

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6a
Date of Meeting November 11, 2014

DATE: October 27, 2014
TO: Theodore J. Fick, Chief Executive Officer
FROM: James R. Schone, Director, Aviation Business Development
James Jennings, Manager, Aviation Properties
Deanna Zachrisson, Business Leader, Airport Dining and Retail
SUBJECT: Tenant Improvement for Baggage Claim Office Space for Airport Management Services, LLC (C800154)

Amount of This Request:	\$350,917	Source of Funds:	Airport Development Fund
Est. Total Project Cost:	\$350,917		
Est. State and Local Taxes:	\$23,003		

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to execute a Tenant Reimbursement Agreement in the amount of \$343,417 for costs already incurred by Airport Management Services, LLC. (operating entity for Hudson Group) for the conversion of unimproved space to office space. The total estimated project cost is \$350,917.

SYNOPSIS

Airport Management Services, LLC. is the operating entity for Hudson Group (Hudson), the convenience and specialty retail concessionaire at Seattle-Tacoma International Airport (Airport). Hudson Group is an affiliate of Dufry North America (Dufry), Inc., the recently selected duty free concessionaire at the Airport. Dufry and Hudson consolidated their office space at the Airport in a new location in baggage claim (Exhibit A) in early 2014. The space was previously used as construction laydown area and an airline data communications room. The unimproved space required substantial modification to prepare it for occupancy. As a result, Port staff determined that the project to improve the space qualified for reimbursement according to the Port's Tenant Reimbursement Guidelines. The tenant reimbursement policy had not previously been used for a non-airline project. Although Port staff previously determined the portions of the project that were eligible for reimbursement, acknowledged the need for certain code-required improvements beyond the initial scope, and thoroughly reviewed all of the tenant's costs, they did not execute a Tenant Reimbursement Agreement, which always would have required Port Commission authorization. Total funds expended by the tenant on this project are \$343,416.76. This request provides the necessary authorization for Port funds to be

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paid to the tenant for work already conducted under the Port's supervision and completed as well as estimated Port costs to close the project.

BACKGROUND

Dufry began operations at the Airport in 2013 following the award of the duty free contract to their firm in 2012. Initially, Dufry shared office space with its affiliate, Hudson, on the Airport's pre-security mezzanine level. Hudson operates 22 retail locations, starting in 2005 and Dufry operates 5 duty free locations in the Airport. With the addition of the duty free business, Dufry and Hudson realized that they needed additional office space to support their operations. They requested assistance from Port staff in locating new office space. This request came at the same time as Port staff were preparing for a series of office relocations in the pre-security mezzanine level area in order to provide more office space for airline tenants. The pre-security mezzanine level office area is considered to be the most desirable space for airline offices due to its location directly above airline ticketing operations.

Representatives from Dufry/Hudson and the Port looked at several potential locations and finally settled on a group of rooms located on the baggage claim level of the main terminal adjacent to baggage carousel #12. This location allowed the Port to provide the tenant with the additional office space that it needed, while concurrently freeing up much needed space on the mezzanine level. The space is a series of interconnected smaller rooms that had not been improved for over 20 years, rather used in a rough condition for construction laydown and data communications. It was clear to all parties that improvements would be needed to make these rooms suitable for occupancy and turnover to the tenant. The application of the Port's tenant reimbursement policy in this baggage claim space represented an opportunity to facilitate the creation of leasable office space which would benefit the Port in both the current and potential future leases.

Commission Resolution 3605, Section 2.4, gives authorization to the Chief Executive Officer to reimburse for work performed by tenants within their leased premises. This policy allows for tenants to complete tenant improvements but also remedy deficiencies in the space that are the Port's responsibility within a single construction project. This policy had primarily been used for airline improvement projects. Port staff determined that the project proposed by Dufry/Hudson also met the criteria for reimbursement according to the Port's Tenant Reimbursement Guidelines. The benefit of this approach was that the tenant would be able to make basic improvements that are normally the landlord's responsibility, while completing their specific tenant improvements as one project. Typically, a tenant's ability to do this preparatory work, combined with their own improvements, has led to both faster occupancy and lower costs than if the Port undertook the project. Port estimators believe that the Port realized significant cost savings with the tenant improvement approach in this project.

However, in implementing this particular project, Port staff did not follow all of the Port's Tenant Reimbursement Procedures, as reflected in AV-2. Specifically, a Tenant Reimbursement Agreement documenting the tenant reimbursement amount, which was originally estimated at \$288,000, was not developed and signed by both parties. And as this amount was above the \$200,000 threshold as reflected in the Tenant Reimbursement Procedure that requires

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Commission approval, this project should have come to Commission for authorization before the tenant was allowed to proceed with construction. Unanticipated costs materialized as the project construction neared completion due to the discovery by Port Building Department inspectors of a number of unacceptable conditions that were the landlord's responsibility and had to be addressed before the space could be occupied. These change orders totaled \$55,416.76 bringing the total cost of the project to \$343,416.76.

The lack of full compliance with the Tenant Reimbursements Procedure can be attributed to several factors. This was the first time that the Tenant Reimbursement Guidelines and Procedures were applied to an Airport Dining and Retail tenant project. The Port staff person working on this project had no prior experience with tenant projects involving these policies. The Port staff member designated by the AV Properties Manager, per the Tenant Reimbursements Procedure, to oversee this project left Port employment in August 2013. This occurred at the very time that the negotiations between Dufry/Hudson and the Port were taking place. And it was these negotiations which would typically determine what documentation would be required based on the Port's procedures. Additionally, insufficient staff resources following the staff member's departure led to this project not receiving the necessary supervision to ensure that all Port policies were followed. It was not until the cost reconciliation was completed during the past several months that the failure to conform to Port policies became known. In reviewing the project history, it is also clear that there was insufficient training of all Port staff that work with this policy. This training will be provided before any other tenant reimbursement projects are started.

PROJECT JUSTIFICATION AND DETAILS

The baggage claim space that was improved by the tenant in this project provides sufficient amount of space for their growing operational needs at the Airport while also freeing up much needed office space on the pre-security mezzanine level for use by airlines.

Project Objectives

- Provide larger, centrally-located office space for the tenant in the main terminal.
- Prepare the preferred location for renovation by first removing portions of the electrical, mechanical and communications infrastructure left behind by a previous tenant to facilitate the turnover to the tenant.
- Allow the tenant to perform the necessary site preparation and demolition work, which was the Port's responsibility, in the preferred location to meet their desired occupancy schedule.

Scope of Work

This scope of work included demolition of electrical infrastructure comprised of a transformer, two electrical sub-panels as well as multiple electrical conduits of various sizes leading to and from the space. This work also involved re-routing several electrical circuits for neighboring tenants that had been established in the panels that had been identified for removal.

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In addition, portions of the communications cable tray, along with several runs of abandoned communications cabling and several sections of HVAC supply and return ductwork were also removed. This infrastructure had been installed by a previous tenant to support computer server and communications network equipment that had been located in these rooms.

Schedule

- Tenant submitted a demolition plan to the Port in August 2013
- Tenant contractor completed demolition in October 2013
- Tenant submitted 90% build out design for Port review in October 2013
- Tenant submitted all permit documents to the Port in November 2013
- Airport Building Department issued the construction permit in December 2013
- Tenant contractor began work in December 2013
- Airport Building Department granted the Certificate of Occupancy in March 2014

FINANCIAL IMPLICATIONS

Budget/Authorization Summary

	Capital	Expense	Total Project
Original Budget	\$288,000	\$0	\$288,000
Previous Authorizations	\$0	\$0	\$0
Current request for authorization	\$350,917	\$0	\$350,917
Total Authorizations, including this request	\$350,917	\$0	\$350,917
Remaining budget to be authorized	\$0	\$0	\$0
Total Estimated Project Cost	\$350,917	\$0	\$350,917

Project Cost Breakdown

	This Request	Total Project
Design	\$70,613	\$70,613
Construction	\$249,802	\$249,802
State & Local Taxes (estimated)	\$23,002	\$23,002
Estimated remaining project closing costs	\$7,500	\$7,500
Total	\$350,917	\$350,917

Budget Status and Source of Funds

This project, C800154 is included in the 2015 – 2019 capital budget and plan of finance. The funding source is the Airport Development Fund

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Financial Analysis and Summary

CIP Category	Renewal/Enhancement
Project Type	Airport Infrastructure
Risk adjusted discount rate	N/A
Key risk factors	N/A
Project cost for analysis	\$350,916.76
Business Unit (BU)	Terminal Building
Effect on business performance	NOI after depreciation will increase
IRR/NPV	N/A
CPE Impact	Less than \$.01.

Lifecycle Cost and Savings

This project has improved a previously un-leasable space that meets the current needs of Dufry/Hudson as well as created an improvement suitable for a much longer period of time.

STRATEGIES AND OBJECTIVES

This tenant improvement project supports the Century Agenda objective to meet the region's air transportation needs at the Airport for the next 25 years by maintaining and upgrading our existing facilities.

TRIPLE BOTTOM LINE

Economic Development

This project provides Dufry/Hudson with sufficient office space to adequately meet their operational needs here at the Airport while also freeing up much needed space for airline offices.

Environmental Responsibility

This project was completed in accordance with all Port environmental standards.

Community Benefits

This project supports the Port's commitment to social responsibility by providing a work space for Dufry/Hudson which contributes to the productivity of the business and support for approximately 350 jobs.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Decline to provide reimbursement to Airport Management Services (operating entity for Hudson Group) for the tenant improvements. It is not clear what action the tenant might take in response to this alternative. This is not the recommended alternative.

Alternative 2) – Reimburse the tenant for the tenant improvements necessary to make un-leasable space productive as office space. This project met the Port's criteria for reimbursable

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tenant improvements despite the lack of a signed Tenant Reimbursement Agreement by both parties. The company is due this reimbursement. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- Exhibit A: Map of new Airport Management Services, LLC office space on the baggage claim level

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- None