PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6a

Date of Meeting June 10, 2014

DATE: May 19, 2014

TO: Tay Yoshitani, Chief Executive Officer

FROM: Mark C. Griffin, Director, Real Estate Development

SUBJECT: Des Moines Creek Business Park – Panattoni Development Company, Inc. Option and Ground Lease and City of Des Moines Second Development Agreement

Amount of This Request:	$0	**Source of Funds:**	Airport Development Fund
Est. State and Local Taxes:	$1,600,000	**Est. Jobs Created:**	1,600 (at full build-out)
Est. Total Project Cost:	$117,000,000 (tenant's total investment)		

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute substantially consistent with the terms described in this memorandum: (1) an option agreement and related ground lease agreements with Panattoni Development Company, Inc. or an affiliated entity; and (2) an amended and restated second development agreement with the City of Des Moines in order for Panattoni to develop a business park consistent with the Port and City of Des Moines vision for the Des Moines Creek Business Park.

SYNOPSIS

Staff proposes to enter into an option agreement with Panattoni Development Company, Inc. or an affiliated entity. The option agreement grants Panattoni the right, over seven years, to enter into one or more ground leases of the 87-acre Des Moines Creek Business Park site. Panattoni intends to develop a business park consistent with the Port and City of Des Moines (City) vision for the site.

Staff also proposes to enter into a related amended and restated second development agreement with the City. The development agreement substantially amends the existing development agreement previously authorized by the Commission and entered into with the City in June 2012. Panattoni will assume all of the Port's obligations under the development agreement upon executing the option agreement with the Port.

BACKGROUND

From 1989 to 1993, the Port acquired approximately 77 acres of residential land in Des Moines as part of the Airport's noise mitigation acquisition program. The Port purchased approximately 12 acres of abandoned streets in 2011 from the City, King County, and the Washington State Department of Transportation. Together this 87-acre assemblage is now referred to as the Des Moines Creek Business Park. The business park site has been vacant since the Port completed the residential acquisitions.

Earlier efforts to ground lease and redevelop the business park proved unsuccessful. Market conditions stemming from the economic recession halted plans to ground lease the site to a developer in 2008. After that, Puget Sound Energy (PSE) opted not to proceed with a lease approved by the Commission in June 2012.

Following PSE's decision, staff issued a request for proposals (RFP) in early 2013 to identify a developer for the site. Staff selected Panattoni's proposal over three other firms and signed a letter of intent last year. Panattoni anticipates investing approximately $117 million in developing the site in three phases totaling about 1.4 million square feet of development. Panattoni expects to start the first phase this summer and will spend approximately $40 million to construct about 535,000 square feet of space for delivery in 2015.

The City strongly supports the ground lease with Panattoni and has invested substantially in the project, most visibly through its "Transportation Gateway Project." The Gateway Project widens South 216th Street and 24th Avenue South, the southern and eastern boundaries of the business park. The South 216th Street segment was completed in fall of 2013 and the 24th Avenue South segment will be completed this spring. All told, the City has invested over $12 million to date in these two segments. This amount includes the Port's early payment to the City of $6 million in frontage improvement in-lieu fees per the terms of the second development agreement.

The proposed amended and restated second development agreement addresses the roles, responsibilities, and obligations between the Port, as the owner of the business park site and the City as the permitting authority. Panattoni, as the developer, will assume the Port's obligations under the development agreement as provided for in the proposed option agreement. The Des Moines City Council unanimously approved the amended and restated second development agreement at its February 20, 2014, meeting.

The second development agreement builds on the ongoing collaboration between the Port and City to ready the business park site for redevelopment. Since 2005, the Port and City have cooperated in completing a conceptual master plan, an environmental impact statement (EIS), and a first development agreement.

KEY OPTION AGREEMENT PROVISIONS

A draft of the proposed option agreement is included as **Attachment 1**. The proposed terms of the option agreement include:

- **Optionee; Assignee.** Panattoni is the optionee under the option agreement. Panattoni expects to assign its interest in the option to an affiliated entity.

- **Optioned Area.** The optioned area covers the entire approximately 87-acre business park site.

- **Term; Lease-up Schedule.** Panattoni will have up to seven years to put the entire, 87-acre site under lease. However, Panattoni must meet certain milestones for leasing portions of the site or base rent payments will be triggered. Panattoni must lease a total of 36 acres by June 2015, 66 acres by June 2016, and 87 acres by June 2018.

- **Use.** Panattoni will build out the business park with approximately 1.4 million square feet of light industrial and commercial uses.

- **Option Payments.** Panattoni will pay monthly option payments to the Port as consideration for exclusive control of the business park site during the option term at a rate of $0.04 per land square foot per year. In 2014, this rate results in about $127,000 of annual revenue. The annual revenue from the option payments decreases over the remainder of the option term as Panattoni leases more of the site and begins base rent payments. The option payments total about $344,000 on a nominal basis over the term of the agreement.

- **In-Lieu Fees Reimbursement.** Generally, as the business park is built out, Panattoni will be responsible for 50% of the cost of the frontage improvements along South 216th Street and 24th Avenue South as required by the City's Comprehensive Transportation Plan and the Des Moines City Code. Instead of each individual property owner constructing the improvements, the City accepts in-lieu cash payments and in turn assumes responsibility for actual construction of the required frontage improvements. Typically, these in-lieu payments are due when building permits are issued for construction fronting on these two streets. However, given the business park's substantial frontage along both streets and the magnitude and complexity of the Gateway Project, completing construction in incremental stages would be significantly more costly than widening the streets as one integrated project. Consequently, the City requested that the Port make an advance payment of all in-lieu fees that will become due as the business park is built-out in order to minimize the overall cost of the Gateway Project and to assist the City in securing the state and federal grants needed to complete the Gateway Project.

  Pursuant to the second development agreement, the Port paid $6 million to the City in 2013. The City discounted the amount due from $9.1 million to $6 million in consideration of the Port's early payment. The option agreement requires Panattoni to reimburse the Port for the $9.1 million undiscounted amount. Panattoni would have otherwise paid this amount directly to the City as a condition of the City issuing building permits for the business park project. The reimbursement due for each phase will be amortized over seven years at an 8% annual interest rate. Panattoni will make monthly payments until the total reimbursement due for that phase is fully repaid.

KEY GROUND LEASE PROVISIONS

A draft of the proposed ground lease agreement is included as **Attachment 2**. The proposed terms of the ground lease include:

- **Term.** The initial term of the ground lease is 55 years. Panattoni will have two, 10-year options to extend the initial term to a maximum of 75 years.

- **Leased Premises.** The ground lease covers all 87 acres of the business park site. The site includes about 66 fully usable acres, 12 acres needed for streets and storm water facilities, and 9 acres of environmentally sensitive areas (steep slopes and wetlands) along the western boundary of the site that are unbuildable. The streets and storm water facilities will become public improvements upon completion and will be deeded or dedicated to the City for long-term maintenance consistent with City code.

- **Rental Rate.** Upon completion of the first phase improvements, Panattoni will pay $0.53 per land square foot per year triple net for the fully usable property and $0.04 per land square foot per year for the environmentally sensitive areas property. During construction, Panattoni will pay the option payment rate of $0.04 per land square foot per year. The base rent rate for the usable property for each successive phase will increase by $0.02 per land square foot per year. The annual base rent payments total about $600,000 beginning in 2015, rise to approximately $1.1 million in 2017, and then to about $1.65 million in 2019 upon full build-out of the project. On a nominal basis over the initial term of the lease, the base rent payments total approximately $115 million.

- **Rental Rate Adjustments.** The base rent rate will increase by 10% every five years.

- **Fair Market Value Adjustments.** At years 26, 36, 46 and for the two, 10-year options to extend the initial term, the site will be re-appraised and the base rent will be adjusted to the then-current fair market value rental rate. However, the reset base rent rate cannot be lower than 90% of the then current rate or greater than 110% of the then current rate.

- **South 208th Street Rent Credit.** This street is the northern boundary and access point for Panattoni's project and will also provide access to the Port's property immediately north in the City of SeaTac. The Port and Panattoni will evenly split the design and construction costs for this street. The Port will provide Panattoni with a rent credit for its

50% share in an amount not to exceed $450,000. The final amount will be settled before the ground lease is executed.

- **Operating Expenses.** The ground lease will be an absolute net lease to the Port. The base rent due to the Port will be free of all charges and deductions. Panattoni will pay all the costs and expenses incurred with respect to the operation and maintenance of the site.

- **Property Condition; Hazardous Substances.** The Port will deliver the site to Panattoni in its "as is" condition. The Port will be responsible for any contamination existing on the site prior to the lease. The lease provides for establishing a pre-lease environmental conditions baseline and a work plan to appropriately manage any contamination discovered during construction. The lease also outlines a site investigation process at the end of Panattoni's tenancy to address any environmental liability issues after Panattoni vacates the premises.

- **Security Deposit.** Panattoni will pay a security deposit equal to one year of base rent.

- **Assignment/Subletting.** Assignment and subletting are generally prohibited without the Port's prior written consent. However, Panattoni may assign or sublease to an affiliated entity.

- **Mortgage Financing.** Any mortgage will be subject and subordinate to the Port's rights in the lease and the leased premises.

- **Brokerage Commission.** The Port will not pay any brokerage commissions in connection with the ground lease.

KEY DEVELOPMENT AGREEMENT PROVISIONS

A draft of the proposed second development agreement is included as **Attachment 3**. Panattoni will assume the Port's obligations under the development agreement as provided for in the proposed option agreement. The proposed terms of the development agreement include:

- **Transportation Impact Fees.** In consideration of the Port's early payment of all frontage improvement in-lieu fees, the Port will not be required to pay transportation impact fees that may otherwise be due for the duration of the second development agreement. Other mitigation identified in the EIS will be required as the business park is built out.

- **Access and Internal Roadways.** Panattoni will construct three new streets, South 208th, South 211th, and South 214th Streets. Upon completion, each will be dedicated to and maintained by the City as public streets.

- **Stormwater Management.** Panattoni will construct two storm water facilities to address surface water runoff. Per City code, both storm water facilities will be deeded to the City upon completion and maintained by the City.

- **Duration and Termination.** The second development agreement will remain in effect for 15 years unless the term is extended, the business park is fully developed, or the agreement is terminated.

- **Vesting of Development Regulations.** All development regulations that govern development of the business park and are in effect when the City approves the development agreement will vest for the 15-year term, subject to the City's authority to impose new or different regulations to the extent necessary or required to address a threat to public health or safety. In addition, compliance with the International Building Code, the City's street design and construction standards, and other regulatory codes adopted by the state and county may preempt the development regulations in effect as of the date Panattoni submits a particular development application to the City for review.

FINANCIAL IMPLICATIONS

The initial base rent rate of $0.53 per land square foot per year triple net represents a 9% return on land valued at $6 per square foot, the average value assumed by the proposals received as part of the RFP process.

As mentioned above, the annual base rent payments total about $600,000 beginning in 2015, rise to approximately $1.1 million in 2017, and then to about $1.65 million in 2019 upon full build-out of the project. On a nominal basis over the life of the lease, the base rent payments total approximately $115 million. The option payments total about $344,000 on a nominal basis.

The $6 million frontage improvements in lieu payment has been accounted for as a prepaid permit fee and recorded as an asset. As the reimbursements become due, the prepaid permit fee will be reduced, and the Port will recognize both operating revenues and operating expenses. Upon successfully leasing out the entire business park, the Port will have recognized at least $9.1 million in operating revenues (depending on the actual timing of Panattoni's repayment) and $6 million in operating expenses. From an accounting standpoint, if Panattoni does not lease the entire business park site (and the Port is unsuccessful in otherwise leasing any remaining portion), a loss will be incurred to write off any of the remaining prepaid amount.

Budget Status and Source of Funds: Funding for the Port's actual out-of-pocket expenses associated with the ground lease will occur over several years and will be included in the Airport's operating budget. The option agreement provides that Panattoni will reimburse the Port for up to $200,000 for these costs.

Financial Analysis and Summary:

CIP Category	Revenue/Capacity Growth
Project Type	Business Expansion
Risk adjusted discount rate	8%
Key risk factors	Panattoni fails to make its rent payments or otherwise defaults under the ground lease terms.
Project cost for analysis	The Port's out-of-pocket expenses from the proposed transaction will accrue over several years. These expenses largely consist of owner's representative services associated with construction coordination and are anticipated to total less than $200,000. The proposed rent credit of up to $450,000 for construction of S. 208th Street has been included in the analysis. The Port has prepaid $6 million in permit fees which Panattoni will reimburse.
Business Unit (BU)	Commercial Properties
Effect on business performance	Funding for the Port's out-of-pocket expenses is included in the Airport's 2014 operating budget and will be included in subsequent operating budgets.
IRR/NPV	The total NPV of the proposed transaction is approximately $25 million. This amount includes option payments of $267,000, lease revenue of $18 million and reimbursement of permit fees of $7 million.
CPE Impact	To the extent net revenues from this project generate positive cash flow and the airport is otherwise generating cash flow in excess of 1.25x debt service coverage, CPE would be reduced through revenue sharing.

STRATEGIES AND OBJECTIVES

The proposed transaction supports the Airport's goal to increase non-aeronautical revenue. Additionally, Panattoni expects that some of the tenants in the business park will be air cargo related, which supports the Century Agenda strategy to position the Puget Sound region as a premier international logistics hub by, in part, tripling air cargo volume to 750,000 metric tons.

TRIPLE BOTTOM LINE

Economic Development

At full build-out, the project is expected to generate approximately 1,600 direct jobs and 350 jobs during construction. The project is projected to yield $6.1 million in annual state and local tax revenue (including $1.2 million per year for the City), $338 million annually in gross receipts, and $114 million annually in employee earnings, all in constant 2014 dollars. One-time state and local tax revenue is estimated to total about $8.5 million, with approximately $750,000 going to the City.

Panattoni anticipates investing a total of approximately $117 million in building out the business park. During the first phase, Panattoni will invest about $40 million and will create about 600 permanent jobs and 139 construction jobs.

Environmental Responsibility

The proposed option and ground lease agreements include language that encourages Panattoni to integrate sustainable development elements in the planning, design, construction and operation of its improvements to the extent such elements are technically and financially practical. The proposed second development agreement calls for the use of "low impact development" features in the design and operation of the storm water management facilities. In addition, the second development requires the impacts associated with filling five small wetlands that total than a quarter of an acre be mitigated by creating new wetland areas along the western boundary of the site that are not otherwise buildable.

Community Benefits

The business park project is the culmination of several years of collaboration between the Port and City. Since 2005, the Port and City have cooperated in completing a conceptual master plan, an EIS, and a first development agreement to position the business park site for redevelopment.

The second development agreement requires construction of a new pedestrian and bicycle trail that will ultimately connect to the City's existing Barnes Creek and Des Moines Creek trails.

ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS

The following alternatives were considered:

- **Alternative 1: Do Nothing:** The Port does not enter into the option, ground lease and development agreements. The site would be available for future lease or sale to another party. Neither the Port nor the City receive any near-term revenue and other economic benefits under this alternative. This is not the recommended alternative.

- **Alternative 2: Sell the Site:** The Port sells the site. This alternative would trigger FAA reimbursement obligations, because the Port used FAA noise grants to acquire the business park site. Any sale, unlike a lease, would require the Port to either reimburse the FAA with approximately 80% of the sale proceeds, or place the proceeds in escrow pending the FAA's approval to use for another FAA grant-eligible project. This is not the recommended alternative.

- **Alternative 3: Lease the Site:** The Port enters into the option, ground lease and development agreements. This alternative results in the revenue and other economic benefits for the both the Port and the City as described above. This is the recommended alternative.

ATTACHMENTS TO THIS REQUEST

- Attachment 1 – Draft Option Agreement
- Attachment 2 – Draft Ground Lease
- Attachment 3 – Amended and Restated Second Development Agreement
- PowerPoint presentation

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

There are no previous commission briefings or actions specifically related to the proposed option and ground lease agreements with Panattoni. However, previous Commission actions or briefings related to the business park project include:

- 06/05/2012 - Commission authorized the execution of the second development agreement with the City and a ground lease with Puget Sound Energy.

- 11/09/2010 - Commission passed Resolution No. 3646 at second reading, surplusing right of way needed by the City.

- 11/02/2010 - Commission authorized acquisition of the abandoned streets within the business park site and passed Resolution No. 3646 at first reading, surplusing right of way needed by the City.

- 07/22/2008 - Commission authorized execution of the first addendum to the first development agreement with the City.

- 02/27/2007 - Staff briefing on progress on the business park project.

- 06/08/2006 - Staff briefing on the completed conceptual master plan.

- 08/23/2005 - Commission authorized preparation of the conceptual master plan.

- 06/28/2005 - Commission authorized the execution of the first development agreement with the City.