

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6b
Date of Meeting October 28, 2014

DATE: October 21, 2014
TO: Theodore J. Fick, Chief Executive Officer
FROM: James R. Schone, Director, Aviation Business Development and Management
Deanna Zachrisson, Business Leader, Airport Dining and Retail
Wayne Grotheer, Director, Aviation Project Management Group
SUBJECT: Airport Dining and Retail Infrastructure Modifications (CIP #C800638)

Amount of This Request:	\$2,801,000	Source of Funds:	Non-Aero Revenues
Est. Total Project Cost:	\$17,353,000		
Est. State and Local Taxes:	\$1,020,000		

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to 1) authorize design for the infrastructure modifications associated with the redevelopment of the Airport Dining and Retail program in the amount of \$2,801,000; 2) transfer scope and budget of \$3,400,000 for two elevators pits from this project (CIP #C800638) to the Checked Baggage Recapitalization/Optimization project (CIP #C800612); and 3) transfer design authorization in the amount of \$375,000 from this project (CIP #C800638) to the Checked Baggage Recapitalization/Optimization project (CIP #C800612). The total cost of the project is \$17,353,000.

SYNOPSIS

The Airport Dining and Retail program plays a significant role in advancing the region as a major tourism destination and business gateway, as envisioned in the Port's Century Agenda. It plays a critical role in the Airport becoming one of the very best in customer service experience, as well as generating increased non-aeronautical revenue and new business and employment opportunities. Currently, the program is the second largest generator of non-aeronautical revenue. The Port aims to grow revenues to \$64 million in 2025, a 94% increase over current revenues. Employment is forecast to grow by approximately 650 new jobs or a 40% increase, and provide many new business opportunities.

This kind of growth in revenues, business opportunities and jobs is only possible if the Airport is able to meet future passenger needs for food service, convenience retail, specialty retail, duty free and passenger services. In order to meet these needs, the Port must make a number of

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coordinated changes to the space configuration and supporting infrastructure in current and future Airport Dining and Retail locations. The scope of the changes fall into three categories: 1) access infrastructure to undeveloped space, 2) reconfiguration of existing space, as well as 3) new and/or changed utilities to spaces. The Port's consultant for the Airport Dining and Retail program master plan has analyzed the proposed improvements in detail with considerations of future anticipated enplanement levels, reasonable sales projections and percentage rent. This analysis indicates that the total investments will lead to a positive financial return to the Port. The investment will also lead to a continued high standard of customer service, increased business activity and employment growth.

The current request is for design funding only. Airport staff anticipates seeking authorization for construction funding for Phase I in early 2015. In 2015, redevelopment shifts into implementation in conjunction with the first lease expirations and new competitive tenant selection processes.

BACKGROUND

This project supports the Port's Century Agenda goal to "advance the region as a leading tourism destination and business gateway" by providing an extraordinary customer experience at the Airport. The project also supports the Aviation Division's strategic goal to operate a world-class international airport and increase non-aeronautical revenue. In addition, the pursuit of this redevelopment is consistent with guidance provided by the Commission in February 2012. This guidance included reinforcement of a Northwest sense of place, competition for opportunities in flexible processes, support for employment continuity, growth in small, local and disadvantaged business participation, as well as a continuation of the Airport's 'street pricing' policy.

On May 27, 2014, Airport staff presented the analysis and planning portions of the overall airport dining and retail master plan. This plan is the roadmap for the redevelopment of the program over the next several years, including new leasing. A key element of a master plan effort is the forecasting of future passenger demand in every part of the Airport, for every type of expected offering. That anticipated future demand drives a determination of the amount of square footage that is required to meet that demand. In many parts of the Airport, the amount of required square footage is more than the amount of available square footage. This is a common phenomenon in airports, which are challenged to meet a large number of facility needs for airline operations.

The total terminal footprint of the Airport is nearly 3.2 million square feet. The Airport Dining and Retail program is extremely space constrained with approximately 163,000 square feet for 92 locations. As a point of comparison, a retail center such as Seattle's Pacific Place has 335,000 square feet for its 60 locations. In an airport, tenants do not pay rent based on the size of the space they occupy, rather rent is based on the amount of gross sales generated from a space. This means that it becomes the challenge of the airport landlord to create commercial spaces that maximize revenue potential in the least amount of space. As a result, the physical redevelopment of program square footage is focused on providing the space and supporting

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infrastructure to meet future passenger demand, and maximizing very limited square footage for its highest and best use.

The current redevelopment represents the first time the Airport staff has been able to take a comprehensive evaluation of every square foot of space for dining and retail since the end of the master concessionaire era in 2005. This master planning effort, underway since 2012, has provided the opportunity for Airport staff to look at each individual area of the terminal, and carefully evaluate the use of space. As a result of this evaluation, there are a number of instances where the current space use needs to change in order to make best use of the space for its location.

Most typically this means conversion from a food service use to a retail use, or vice versa. However, there are instances where a current commercial space will be converted to another passenger amenity such as a children's play area. Some spaces will remain in the same type of use, but the current configuration of the space is not operationally efficient and as a result cannot maximize its ability to service passengers and generate revenue.

There also is the potential to meet future passenger needs in currently undeveloped space. The most significant opportunity is in the Central Terminal, where upper level mezzanine space was created for future development, but without the public elevator and stair access needed. This space remains vacant and cannot be developed without the means for the public to access it.

Both in the case of newly developed and re-aligned commercial use, there are requirements for utility infrastructure such as mechanical, electrical, water/sewer and data communications that must be provided or relocated. There are also a number of instances where infrastructure is known to be inadequate in light of anticipated future use.

Public Access Infrastructure for Undeveloped Space

The most significant investment is the recommended installation of elevator and stair access to the mezzanine level above the existing food service locations in the Central Terminal (see Exhibit B). The mezzanine level square footage was built with the intent of future expansion as part of the Central Terminal Expansion project that was completed in 2005.

The south mezzanine is 6,103 square feet of undeveloped space. The north mezzanine has 4,193 square feet of undeveloped space, while 793 square feet already functions as kitchen space for Anthony's Restaurant. Neither mezzanine level has public access; however, both have access via non-public service and freight elevators. The space was created for future use, as it was not initially needed for dining development when originally built.

Installation of public elevators and stairs for access to the mezzanine level requires careful coordination with the Baggage Optimization Project on the level directly below the Central Terminal. A passenger elevator requires an elevator pit that extends into the space below where the new baggage screening system will be built. If elevator access is not installed now, it will be

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prohibitively expensive and disruptive, once the screening system is in place, to add this infrastructure later. Without public access to the mezzanine, this square footage cannot be developed for commercial use.

The project includes the installation of elevators and elevator pits on both sides of the atrium. The work would begin on the south side of the atrium in conjunction with the closure of two quick serve units in September 2015 with anticipated completion in June 2016. Tenant build-out of the mezzanine level restaurant would commence thereafter. The north elevator construction will be planned to coincide with the tenant renovation of the space in the fall of 2017 that is part of Phase II.

The program's demand analysis supports the development of mezzanine level space for full-service dining. Mezzanine level dining exists in numerous other airports and the key to its success is a strong brand name concept, an appealing visual sight line and easy access. Airport staff has studied both successful and less successful upper-level dining operations in numerous other airports, and understand how to assure successful development in the Central Terminal. The Port already has received inquiries about tenancy in this space. Airport staff believes that if properly executed from the start, and with a strong concept, the space has potential to be the next great full-service dining experience at the Airport.

Reconfiguration of Existing Spaces

There are numerous examples throughout the terminal where the configuration of a restaurant or retail location is not optimized for its intended use. In some instances, a location can be reconfigured for a new use, while in other cases the use will remain the same but with an improved unit configuration.

One of the best examples of a space re-configuration is the five food service units on the south side of the Central Terminal atrium. These units were designed to fit within a fan-shaped base building structure. The atrium storefronts contribute to the pleasant market-like feel of the atrium, but the back-of-house spaces are extremely small and very oddly shaped with multiple jogs in separating walls. The space that exists cannot be used effectively for food preparation, refrigeration and storage. The units are close to operational capacity in their current configurations, and their productivity is not sustainable in the long-term. Airport staff recommends a modification and slight expansion to the base building (see Exhibit B) in order to create the needed space for rectangular quick serve units.

Other examples include (see Exhibit B):

- The two existing anchor retail units in the Central Terminal (currently occupied by Fireworks and ExOfficio) are too small for the volume of business generated in these locations. The result is overcrowding of passengers with bags. Both of these spaces would be expanded.

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- In Concourse C near Gate C10, there are two existing dining and retail spaces separated by a 236 square foot hallway and an abandoned airline break room. This space would be reconfigured to include the space into one of these existing units in order to create contiguous and fully utilized space.
- Demand for post-security food service exceeds readily available space. In order to create more post-security food service, another reconfiguration entails turning the entrance of a restaurant that currently opens to the pre-security side to the post-security side. This also involves relocation of utilities.

There are a total of 25 locations that are slated to undergo some form of unit reconfiguration.

Modification and/or Installation of Support Utilities

The work in this category is a collection of relatively small changes in units throughout the main terminal. All of these changes are related to the basic infrastructure needed to operate a restaurant and retail shop.

The most significant change to existing infrastructure is the cooking exhaust (grease duct) system serving the six quick serve restaurants on the south side of the Central Terminal. It has been problematic since it went into service in 2005, and it needs to be replaced with an improved system. One of the flaws of the current system is that it has a number of long horizontal grease duct runs. The most westerly unit (currently Wendy's Hamburgers) operates with an 84-foot long horizontal duct run before it turns vertical to vent out from the building. Ideally, grease laden exhaust should be vented vertically out of a building to minimize grease accumulation in ductwork and the existing system is not compliant with current building code requirements. In Phase I, Airport staff recommends removing the old system and replacing it with a liquid tight, stainless steel system that will meet building code requirements. Additionally, the two most westerly units will be converted to uses that do not require grease ducts in order to eliminate those portions of the system entirely.

Other examples include:

- Relocation of a vertical mechanical chase (a hollow section of wall in which ductwork and other building systems are run) that is located in the midst of two storefronts in the front portion of Concourse C near Horizon Air gate lobbies. In addition to impacting the visibility, this utility chase compromises the ability for travelers to enter what is slated to become the new massage services location.
- Installation of a new grease interceptor to serve new restaurant capacity in Concourse C. A grease interceptor captures grease and milk fats in waste water before it reaches the sewer treatment plant.

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- Installation of water/sewer, natural gas and data communications for the creation of a new 6,000 square foot open-air restaurant and gourmet market in an underutilized non-revenue generating space on Concourse A. Currently, there are no food service utilities to this space.

PROJECT JUSTIFICATION AND DETAILS

Airport staff recently updated the future Airport Dining and Retail program sales projections in light of recently updated enplanement forecasts through 2025. With the new program and the associated facility investments to support it, gross sales are anticipated to grow by 74%, or reach \$400 million in the year 2025, by providing added capacity in the needed locations to serve passengers. These gross sales are anticipated to generate \$64 million in revenue to the Port, an increase by 94% over current revenues.

In order to achieve this growth, the Airport must expand dining and retail capacity throughout the terminal and also change the uses of some existing units to meet specific demand. All identified changes in use as well as the development of new locations have been evaluated and have been projected to increase sales by meeting passenger demand for products and services.

Project Objectives

The objectives of this project include:

- Develop new or currently unused space or repurposing existing dining and retail space to serve passenger demand and generate additional revenue
- Reconfigure existing space to assure the ability to meet passenger demand and generate revenue
- Maximize the overall use of space in order to achieve the optimal mix of offerings in every area of the Airport
- Ensure that necessary utility points of connection and other required infrastructure are in place for each unit to support operations
- Carefully phase work that could impact ongoing revenue generation and airline operations in the terminal

Scope of Work

With the exception of the portions of work identified in the Central Terminal, this project can be characterized as a collection of smaller projects, mostly in or supporting tenant spaces, in the Airport's main terminal. As described above, the scope of this work falls into three categories.

In summary, the proposed infrastructure improvements include:

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- Providing public elevator and stair access to undeveloped restaurant space in the Central Terminal
- Reconfiguring the floor plans of specific dining and retail locations in order to improve operational efficiency and maximize revenue
- Providing new and/or modifying existing mechanical, electrical, water/sewer, grease interceptor, data communication and other points of connection to support each space

Outside the scope of this project, the Port has identified two specific facility deficiencies that are necessary to remedy in order to support expansion of the Airport Dining and Retail program, as well as Airport expansion in general. In the Central Terminal, there is a lack of adequate HVAC capacity, which Airport staff will propose to remedy in a separate capital project. In Concourse C, there is a lack of adequate electrical capacity. An expansion of this capacity also will be proposed in a separate capital project. A portion of these other investments will be borne by the revenues derived from the dining and retail program.

Schedule

Activity	Start	End
Design	November 2014	April 2015
Phase I Construction	May 2015	August 2017
Phases II and III Construction	September 2017	June 2020

The completion of Phase I work will inform subsequent phases of the work and will enable further refinement of the scope of work and schedule as each ensuing phase is better defined. In all, 3 phases of this work are anticipated to take place through the end of Q2 2020.

FINANCIAL IMPLICATIONS

Most capital investment projects have the potential to increase the Cost Per Enplanement (CPE) to the airline carriers. This project is unique due to its ability to increase additional non-aeronautical revenue which has the potential to reduce CPE. This is due to the revenue sharing provision of the current airline agreement, which provides for a 50% sharing of all net operating income above 125% of the Airport's annual debt service with the airlines.

Budget/Authorization Summary

	Capital	Expense	Total Project
Original Budget	\$10,900,000	\$0	\$10,900,000
Budget Transfer	\$939,000		\$939,000
Budget Increase	\$5,514,000		\$5,514,000
Previous Authorizations	\$190,000	\$0	\$190,000
Current request for authorization	\$2,801,000	\$0	\$2,801,000

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Total Authorizations, including this request	\$2,991,000	\$0	\$2,991,000
Remaining budget to be authorized	\$14,362,000	\$0	\$14,362,000
Total Estimated Project Cost	\$17,353,000	\$0	\$17,353,000

Project Cost Breakdown

	This Request	Total Project
Design	\$2,801,000	\$2,801,000
Construction	\$0	\$13,532,000
State & Local Taxes (estimated)	\$0	\$1,020,000
Total	\$2,801,000	\$17,353,000

Budget Status and Source of Funds

This project has been included in the 2014-2018 capital budget under CIP#C00638. The complete scope and budget has been transferred from CIP #C800706 to account for the installation of a grease interceptor on Concourse C. The budget has been increased primarily due to the addition of the central terminal elevators and stairs and communications infrastructure to the project scope. The source of funding is the Airport Development Fund and future revenue bonds. The Port anticipates issuing revenue bonds in 2015 to fund a number of projects.

Return on Investment

Most investments at the Airport are intended to directly support airline operations. The investments outlined in this proposal indirectly support airline operations by providing needed products and services to their customers as well as visitors to the Airport. However, the benefit to airline customers is only the beginning of a cycle of business activity ultimately benefiting the Airport with a healthy return on investment along with considerable positive impact on the community beyond the Airport. This impact comes through businesses locally procuring the products they need to support their business and by way of increased employment both in the short-term for design and construction jobs, as well as the long-term with at least 650 new permanent jobs.

The Net Present Value of these investments has been analyzed over a period of 20 years. Generally, these investments represent permanent changes to the facility in order to support commercial use of terminal space. The increased revenues generate a Net Present Value of over \$20 million. Even if some portion of the Central Terminal HVAC and Concourse C power upgrade projects were allocated to this project, the results would remain very positive. Over the course of the next 20 years, staff does not believe that that further major infrastructure investments will be needed in the Main Terminal to support the projected growth in program revenues.

The Airport Dining and Retail master plan includes gross sales assumptions for each anticipated location for food service, retail and passenger services which have been used as the baseline for the future return on investment. These sales assumptions through 2036 include elements for enplanement growth and sales per enplanement growth. Enplanement assumptions are derived

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from the most recent enplanement forecasts produced for the Sustainability Master Plan in September 2014.

Financial Analysis and Summary

CIP Category	Capacity/Revenue Growth
Project Type	Business Redevelopment and Expansion
Risk adjusted discount rate	7.5%
Key risk factors	<ul style="list-style-type: none">• Coordination with other construction projects• Delays in improved base building HVAC and electrical capacity to support expansion• Delays in needed leasing activity
Project cost for analysis	\$17,353,000
Business Unit (BU)	Non-Aeronautical (Airport Dining and Retail)
Effect on business performance	NOI after depreciation will increase
IRR/NPV	15%/ \$21 million
CPE Impact	Potential reduction in CPE due to revenue sharing

Lifecycle Cost and Savings

Long-term capital and operating costs will be minimized by incorporating energy and water efficient equipment and components and sustainable materials with pre- and post-consumer recycled content, wherever possible. These choices will support environmentally sustainable development and conservation. They may also reduce initial acquisition cost and long-term operations and maintenance costs.

There will be incremental maintenance costs associated with the facility-owned mechanical, water, communication, and electrical utilities added to the lease line of each unit. However, every tenant is responsible for providing ongoing maintenance for the materials and equipment within their leased area in accordance with the Port's preventive maintenance program for dining and retail.

STRATEGIES AND OBJECTIVES

This project supports the Port's Century Agenda goal to "advance the region as a leading tourism destination and business gateway" by providing an extraordinary customer experience at the Airport. The project also supports the Aviation Division's strategic goal to operate a world-class international airport and increase non-aeronautical revenue. In addition, the pursuit of this redevelopment is consistent with dining and retail specific guidance principles provided by the Commission in February 2012.

Small Business Participation

The project manager will collaborate with OSR to determine the maximum number of small business opportunities associated with this project.

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ENVIRONMENTAL RESPONSIBILITY AND COMMUNITY BENEFITS:

The Airport Dining and Retail program generates enormous benefit for the Airport and the broader community. The construction for this infrastructure work, as well as tenant construction that will follow, will employ architects and engineers for the design as well as contractors for its construction, and skilled laborers for ongoing maintenance and repairs. Building materials will be procured locally in accordance with Port environmental standards. In addition, once operators are open for business, they will continue to generate benefit for local suppliers by way of wholesale product procurement for their businesses.

One of the most significant direct benefits of a prosperous and growing dining and retail program is the number of local (and non-local) jobs that the program makes possible. Currently, there are approximately 1,600 jobs in the dining and retail program. An analysis conducted as part of the Airport Dining and Retail master plan forecasts that the program can grow job opportunities by 40%, or another 650 jobs, presuming that investments are made in order to expand square footage where possible, and make current square footage more efficient.

In addition, Airport staff will explore opportunities to re-use and/or recycle materials that will be removed from existing locations. For example, stainless steel sewer lines that will no longer be needed for certain locations, will be dismantled and reused in new locations. These sewer lines have a 50-year life span and can remain part of the Airport infrastructure. In some instances, equipment, such as walk-in refrigerators, will be removed from some units and commercially recycled or reused in new businesses outside the Airport.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Make no improvements. Such an approach is similar to deferring essential facility upgrades and/or replacement even as infrastructure becomes antiquated or reaches the end of its operational life. Without even basic sustaining upgrades, unanticipated system failures could place tenant or even Airport operations in jeopardy. In some instances, a lack of available or operationally efficient space will effectively cap the capacity to serve passengers and lead to a loss of potential sales and revenue as well as complaints from customers and a loss of reputation for the Airport. This is not the recommended alternative.

Alternative 2) – Perform only minimal upgrades. These types of upgrades would assure basic operational integrity for Airport dining and retail tenants. The scope would be limited to the reconfiguration of the quick serve units and the removal and replacement of the existing grease duct system on the south side of the Central Terminal, as well as a number of other utility upgrades to data and communications infrastructure. The estimated cost of such improvements is \$3.9 million, however, the investment would not lead to any incremental increase in sales and revenue; rather only assure that operations can continue at current levels. This is not the recommended alternative.

Alternative 3) – Invest in infrastructure improvements to support the Airport Dining and Retail business. The program master plan demand forecast indicates a need to develop additional space

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as well as more efficiently configure existing space. This alternative allows the Airport to develop currently vacant space to serve passengers and generate revenue, make better use of existing space, as well as provide the basic utilities to support business operations. The Airport will have the ability to grow dining and retail gross sales from an estimated \$217 million in 2014 to at least \$400 million, and Port revenues from \$32 million to \$60 million in 2025. The investments will proactively position the Airport to respond to projected increases in passenger volume and further enhance the ‘world class’ offering that travelers have come to expect from Seattle-Tacoma International Airport. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- Exhibit A: PowerPoint presentation
- Exhibit B: Terminal Map
- Exhibit C: Computer simulation of future program

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- September 30, 2014 – (Briefing) Drivers for Phasing Plan Decisions
- May 27, 2014 – (Briefing) Airport Dining and Retail Master Plan
- April 22, 2014 – Terminal Utility Upgrades Design Services Contract (CIP #C800638)
- September 11, 2012 – (Briefing) Airport Concessions Master Plan Update
- March 27, 2012 – Briefing about Interim Concessions Leasing
- February 14, 2012 – Commission Motion Concerning the Airport Concessions Program
- December 13, 2011 – Aviation Concessions Program Principles and Practices
- July 26, 2011 – Procurement for Concessions Planning and Leasing Services