PORT OF SEATTLE

MEMORANDUM

COMMISSION AGENDA ACTION ITEM		**Item No.**	4d
		Date of Meeting	July 22, 2014

DATE: July 3, 2014

TO: Tay Yoshitani, Chief Executive Officer

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

SUBJECT: First Amendment to Lease with Arctic Storm Management Group at Pier 69

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute First Amendment to Lease with Arctic Storm Management Group to revise the current lease period to 12 years and three months, including an early termination and a five-year option to extend and provide Port funding of $114,000 for additional tenant improvements plus $65,643 for a tenant broker commission fee.

SYNOPSIS

The lease amendment would provide the tenant with a longer initial term of 12 years, three months vs. five years, three months, revising the lease expiration date to May 31, 2022, and provide an option to extend for five years. It would also provide Port funding of $114,000 for a tenant improvement allowance to refresh the premises that would include but not be limited to new carpet and paint. The amendment would include a termination period commencing in year 11 up to six months prior to the lease expiration date of May 31, 2022. Arctic Storm Management Group (ASMG) may sell their business after year ten and it would be of benefit to have the additional term to solicit for a buyer. ASMG has requested the option to extend their lease for five years either for themselves or for the potential buyer to occupy in an established location of the business at Pier 69.

Port staff proposes a First Amendment to the lease to provide changes to the initial lease as described in Attachment A to this memo.

BACKGROUND

Arctic Storm Management Group (ASMG) was formed in October 2001 and provides management services to the fishing vessels Arctic Storm Inc., Arctic Fjord Inc., Sea Storm, and Neahkahnie and has been a long-term customer of the Port, mooring vessels at other Port properties. ASMG employs approximately 400 people on an annual basis and currently employs 25 people at Pier 69. Annual wages for their entire operations fluctuate depending on the value of the catch. ASMG is forecasting annual wages in excess of $20,000,000 for 2014. ASMG practices conservation and sustainability of the fisheries in which they participate, including participation in the Sea Processors Association, Marine Stewardship Council, Genuine Alaska Producers, and Sea Share. ASMG has been a tenant at Pier 69 since June of 2010. ASMG's current lease expires May 31, 2015, unless ASMG provides written notice to the Port to exercise its option to extend for five years no later than September 30, 2014.

ASMG, through their broker, approached Port staff to discuss their desire for a potential sale of their business beyond the five-year option period provided in their current agreement and have requested the following:

a) to modify the existing five-year option to extend to become a seven year option to extend;
b) an early termination period of 18 months commencing in the sixth year of the modified seven-year option to extend;
c) an additional, second option to extend for five years;
d) a Port contribution of $114,000 toward the cost to refresh the premises, primarily for new paint and carpet to be installed sometime within the modified seven-year extension period; and
e) reduction of the current security deposit obligation from $125,258 to $75,004.

Port staff negotiated amending the existing term, which expires May 31, 2015, to add seven years to the initial term under their current agreement for a revised term of 12 years and three months, expiring May 31, 2022, and provided a new first option to extend for an additional five years.

MARKET CONDITIONS

Under ASMG's current agreement, the rent for the first option to extend period is to be negotiated at a fair market rate. To determine the fair market rate, the Port referred to an existing appraisal from the recently negotiated lease with Clipper Navigation (CNI); and which was from services of a real-estate appraisal firm engaged through our IDIQ contract. The Port considered the appraisal for CNI since ASMG and CNI each have similar administrative office and storage/warehouse uses. The Port staff negotiated a fair market rate of $21.50 per rentable square feet for the office and $6.81 per rentable square feet for the storage/warehouse. Annual rent increases of $.50 for the office and 3% for the storage/warehouse are included to keep the rent within the range of market rates through the modified initial term. The rent for the first option to extend period will be negotiated to the then fair market rate.

FINANCIAL IMPLICATIONS

Project Cost Breakdown	This Request	Total Project
Tenant Improvement Allowance	$114,000	$114,000
Tenant Broker Commission	$65,643	$65,643
Total	$179,643	$179,643

Budget Status and Source of Funds

Of the expenses listed above, only the first half of the broker commission, in the amount of $32,822, will be paid in 2014. It is expected that lower spending on other budgeted broker commissions will offset this unplanned 2014 expense. Both the remaining broker commission and the entire tenant improvement allowance will be paid in 2015. These expenses will be included in the 2015 operating budget.

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 totaling $75,004 (reduced from the previous $125,258 requirement)
Good standing status as a current tenant of the Port
Risk of early termination, which is partially mitigated by:
Termination fee of $76,771 (3 months’ rent)</td></tr>
<tr><td>Project cost for analysis</td><td>$179,643</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 First Amendment of this lease on Net Operating Income (NOI) for Year 2014 through Year 2018:
<table>
<tr><th>Incremental Incr/(Decr)
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>$0</td><td>$159</td><td>$276</td><td>$283</td><td>$290</td></tr>
<tr><td>Expense</td><td>$33</td><td>$147</td><td>$0</td><td>$0</td><td>$0</td></tr>
<tr><td>NOI</td><td>($33)</td><td>$12</td><td>$276</td><td>$283</td><td>$290</td></tr>
</table>
Incremental revenue is generated by extending the original lease term an additional 7 years, for a total term of 12 years and 3 months. Incremental expense is generated by the Tenant Improvement allowance (paid in 2015) and the Broker Commission (first half paid in 2014, second half paid in 2015).

Note that the table above captures only the first five years of incremental impacts, which continue through May 31, 2022.</td></tr>
<tr><td>IRR/NPV</td><td>Assuming the tenant stays for the full term of the amended lease, which expires May 31, 2022:
<table>
<tr><th>NPV
(in $000's)</th><th>IRR
(%)</th><th>Payback
Years</th></tr>
<tr><td>$1,357</td><td>NM</td><td>1</td></tr>
</table>
If tenant exercises its right of early termination during the allowed period of June 01, 2020, through November 30, 2021:
<table>
<tr><th>NPV
(in $000's)</th><th>IRR
(%)</th><th>Payback
Years</th></tr>
<tr><td>$1,019</td><td>NM</td><td>1</td></tr>
</table>
The NPVs are based on incremental net cash flows generated by the lease and do 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 “Market Conditions.”</td></tr>
</table>

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Should the Port not enter into a First Amendment to Lease, ASMG may exercise their option under the current agreement to extend for five years. However, the Port would risk losing ASMG or its potential purchaser as a longer term tenant. The Port would also lose the potential revenue related to the additional two years of the extended initial term. The tenant and/or buyer may choose to relocate operations leaving the space vacant for the Port to secure a new water-dependent tenant. The Port would incur loss of revenue during the down time to secure a new water-dependent tenant, costs for broker commissions and concession fees such as abated rent and higher tenant improvement costs. This is not the recommended alternative.

Alternative 2) – Port staff proposes to enter into a First Amendment to Lease that would provide additional revenue to the Port for seven years. The additional two years would allow ASMG time to solicit and sell to another water dependent tenant during which time the Port, should ASMG vacate, would receive a termination fee of $76,771, which is equivalent to three months of the June 2020 rent. Two alternatives are possible should ASMG be successful in selling their business: 1) ASMG would assign the lease to the purchaser and purchaser would exercise the First Option to Extend, 2) ASMG would terminate the lease after year 11, paying a termination fee of $76,771. 3) It is also possible, should ASMG not acquire a purchaser, ASMG would exercise the First Option to Extend under the new First Amendment to Lease and continue to occupy. By ASMG securing an Assignee, the Port would benefit by not incurring a broker commission or concession fee such as abated rent or the cost for additional tenant improvements. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- First Amendment to Lease
- Attachment A

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- February 23, 2010 – The Commission approved for the Port to enter into a new Lease with Arctic Storm Management Group for a term of five years and three months with one five-year option to extend and Port funded tenant improvements in the amount of $228,000.00.