PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6e

Date of Meeting July 1, 2014

DATE: June 26, 2014

TO: Tay Yoshitani, Chief Executive Officer

FROM: Michael Burke, Director, Leasing and Asset Management

SUBJECT: Lease Termination Agreement for Terminal 5 and related amendments to crane and lease agreements for Terminal 18 and Terminal 30.

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to (1) execute the Terminal 5 Lease Termination Agreement with Eagle Marine Services, Ltd. (EMS); and (2) execute amendments consistent with the draft letter of intent in the attached exhibits to the Terminal 18 Crane and Terminal leases with SSA Terminals LLC (SSAT) and Terminal 30 lease with SSA Terminals (Seattle), LLC (SSAT-Seattle) due to negotiations associated with the Most Favored Nations (MFN) clause in the respective Terminal leases triggered by the Port's Terminal 46 lease extension with Total Terminals International LLC (TTI).

SYNOPSIS

With the upsizing of vessels calling in the Pacific Northwest by the G6 shipping alliance, most of the container business currently being handled at Terminal 5 can no longer call at that terminal due to the size of the container cranes there. The crane size cannot be increased without a significant structural rebuild of the dock. With larger vessels, any major dock upgrade project would significantly limit vessel activity during construction. The current tenant at Terminal 5, Eagle Marine Services, Ltd. (EMS), would like to transition operations to Terminal 18.

Container operations at Terminal 5 currently generate over 5,000 direct, indirect, and induced jobs for the region. Almost all of these jobs would be preserved if the container business stays in the Port of Seattle. In order to preserve this business activity, and the related jobs, staff proposes that the Port execute the Terminal 5 Lease Termination Agreement with EMS, and a consent to a sublease between EMS and SSAT at Terminal 18. These agreements provide the Port a volume guarantee to keep the cargo and related benefits in Seattle. Without this guarantee, the volume could shift to other gateways such as Southern California or British Columbia. These agreements will also allow the Port to modernize the dock system at Terminal 5 for the larger container cranes needed to handle current and anticipated vessels expected to call Seattle.

BACKGROUND

Terminal 5 began operating as a container terminal in 1964. Since that time, the Port invested in significant environmental cleanup and facility improvements to create a 182 acre state of the art international container terminal, which was completed in 1997. The site is currently leased and operated by EMS, a subsidiary of American President Lines (APL). The current lease expires in 2028.

Vessels calling to the Port of Seattle have grown in size from 4,800 TEUs (twenty foot equivalent units) in 1997 to 10,000 TEUs today with 18,000+ TEUs currently operating globally. To maintain the Port's competitive position and preserve jobs, dock and infrastructure upgrades are needed to modernize the terminal for handling current and future class of container vessels including the capability for installing larger dual-hoist cranes. Construction of these improvements will significantly reduce the capacity of the terminal by limiting the terminal to only one berth for several years.

Recently, the shipping lines APL, MOL, Hyundai, OOCL, NYK and Hapag-Lloyd have formed the G6 container shipping alliance. The G6 plans to upsize the vessels calling in the PNW to the 8,000 TEU class and above. This size vessel cannot be handled with the current size cranes at Terminal 5 and EMS believes it cannot feasibly operate the terminal. EMS also faces additional costs to meet current storm water treatment regulations if the terminal remains in operation, further reducing the feasibility of remaining open. EMS has requested we work out a termination agreement of their lease. They have also indicated that a key issue in any lease settlement is how the financial accounting is handled in a long-term commitment.

EMS has previously filed an MFN claim for additional concessions from the Port related to the recent TTI Terminal 46 lease extension. While our legal analysis indicates some claims had merit and others did not, any settlement could substantially reduce the financial benefit of the current lease at Terminal 5. In addition, the current lease requires the Port to maintain five functional cranes at Terminal 5 and the existing cranes are at (or close to) the end of their useful life. Due to the current dock limitations, any replacement cranes would have to be of similar capacity to the existing cranes and thus not be able to handle the larger ships planning to call in the PNW. Replacement cost of these cranes could be $50-60 million.

Staff is proposing the Port enter into a termination agreement with EMS that is a combination of an annual termination payment and a volume guarantee for container volume in the Port of Seattle. In addition, this agreement would facilitate the Port being able to upgrade the dock and related infrastructure at Terminal 5 so that the terminal could handle the largest ships expected to call in the PNW in the future and eliminate the Port's obligation to provide five functional cranes. As part of the termination, EMS wants to enter into a sub-lease at Terminal 18 to handle the volume required by its volume guarantee.

The lease amendments for Terminal 18 and Terminal 30 are required to modify the MFN clauses in the respective Terminal 18 and 30 leases and to settle claims related to the MFN clauses for rent and cranes. As discussed in the December 6, 2012 commission memo and presentation to the Port Commission, the new land rent structure for the Terminal 46 lease with TTI required that the Port offer this new land rent structure to its other container terminal customers. Other MFN elements of the amendments are discussed further below.

SUMMARY OF PROPOSED AGREEMENT TERMS

Listed below is a summary of the key terms of the agreements.

Proposed Terminal 5 Lease Termination Agreement:

- EMS Terminal 5 Lease terminates effective July 31, 2014.
- EMS commits to a 10-year volume guarantee of 150,000 lifts per year to the Port of Seattle.
- All APL, G6, Westwood Shipping Line, and other volume from customers currently using Terminal 5 will count towards the guarantee with penalties of $75/lift for the first 50,000 lifts to $100/lift for shortfall volumes above 50,000 lifts.
- EMS also commits to a vessel call guarantee of 50 vessels per year of a size of 7,500 TEUs or greater with a penalty of $100,000 per shortfall vessel call.
- The vessel shortfall penalty payable by EMS to the Port shall not apply if the number of lifts exceeds 250,000 during the same Annual Commitment Period.
- The Port's Chief Executive Officer may exercise reasonable discretion to relieve EMS of one or more vessel call obligations based on force majeure (as defined in the SSAT Terminal 18 Lease) or dry-docking schedules of APL.
- In addition to all the normal obligations of vacating the Terminal 5 lease premises, EMS shall be responsible for cleaning out the storm water system pipelines and catch basins throughout the premises.
- EMS will transfer its industrial general stormwater permit (IGSP) to the Port, if needed, to facilitate transition of the IGSP permit when Terminal 5 resumes operations.

Proposed Terminal 18 Agreement to Sub-Lease Consent:

- SSAT will pay the Port $9,000,000 a year for 10 years. It is expected that SSAT will recover these costs from EMS as part of their sub-lease with EMS.
- The Port will be a Third Party beneficiary in the event of a default by EMS under the Sub-Lease Agreement. This will allow the Port to pursue EMS and its parent company for full financial performance.
- SSAT will be allowed to use Terminal 5 for Westwood Shipping while SSAT constructs covered storage at Terminal 18. In exchange for this temporary use, SSAT will maintain the Port cranes at Terminal 5 in a mothballed state for up to five years.

***Proposed Terminal 18 Lease Amendment*:**

- MFN land rent clause definition would be enhanced to emphasize it is only related to land rent in Elliott Bay for international container terminals. MFN clause is further amended to be a "mutual" MFN, meaning the lease rate can go both down and up for land rent if the Port's land rent at Terminal 5 and Terminal 46 (whichever is lower) increases or decreases during the remaining term of the Terminal 18 lease. SSAT can opt out of the application of the MFN clause at any time but once they do, the MFN clause for land rent is terminated and removed from the Terminal 18 lease.

- Following December 31, 2025 (expiration of the Terminal 46 lease), and every five (5) years thereafter, the rent structure for determining the per acre minimum annual guarantee (MAG) will be subject to a market rate adjustment.
- In between market rate adjustments, the land rent will increase every non-market rate adjustment year by not less than 2% regardless of CPI, and with the maximum increase capped at the lesser of the CPI increase or 5%.
- The Port and SSAT would handle stormwater infrastructure improvements to meet SSAT's current stormwater discharge requirements at Terminal 18 in the following manner:

    - SSAT will be solely responsible for compliance with its industrial stormwater permit at Terminal 18.
    - To the extent required to achieve regulatory compliance, SSAT would undertake construction of the stormwater infrastructure improvements ("SII") necessary to comply with its industrial stormwater permit at Terminal 18.
    - The Port, with regard to expenses incurred on or after June 1, 2013, would share with SSAT, calculated together, the design, and construction costs of the SII at Terminal 18 as follows:

i.	$0.00 - $10 million:	SSAT 75%; Port 25%
ii.	$10 million - $20 million:	SSAT 25%; Port 75%
iii.	$20 million and over:	SSAT 50%; Port 50%

Proposed Terminal 30 Lease Amendment:

- MFN definition enhanced to emphasize it is only related to land rent in Elliott Bay for international container terminals. MFN clause is further amended to be a "mutual" MFN, meaning the lease rate can go both down and up for land rent if POS land rent at Terminal 5 and Terminal 46 (whichever is lower) increases or decreases during the remaining term of the Terminal 30 lease. SSAT-Seattle can opt out of the application of the MFN clause at any time but once they do, the MFN clause for land rent is terminated and removed from the Terminal 30 lease.
- Following December 31, 2025 (expiration of the Terminal 46 lease), and every five (5) years thereafter, the rent structure for determining the per-acre minimum annual guarantee (MAG) will be subject to a market rate adjustment.
- In between market rate adjustments, the land rent will increase every non-market rate adjustment year by not less than 2% regardless of CPI, and with the maximum increase capped at the lesser of the CPI increase or 5%.
- No Stormwater component will be included as part of this lease amendment.

Proposed Terminal 18 Crane Amendment:

IHI cranes [three (3) Cranes numbers 51, 52 and 53]: SSAT will be able to use the IHI cranes free of charge as long as SSAT performs all necessary maintenance on the cranes. SSAT can request the Port to remove the cranes and the Port will have 12 months to do so once requested. SSAT is responsible for any tax liability related to crane use.

MHI cranes (three (3) Crane numbers 70, 71 and 72): The Port will transfer ownership of the cranes to SSAT for $1.00 a crane. The Port and SSAT will equally split the cost of any sales tax related to the transfer of ownership.

FINANCIAL IMPLICATIONS

Budget Status and Source of Funds

The proposed actions reduce sources of cash as assumed in Port's 2014 Plan of Finance and will create unfavorable Net Operating Income variances relative to the 2014 Budget and current 2014 Full Year Forecast. The following table summarizes the impact of the actions on August through December 2014 Net Operating Income for Terminals 5 and 18.

Net Operating Income $'s 000	Without Lease Termination	With Lease Termination	Change
2014 Budget (Aug.-Dec.)	$18,377	$13,584	($4,793)
2014 Forecast (Aug.-Dec.)	$16,242	$12,383	($3,859)

Note:* Forecast is lower than Budget because volumes and related crane rent and intermodal revenues are based on more current assumptions.

The proposed Terminal 18 Lease and Crane Amendments will also require the Port to contribute to the design, and construction costs of the Stormwater Infrastructure Improvements at Terminal 18 and share in any sales tax obligation for crane transfer. The extent and timing of the required investment has not yet been estimated, but this investment requirement was not anticipated in the 2014 Capital Budget.

CIP Category	Not applicable
Project Type	Not applicable
Risk adjusted discount rate	7.5%
Key risk factors	• Tenant is being released from long-term lease agreement running through August 2028 for a shorter-term volume commitment and elimination of the Port's potential obligation to provide 5 new cranes at Terminal 5. • Lower revenue will reduce the future borrowing capacity of the Seaport Division and could impact the Port's overall credit rating. Uncertainty with regard to cost of stormwater infrastructure improvements at Terminal 18 and potential stormwater related requirements at Terminal 5. • Uncertainty with regard to potential sales tax liability associated with not charging crane rent and transferring of crane ownership at Terminal 18.

Project cost for analysis	Cost of Terminal 18 Stormwater Improvements not yet estimated
Business Unit (BU)	Seaport Division – Container Operations
Effect on business performance	Following is an estimate of the incremental impacts the Terminal 5 Lease Termination and Terminal 18 Agreement to Sub-Lease will have on Net Operating Income (NOI) to the Seaport Division for 2014 through 2019: Note that impact is compared against Alternative 1 whereby Terminal 5 would be held to lease obligation through August 2028.
IRR/NPV	The incremental NPV impact of the proposed Terminal 5 lease termination and sublease with Terminal 18 is shown below. The analysis assumes that the Terminal 5 lease is held to MAG program lease rates currently in effect through August 2028, current crane minimums are in place through 2016 for fixed rate cranes and through 2019 for tariff cranes, and intermodal minimums are in effect for term of lease.

NOI (in $million's)	2014	2015	2016	2017	2018	2019
Revenue	($5.1)	($14.9)	($15.0)	($14.9)	($15.3)	($15.7)
Expenses	(1.2)	0.0	0.0	0.0	0.0	0.0
NOI	($3.9)	($14.9)	($15.0)	($14.9)	($15.3)	($15.7)

Financial Impacts vs. Alternative 1

Agreement Impact Through August 2028	NPV in $millions	Nominal $'s in $millions
Terminal 5 Termination		
Pref Use and Space Rent	($181.3)	($298.9)
Special Improve Rent	(14.9)	(23.7)
Crane Rent	(5.0)	(6.0)
IY Revenue	(6.0)	(10.0)
1st POC Payment	(4.5)	(7.2)
Stormwater Fees	(5.4)	(8.7)
Sub-Total	**($217.1)**	**($354.5)**
Terminal 18 Sublease		
Pref Use and Space Rent	4.2	9.2
Crane Rent	(3.6)	(3.8)
IY Revenue	1.5	2.7
IHI Removal Costs	1.2	1.2
Stormwater Infrastructure	(9.2)	(11.0)
Sublease Payments	66.4	90.0
Sub-Total	**$60.5**	**$88.3**
Total	**($156.7)**	**($266.1)**

The incremental NPV impact of the lease amendments for Terminal 18 and Terminal 30 for years beyond 2025 is summarized below:

Financial Impact of Change in Post 12/31/2025 Rent Structure

Agreement Impact - Jan 1, 2026 thru Aug 2, 2039	NPV in $millions	Nominal $'s in $millions
Terminal 18	($107.3)	($389.8)
Terminal 30	(38.4)	(139.6)
Total	**($145.8)**	**($529.4)**

Community Benefits

These agreements, with their volume guarantee, will help preserve the economic benefits, including the jobs that are generated by the business that has been using Terminal 5.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Do nothing and hold EMS to their lease obligations. EMS will at some point pursue actions to terminate the lease. Since EMS is not in bankruptcy, any financial settlement would likely be substantial and greater than the proposed termination settlement. This could be reduced by the value of the Port's obligation to replace cranes and any MFN claim settlement. There would be no volume guarantee and almost all of the current business at Terminal 5, and the jobs related to that business, would be lost to Seattle and potentially to the region.

Alternative 2) – Negotiate a pure financial settlement for lease termination. EMS would not want to do this immediately with the potential financial accounting issues. This alternative would look almost identical to Alternative 1 with that issue.

Alternative 3) – Proceed with the proposed termination agreement giving the Port some financial compensation and the volume guarantee to preserve the job benefits from this business. This does not resolve any MFN claims related to the Terminal 18 and Terminal 30 leases.

Alternative 4) – Proceed with the proposed termination agreement and related lease and crane agreement amendments at Terminal 18 and Terminal 30, giving the Port some financial compensation and the volume guarantee to preserve the job benefits from this business. This also settles claims related to MFN clauses for Terminal 18 and Terminal 30 leases and provides a framework for transitioning out of the MFN clauses in the future. This also allows for accommodations to help keep Westwood Shipping Lines in the Port of Seattle. ***This is the recommended alternative.***

ATTACHMENTS TO THIS REQUEST

1. Proposed Terminal 5 Lease Termination Agreement (draft) with EMS.
2. Draft Letter of Intent with SSAT related to proposed lease and crane agreement amendments.

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- May 18, 2014: Commission briefing on the dock upgrade program at Terminal 5 to make it "big ship" ready.
- December 6, 2012: Commission meeting presentation of the proposed 13th lease amendment to the Terminal 46 lease to extend the lease term, and change the land rent structure to a minimum annual guarantee of revenue per acre plus a container volume lift rate fee. This amendment also obligated the Port to certain capital improvements and maintenance items for this facility.