately 54 vehicles.
Premises:	Premises consists of approximately 15,084 square feet of industrial flex space and 29,545 square feet of improved land used for parking.

Base Rent: 15,084 square feet of industrial office @ $9.40 per square foot = $141,790
29,545 square feet of improved land @ $2.90 per square foot = $85,681

Rent Increase: The Base Rent shall be adjusted on the anniversary of the rent commencement date and annually thereafter through year five by two and a half percent. The rent will be renegotiated in year six to the then fair market rental value and shall increase annually through year ten by two and a half percent.

Option to Extend: PMI has an option to extend for one five year term. The rental rate the option term will be at the then market rate.

Operating Expenses: PMI shall be responsible for all utilities, repairs and maintenance of the building and the improved land.

Port Improvements: The Port will provide a tenant improvement allowance not to exceed $85,000 toward the cost of one new HVAC unit and new carpet.

Security Deposit: The Port requires a security deposit in the amount of $127,421.72; equal to the average of six month's rent over the term of the lease.

Remove Easement for Ingress/Egress: PMI shall cause the removal of the exiting Ingress/Egress Easement that granted access through Port owned Jack Perry Park to the parking lot located on the west side of the property directly behind the office building.

License for Temporary Occupancy or Use: The Port will enter into a License for Temporary Use and/or Occupancy to grant PMI ingress/egress to PMI's parking lot located behind the building with the only means of access through Port owned Jack Perry Park from the south side.

FINANCIAL IMPLICATIONS

Budget/Authorization Summary	Capital	Expense	Total Project
Original Budget	$0	$0	$0
Previous Authorizations	$0	$0	$0
Current request for authorization	$0	$178,602	$178,602
Total Authorizations, including this request	$0	$178,602	$178,602
Remaining budget to be authorized	$0	$0	$0
Total Estimated Project Cost	$0	$178,602	$178,602

Project Cost Breakdown	This Request	Total Project
Tenant Improvement Allowance	$85,000	$85,000
Leasing Broker Commission	$93,602	$93,602
Other	$0	$0
Total	$178,602	$178,602

Budget Status and Source of Funds

The operating expense portion of the project costs will be included in the 2014 Operating Expense Budget and the portion of the tenant improvements qualifying for capitalization are provided for in Committed CIP C800126 Tenant Improvements.

The source of funds 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 $127,423
Good standing status as a current tenant of the Port</td></tr>
<tr><td>Project cost for analysis</td><td>$178,602</td></tr>
<tr><td>Business Unit (BU)</td><td>Portfolio Management, Real Estate Division</td></tr>
<tr><td>Effect on business performance</td><td>Net Operating Income After Depreciation for the period Year 1 through Year 5 is shown below:
<table>
<tr><th>NOI (in $000's)</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th></tr>
<tr><td>Revenue</td><td>$171</td><td>$232</td><td>$238</td><td>$243</td><td>$250</td></tr>
<tr><td>Expenses</td><td>($134)</td><td>($4)</td><td>($4)</td><td>($4)</td><td>($4)</td></tr>
<tr><td>NOI</td><td>$36</td><td>$228</td><td>$234</td><td>$239</td><td>$245</td></tr>
<tr><td>Depreciation</td><td>($4)</td><td>($5)</td><td>($5)</td><td>($5)</td><td>($5)</td></tr>
<tr><td>NOI After Depreciation</td><td>$33</td><td>$219</td><td>$225</td><td>$231</td><td>$236</td></tr>
</table>
Lower Net Operating Income in Year 1 is primarily a reflection of the payment of Broker Commissions ($94K) and the expensed portion of the tenant improvements ($38K). Depreciation is based on the capitalized portion of the tenant improvements (HVAC unit cost of $47K) depreciated over a 10 year useful life.</td></tr>
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<td>IRR/NPV</td>
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<tr><th>NPV
(in $000's)</th><th>IRR
(%)</th><th>Payback
Years</th></tr>
<tr><td>$1,613</td><td>NA</td><td>2</td></tr>
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The NPV is based on incremental net cash flows 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”.
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ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) –Not enter into a new lease with PMI; Pursing a new Tenant.

Port staff could advertise through a request for proposal in pursuing another potential tenant for Terminal 34. This option has several risks: the Port may receive proposals with lower rental rates than currently negotiated with PMI, no revenue to the Port during the downtime between vacating PMI and new tenant’s start, and the new Tenant would likely require higher funding by the Port for tenant improvements. PMI would relocate elsewhere which is no easy task, interrupting their scheduled education and training courses that support the maritime industry. This is not the recommended alternative.

Alternative 2) – Keeping with the current use of the property as currently improved by proceeding with the proposed lease agreement that will increase the revenue to the Port. In addition PMI as a long-term tenant of the Port will continue to provide education and training to the maritime industry supporting the mission of the Port and aligns with the Commission’s interest in retaining maritime related jobs and training facilities. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- Draft Term Lease
- PowerPoint presentation