PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6a

Date of Meeting April 22, 2014

DATE: April 14, 2014

TO: Tay Yoshitani, Chief Executive Officer

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

SUBJECT: Pier 69/Vine Street Permit Leases- Clipper Navigation, Inc.: Terminate Two Existing Term Leases; Enter into Two New Leases.

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to terminate two existing leases and enter into two new leases, with Clipper Navigation, Inc. (Clipper) that include Pier 69 for a term of fifteen years ending April 30, 2029 with one five year option to extend and a separate lease for the Vine Street Submerged Land for a term of seven years, eight months and fifteen days with a first option to extend until April 30, 2029 and a second five year option substantially as drafted in Attachment 1 and according to the terms laid out in this memorandum at a fair market rate.

SYNOPSIS

To provide for an improved customer experience, Clipper Navigation, Inc., a long term tenant at Pier 69, is proposing modifications to their offices, restrooms, and the terminal facilities that will include upgrades to the lighting, ceiling, flooring, walls and sprinkler system. The estimated cost of the proposed improvements is approximately $700,000. The Port will provide a tenant improvement allowance of $200,000 to be utilized toward the proposed improvements.

Port staff proposes two new leases—one for Pier 69 leased premises and one for the Vine Street Submerged Land leased premises at the terms discussed later in this memo. Based on the Port staff's determination of initial market rates for use of the Premises, the total projected rent to be received over the terms of these two new leases is approximately $ 3,208,219.

BACKGROUND

Founded in 1986, Clipper Navigation, Inc. is a privately held company in Seattle, Washington that provides multiple transportation and vacation packages (many of which are offered under the name Clipper Vacations) that include hotel and tour packages in Victoria, Seattle, Vancouver, Friday Harbor, Portland, Whistler, British Columbia the Canadian Rockies and Kelowna. Clipper also offers gray and orca whale watching. The Clipper fleet consists of three catamarans; all of which are high speed ferries—Clipper IV being one of the fastest passenger vessels in the western hemisphere. Clipper employs 104 full time staff year round and 139 full time staff during peak season May through September with a total gross payroll of approximately $5.3 million dollars for 2013. Clipper boosts the local economy through year-round vacation packages that include hotel accommodations, shopping, dining and attending sports events, as well as sightseeing tours.

Clipper Navigation has been a tenant at Pier 69 since 1987. The Port entered into the Pier 69 Lease with Clipper in July 1989. The lease was subsequently amended in September 1991 to include additional office space and the Vine Street submerged land. A second amendment was completed in January 2003 which extended the term from twenty to thirty years, expiring April 30, 2019 and included Special Improvement rent that provided Clipper with funding in the amount of $350,000 to repair and improve the berthing and docking area. The Port recently entered into a separate lease with Clipper for approximately ninety-one square feet of storage on the fingerling dock on the south side of Pier 69.

Clipper's existing lease agreement includes a provision for a market rate adjustment effective May 1, 2014. During the recent rent renegotiation, Clipper notified the Port of their desire to refurbish the public areas of their Premises (terminal, restrooms and corridor), the cost of which are estimated at $700,000. In order to achieve a viable financial return on the investment, Clipper requires a longer term and requested an amendment to their current lease, which expires on May 30, 2014 to extend the term an additional ten years, expiring on May 30, 2029, and includes an option to extend for an additional five years. Clipper also asked that the Port consider paying $200,000 toward the cost of these improvements which include modifications that will bring the restrooms up to current code compliance and will provide upgrades to the electrical and fire sprinkler systems.

Port staff has determined that it is in the Port's best interest to enter into two new leases which will:

a) Eliminate the twenty-five year old lease document and update the agreements between the Clipper and the Port to reflect the Port's current standard language; in particular as it relates to insurance and indemnity;
b) Provide a separate lease for the Pier 69 leased premises and one for the Vine Street Permit area which will align that lease expiration with the expiration of the permit;
c) Include the extended terms and renewal options as proposed;
d) Include the currently negotiated/market rents;
e) Include the proposed improvements estimated at $700,000, and the Port's investment of $200,000 toward those improvements, thereby increasing the value of the Port asset.

MARKETING CONDITIONS

Clipper's current agreement has a provision for a market rate adjustment to commence May 1, 2014. To determine the market rate for Clipper's specific use, the Port staff engaged the services of an architect to field verify the size and use of the premises and engaged the services of a real estate appraisal firm through an existing IDIQ contract.

The appraisal evaluated recent lease transactions of other similar use properties in the Seattle area and concluded market rates that would generate $304,107 per year vs. the current annual rent of $274,065 with CPI rent increases every 30 months. Taking into consideration the market rates supported by the appraisal, the Port negotiated a new annual rent of $294,650. Port staff also negotiated accelerating the CPI rent adjustment from every 30 months to annual adjustments, with market rate adjustments every five years. Also, under the current lease the Port reimburses Clipper for the annual cost of the Vine Street Permit, which is approximately $13,500 for 2014 and subject to annual escalations. In the new lease, the Port will no longer reimburse Clipper for the cost of the Vine Street Permit. Under the new lease agreement Clipper will reimburse the Port for the annual Vine Street Permit fee. Together, under the new lease agreements, the effective result is that the Port increases the total net revenue from Clipper 13% over their current revenue and reduces its risk as the Port will not be responsible for the cost of the Vine Street Permit and annual escalations.

Although the initial term for the new Vine Street Submerged Land Lease is actually seven years, eight months and fifteen days; the analyses of the two lease agreements assume fifteen year terms for both the Pier 69 Lease and the Vine Street Submerged Land Lease. It is assumed that SDOT will extend the Vine Street Permit at the end of its term in order for Clipper to continue to operate their business. The savings resulting from the Clipper payment of the Vine Street Permit was included in the analysis of this transaction.

TERMS OF PROPOSED LEASES

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

A) PIER 69 LEASE

Term: Fifteen years, Commencing May 1, 2014
Expiring April 30, 2029

Option To Extend: One five year option

Use: Waterborne passenger transportation services in the State of Washington, and between the State of Washington and the Coast of British Columbia, as well as harbor tours, dinner cruises and sales of travel, sightseeing and hotel accommodation packages in connection with Clipper marine transportation services.

Premises: Premises consist of approximately 47,672 square feet comprised of general administration office, working area, inside storage, outside storage, some portions of the north and south apron, submerged land for berthing and a kiosk.

Base Rent: 5,818 sf of Office @ $16.00/sf/yr. = $93,088.00/yr. ÷ 12 = $7,757.33/mo.

6,174 sf of Working Area @ $14.00/sf/yr. = $86,436.00/yr. ÷ 12

= $7,203.00/mo.

5,765 sf of Storage @ $7.10/sf/yr. = $40,931.50/yr. ÷ 12 = $3,410.96/mo.

91 sf of Outside Storage @ $6.05/sf/yr. = $550.55/yr. ÷ 12 = $45.88/mo.

8,909 sf of South Apron @ $2.10/sf/yr. = $18,708.90/yr. ÷ 12 = $1,559.08/mo.

952 sf of North Apron @ $2.10/sf/yr. = $1,999.20/yr. ÷ 12 = $166.60/mo.

10,643 sf of Submerged Land (Berth A) @ $2.60/sf/yr. = $27,671.80/yr. ÷ 12 = $2,305.98/mo.

9,240 sf of Submerged Land (Berth B) @ $.50/sf/yr. = $4,620.00/yr. ÷ 12 = $385.00/mo.

80 sf of Kiosk @ $40.80/sf/yr. = $3,264.00/yr. ÷ 12 = $272.00/mo.

Rent Increase: Annual rent increases by CPI and every sixth year a market rate adjustment is negotiated.

Operating Expenses: Tenant is responsible for all the utilities and repairs and maintenance within the Premises.

Port Improvements: The Port will provide $200,000 toward the cost of renovating the terminal reception area, corridor and restrooms.

Security Deposit: The Security Deposit is one hundred twenty six thousand seven hundred thirty two and 80/100 dollars, equal to approximately four and one-half month's rent.

(B) VINE STREET SUBMERGED LAND LEASE

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

Term: Seven years, eight months and fifteen days commencing May 1, 2014 and expiring January 15, 2022.

Options to Extend: First Option: Additional seven years, three months and fifteen days to expire concurrent with Pier 69 Premises Lease #002533.

Second Option: Additional five years concurrent with the Pier 69 Premises Lease #002533.

Use:	Maintenance and operations of a pedestrian boat moorage and passenger loading facility consistent with the permission granted in Ordinance 124012 and consistent with the provision of waterborne passenger transportation services
Premises:	Premises Consists of approximately 34,760 square feet of Vine Street Right of Way
Base Rent:	34,760 sf of Vine Street Right of Way @ $.50/sf/yr. = $176,380/yr. ÷ 12 = $1,448.33/mo.
Rent Increase:	Annually rent increases by CPI and every sixth year a market rate adjustment is negotiated.
Operating Expenses:	Tenant is responsible for all the utilities and repairs and maintenance of the Facility abiding by all provisions under the Ordinance 124012. Tenant will reimburse the Port for the annual Vine Street Permit fee.
Port Improvements:	None
Security Deposit:	The Security Deposit is seven thousand six hundred forty two and 23/100 dollars, equal to approximately four and one-half month's rent.

FINANCIAL IMPLICATIONS

Budget/Authorization Summary	Capital	Expense	Total Project
Original Budget	$0	$0	$0
Previous Authorizations	$0	$0	$0
Current request for authorization	$0	$200,000	$200,000
Total Authorizations, including this request	$0	$0	$0
Remaining budget to be authorized	$0	$0	$0
Total Estimated Project Cost	$0	$200,000	$200,000

Project Cost Breakdown	This Request	Total Project
Tenant Improvement (TI) Allowance	$200,000	$200,000
Other	$0	$0
Total	$200,000	$200,000

Budget Status and Source of Funds

As the Clipper's lease was not up for renewal in 2014, the Real Estate Division's 2014 Operating Budget did not specifically include a tenant improvement allowance for this lease. However, based on historical experience, it is expected that lower spending on other budgeted tenant improvements will offset any potential unfavorable expense variance related to this allowance.
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 deposits totaling $134,375
Good standing status as a current tenant of the Port</td></tr>
<tr><td>Project cost for analysis</td><td>$200,000</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 incremental impact of the new lease on Net Operating Income (NOI) for Year 1 through Year 5 is shown below:
<table>
<tr><td>Incremental Incr/(Decr)
<u>NOI (in $000's)</u></td><td><u>Year 1</u></td><td><u>Year 2</u></td><td><u>Year 3</u></td><td><u>Year 4</u></td><td><u>Year 5</u></td></tr>
<tr><td>Revenue</td><td>$5</td><td>$12</td><td>$20</td><td>$13</td><td>$13</td></tr>
<tr><td>Expenses</td><td>$187</td><td>($14)</td><td>($15)</td><td>($16)</td><td>($17)</td></tr>
<tr><td>NOI</td><td>($182)</td><td>$26</td><td>$35</td><td>$29</td><td>$30</td></tr>
</table>
Incremental revenue is generated by: Accelerating CPI adjustments, adding new lease area, converting a month-to-month lease to a term lease, and extending the lease termination date 10 years. Incremental expense is generated by: Tenant improvement allowance, partially offset by the elimination of the annual Vine Street Permit expense currently paid by the Port.

Note that the most significant the incremental increase to NOI (the extension of the lease termination) occurs in Year 6 through Year 15 starting at approximately $330K in year 6 growing to approximately $400K in year 15.

It is possible that a portion of the tenant improvement allowance may qualify for capitalization, but sufficient information is not available to reach that conclusion at this time. To be conservative, the allowance is assumed to be 100% expense. Lower Net Operating Income in Year 1 is primarily a reflection of the payment of the tenant improvement allowance.</td></tr>
<tr><td>IRR/NPV</td><td>
<table>
<tr><td>NPV
(in $000's)</td><td>IRR
(%)</td><td>Payback
Years</td></tr>
<tr><td>$1,820</td><td>NM</td><td>5</td></tr>
</table>
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 rates for the lease is described in the memo under "Marketing Conditions."</td></tr>
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ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) Renegotiate Clipper's rent to current market rate effective May 1, 2014 per the market rate adjustment in their current lease, with the all other terms of the agreement remaining the same including: 1) CPI increase every thirty months 2) the Port remaining responsible to reimburse Clipper for the annual Vine Street Permit fee, which is $13,500 for 2014 and is subject to annual escalations and 3) loss of the $57,000 incremental revenue the Port would receive under the new lease over the remaining five year term. Clipper may choose to relocate to other existing terminals along Alaskan Way or to alternative locations that may become available through the new waterfront redevelopment at the end of their term, April 30, 2019. As a result of Clipper vacating, the Port would then be left with finding another compatible water dependent user that is shoreline compliant. The Port would likely incur a loss of revenue during the vacant period and incur broker fees and higher concession fees (tenant improvement funding and abated rent) attributed to the lease up of a new tenant.

Also, deferring the negotiation of a new lease with Clipper for another five years, when Clipper's current lease expires April 30, 2019, has the potential of increasing the Port's risk of having to negotiate during a time of depressed rates as a very likely consequence of the heavy construction activity related to the viaduct replacement and seawall projects that will continue to affect businesses along the waterfront over the next five years. This is not the recommended alternative.

Alternative 2) Port staff proposes terminating Clipper's existing leases with a remaining term of five years and entering into two new fifteen leases that would increase the net revenue to the Port over the existing five year term by $57,000 more than what would have been achieved with only the market rate adjustment for the remaining term under the existing lease. Entering into the new leases secures a water dependent tenant for a longer term with a net present value (NPV) to the Port of $1,820,000 over fifteen years. Additional savings to the Port over the term of the lease as a result of passing the cost of the Vine Street Permit fee through to Clipper is $259,000. Clipper's net investment of $500,000 to the Premises would include real property improvements such as updating the public restrooms and sprinkler systems to meet current code requirements, installing new ceiling and lighting fixtures, all of which would increase the value of the Port's asset. An additional benefit to the Port, by entering into a new lease, is that using the new Port standard term lease document, the Port reduces its risk under the insurance, indemnification and environmental provisions. Clipper is a valued tenant whose operations at Pier 69 as a water-dependent user support the mission of the Port and aligns with the Commission's interest in retaining maritime related jobs. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

Attachment 1: Pier 69 Draft Lease
Attachment 2: Vine Street Submerged Land Draft Lease
Supplement 1: Presentation