

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6e
Date of Meeting September 11, 2014

DATE: September 3, 2014
TO: Tay Yoshitani, Chief Executive Officer
FROM: Mark C. Griffin, Director Real Estate Development
W. Allan Royal, Manager Real Estate Development

SUBJECT: Option to Ground Lease - Credit Lease Investments LLC

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute, substantially consistent with the terms described in this memorandum, an option to ground lease agreement for an approximately 20-acre site in the City of SeaTac with Credit Lease Investments LLC or an affiliated entity.

SYNOPSIS

The federal General Services Administration (GSA) has published a request for lease proposals (RLP) to lease approximately 300,000 square feet of Class A office space to house the Federal Aviation Administration's (FAA) regional headquarters.

Staff proposes to enter into an option to ground lease agreement with Credit Lease Investments LLC (CLI). The option agreement grants CLI the right to ground lease an approximately 20-acre site at the northwest corner of 28th Avenue South and South 200th Street in the City of SeaTac to build the space needed for the FAA project. CLI may exercise the option only if the GSA selects the site and CLI for the FAA project.

BACKGROUND

Earlier this year, the GSA restarted the process to secure a new lease for the FAA after putting the project on hold in 2010 due to budget and other issues. This new procurement for a 20-year lease has been fully approved and funded by Congress and the federal Office of Management & Budget.

The GSA is considering both existing buildings and new, build-to-suit facilities for the 300,000 rentable square feet requirement, a smaller requirement than the 2010 solicitation. Also, unlike the 2010 procurement, the acceptable geographical area now includes downtown Seattle in addition to several South King County cities, including SeaTac, Des Moines, Renton, and Kent. Occupancy of the new space must be completed by August 1, 2017. The project will house about 1,600 FAA employees.

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The GSA will make its selection based on the overall value to the FAA. The GSA's decision will include both price and non-cost factors. Among the non-cost factors that will be considered are proximity to mass transit, a high level of site security, and achieving a LEED Gold standard in the project's design.

The GSA has informed staff that the Port's proposed site is capable of meeting the project's minimum requirements. The Port's 20-acre site is directly across 28th Avenue South from Sound Transit's Angle Lake light rail station that is currently under construction and scheduled for completion in 2016.

In June, staff issued a request for qualifications (RFQ) to identify developers interested in optioning to the Port's proposed site and capable of delivering the FAA project. CLI responded to the RFQ. CLI's track record includes the successful completion of several similar projects for GSA across the country. CLI needs control of the Port's site by way of the proposed option agreement to complete its lease proposal to the GSA.

The proposed FAA project synchs nicely with the collaborative planning staff is engaged in with City of SeaTac staff. City staff is in midst of preparing a station area plan for the Angle Lake station area that will encourage transit-oriented development on the Port's proposed site and other properties in close proximity to the new Angle Lake station. The City is also acquiring right-of-way (including some from the Port) and finalizing design to begin construction on the extension of 28th Avenue South, south to the boundary with the City of Des Moines. The FAA's offices would be an excellent use to capitalize on the infrastructure under construction in the area. The GSA's August 1, 2017, occupancy date, however, will likely be a challenge for CLI and other interested developers proposing build-to-suit projects, particularly given that the GSA doesn't anticipate final award of the project until the end of March 2015.

KEY OPTION PROVISIONS

A draft of the proposed Option to Ground Lease Agreement is included as **Attachment 1**. The proposed terms of the option agreement include:

1. **Optionee; Assignee.** CLI is the optionee under the option agreement. CLI expects to assign its interest in the option to an affiliated entity.
2. **Optioned Area.** The optioned area covers an approximately 20-acre site located at the northwest corner of 28th Avenue South and South 200th Street in the City of SeaTac.
3. **Term.** The term is one year beginning upon execution of the agreement.
4. **Exercise of Option.** The option may be exercised only if the GSA chooses CLI and the site for the FAA project.
5. **Option Fee.** The option fee is a non-refundable, one-time payment of \$8,727.00 payable upon execution of the agreement.

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KEY GROUND LEASE PROVISIONS

The key terms of the proposed ground lease are summarized in Exhibit B of the proposed option agreement. The key terms include:

1. **Term.** The initial term of the ground lease is 22 years with ten 5-year options to extend plus one additional three-year option for a maximum term of 75 years.
2. **Leased Premises.** The ground lease covers the same area as the option agreement.
3. **Commencement Date:** The term will commence upon execution of the ground lease.
4. **Base Rent.** Base Rent will begin on the commencement date as follows:
 - a. **During Construction.** From the commencement date to substantial completion of the project, not to exceed 24 months, monthly base rent shall be approximately \$5,880 per month (10%) of the Post Construction Base Rent rate or Eight and One One-Hundreds Cents (\$0.081) per land square foot per year - Triple Net (NNN) (meaning Tenant is liable for Taxes, Insurance and Maintenance).
 - b. **Post Construction.** From substantial completion of the project to five years from such date, \$58,806 per month. This amount equals Eighty-One Cents (\$0.81) per land square foot per year NNN. This amount represents an eight percent (8%) annual return on a \$10.17 per square foot land value for the property.
 - c. **Rent Adjustments.** Adjustments to the monthly base rent will occur at the beginning of the 8th year of the ground lease and every five years thereafter (years 13, 18, etc.). Upon each adjustment date, the monthly base rent will be increased by five percent (5%) per year compounded annually compared to the prior 5-year period.
 - d. **FMV Re-appraisals.** At the beginning of the 23rd agreement year and any extension options that CLI exercises, 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 the then current rate or greater than 110% of the then current rate.
5. **Operating Expenses.** The ground lease will be an absolute NNN lease. The base rent due to the Port will be free of all charges and deductions. CLI will pay all the costs and expenses incurred with respect to the operation and maintenance of the site.
6. **Property Condition; Hazardous Substances.** The Port will deliver the site 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.
7. **Security Deposit.** CLI will pay a security deposit equal to one year of base rent.

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8. **Assignment/Subletting.** Assignment and subletting are generally prohibited without the Port's prior written consent. However, CLI may assign or sublease to an affiliated entity.
9. **Mortgage Financing.** Any mortgage will be subject and subordinate to the Port's rights in the lease and the leased premises.
10. **Brokerage Commission.** The Port will not pay any brokerage commissions in connection with the ground lease.

FINANCIAL IMPLICATIONS

The initial, post-construction base rent rate of \$0.81 per land square foot per year triple net represents an 8% return on land valued at \$10.17 per square foot.

The annual base rent payments total approximately \$70,000 beginning in 2015 and increase to about \$700,000 annually in 2017 upon build-out of the project. On a nominal basis over the initial 22-year term, the base rent payments total \$21 million. If all options are exercised, nominal base rent payments would total \$440 million.

Budget Status and Source of Funds: Funding for the Port's actual out-of-pocket expenses associated with the option agreement will be included in the Airport's operating budget. The option agreement provides that CLI 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	7%
Key risk factors	CLI fails to make its rent payments or otherwise defaults under the ground lease terms.
Project cost for analysis	The Port's expenses from the proposed action will accrue over several years. These expenses consist of owner's representative services for construction coordination and are anticipated to total less than \$200,000. CLI has agreed to reimburse the Port up to \$200,000 for Port's direct costs. For purposes of the financial analysis, no Port costs were assumed.
Business Unit (BU)	Commercial Properties
Effect on business performance	Funding for the Port's out-of-pocket expenses will be included in the Airport's 2015 operating budget and will be included in subsequent operating budgets.
IRR/NPV	NPV: \$8.9 million for the initial term, \$21.1 million including all option terms. IRR: N/A (based on the assumption of zero Port costs)
CPE Impact	Any net positive cash flow, as long as the airport is generating cash flow in excess of 1.25x debt service coverage, contributes to lower CPE due to revenue sharing.

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STRATEGIES AND OBJECTIVES

This action will support the Airport objective to “maximize non-aeronautical net operating income consistent with current contracts, appropriate use of Airport properties and market demand.”

TRIPLE BOTTOM LINE

Economic Development

The FAA project will create a large number of construction jobs during the two years of construction and will act as an anchor tenant for the future development of Port property along 28th Avenue South.

Environmental Responsibility

The GSA requires the building to be certified LEED Gold, which will help ensure a quality and environmentally friendly development.

Community Benefits

The proposed facility will house 1,600 staff that will be new consumers for the existing businesses. The project may also help spur new development opportunities.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Do Nothing – The FAA project would be located somewhere else in the region, but there would be no new non-airline revenue from the project and an ideal anchor for the future development along 28th Avenue South would be lost. This is not the recommended alternative.

Alternative 2) – Proceed with the proposed option agreement with CLI to enable CLI’s lease proposal to the GSA. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- Computer slide presentation
- Attachment 1 - Option to Ground Lease Agreement

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- None