

**PORT OF SEATTLE**  
**MEMORANDUM**

**COMMISSION AGENDA**  
**ACTION ITEM**

**Item No.** 4f  
**Date of Meeting** November 25, 2014

**DATE:** November 18, 2014  
**TO:** Ted Fick, Chief Executive Officer  
**FROM:** Mike Campagnaro, Manager, Seaport Leasing and Industrial Properties  
Jasmin Contreras, Property Manager, Seaport Leasing and Industrial Properties  
**SUBJECT:** ConGlobal Industries LLC Lease Approval for Terminals 106 West and 108

**ACTION REQUESTED**

Request Commission authorization for the Chief Executive Officer to execute a lease, substantially as drafted, with ConGlobal Industries LLC (“CGI”) for a term of 12 years for Terminals 106 west and 108.

**SYNOPSIS**

The Port owns Terminal 106 west and Terminal 108, which combined constitute approximately 19.22 acres of land. Terminals 106 and 108 (hereafter referred to as the “Site”) are located in the Duwamish Manufacturing and Industrial Center on the east side of the Duwamish Waterway, a heavy industrial-use neighborhood with several properties supporting the Port’s seaport cargo businesses at the Port’s container terminals.

The Site has a long history of environmental issues and is included in the Washington State Department of Ecology’s (Ecology) Lower Duwamish Waterway Superfund site source control program. The Site is currently leased and operated by CGI, and the lease expires March 31, 2015. CGI (as its predecessor, Container Care International, Inc.), has been a Port tenant since July 1990. The company has transferred ownership over the past two decades.

The proposed new lease did not go out for competitive bid. In evaluating this proposed lease in contrast with other market lease scenarios, staff analyzed other alternatives. These alternatives compared the Port’s estimated cost of \$8.5 million to rebuild and restore the site with a new storm water conveyance system and new asphalt, and leasing the site at a full market value, versus this proposal of leasing the site “as-is” with the tenant installing its own storm water infiltration system at an estimated cost of \$2.25 million to \$3 million. The Net Present Value of these alternatives are outlined in the attachment hereto and explained further herein.

CGI has struggled to meet Ecology’s required benchmarks for stormwater quality due to the industrial site uses and the generally poor condition of much of the pavement on the property. This lease negotiation includes construction of a CGI-funded stormwater facility to address Department of Ecology permit requirements.

## **COMMISSION AGENDA**

Ted Fick, Chief Executive Officer

November 18, 2014

Page 2 of 8

The proposed new lease will allow CGI to invest in a “state of the art” stormwater treatment system capable of treating stormwater for the entire Site. The proposed new lease secures a continued revenue stream to the Port that ranges from \$1.1 million to \$1.9 million annually, averaging \$1.5 million per year over the lease term. In addition, the Port will preserve lease termination rights and the ability to reclaim the Site in the event of a major capital improvement or a site cleanup triggered by Ecology’s Duwamish Waterway source control program.

## **BACKGROUND**

### ***Company Profile***

CGI is one of the largest full-service suppliers to the intermodal industry in North America. It provides equipment repair, maintenance, storage, and redistribution services to global shipping lines and leasing companies. CGI is also the leading retailer of standard and modified equipment in new and used condition to consumers, corporations, and government and military institutions. CGI is a wholly owned subsidiary of In-Terminal Services (ITS), one of the leading operators of intermodal facilities in North America. ITS is the industry-leading provider of intermodal rail terminal services, auto loading and unloading, and container depot services. ITS operates at over 90 facilities with roughly 3,100 employees. With its acquisition of CGI, ITS expanded its service offerings to container depot services.

### ***Lease Background***

CGI operates under a state water quality permit that requires monitoring and treatment of stormwater that drains from the Site. On September 2011, CGI received a “Notice of Intent to Sue under the Clean Water Act” from the law firm of Smith & Lowney, representing the Waste Action Project in Seattle. This was followed with Ecology’s issuing a fine to CGI for failing to meet its Industrial Stormwater General Permit (ISGP). Although CGI employed various methodologies to attempt to meet benchmark values for the specific parameters for the Site, CGI has struggled to meet the required benchmarks due to the industrial site uses and the generally poor condition of much of the pavement on the property.

Over the past three years, the Port and CGI have worked through the current environmental challenges related to CGI’s stormwater runoff, particularly as it related to the renewal of its lease following its original March 31, 2013 expiration. The Port executed an interim 2-year agreement with CGI to give both parties additional time to discuss and finalize the terms of a new long-term agreement, pending the completion of CGI’s ongoing due diligence related to its proposed permitting, construction, and installation of stormwater management infrastructure.

### ***Stormwater Quality and Permit Compliance***

The Terminal 108 site has experienced a long industrial history and it continues to support maritime-related industrial activities. West of the Terminal 108 parcel is a Port of Seattle public access park and a habitat mitigation area located along the southern shoreline, adjacent to the Lower Duwamish Waterway.

## **COMMISSION AGENDA**

Ted Fick, Chief Executive Officer

November 18, 2014

Page 3 of 8

Due to the industrial activity, location, architectural and transportation sources, the Site has experienced benchmark exceedances for zinc, copper, and turbidity. Without CGI coming into compliance with the benchmarks outlined in its ISGP, CGI's longevity at the Site has been in question. CGI's ISGP permit requires installation of treatment at the site once benchmarks are exceeded three times in one calendar year. CGI, like many of our other tenants, has triggered the requirement for treatment at their Site.

CGI is proposing to install piping, pumps, and associated structures capable of treating stormwater for the entire Site. The proposed system is a fully automated electrocoagulation-based<sup>1</sup> technology, Enpurion® EB, with a sedimentation process and multiple passes through a high capacity sand filter; a technology that promises to consistently meet Ecology's benchmarks for regulated pollutants. This combination of stormwater systems (electrocoagulation and sand filter) is the Cadillac of stormwater systems, and if operated properly, the system should be able to treat current stormwater contaminants of concern, including fecal coliform. The proposal from CGI's environmental consultant promises that the proposed technology consistently meets Ecology's ISGP benchmarks for regulated pollutants at other locations.

### ***Environmental Conditions***

Beginning in the 1930s, the Terminal 108 site had a long history of industrial operations/activities and owners/tenants, including a wastewater treatment facility (with waste sludge disposal lagoons), PCB-contaminated sediment treatment ponds, bulk cement terminal, and petroleum-contaminated soil treatment beds. As a result, the site has undergone numerous environmental investigations. In general, site soil and groundwater have various degrees of chemical contamination related to the historic site uses, and some of these areas are contaminated above regulatory standards. The Site has been studied as part of Ecology's Source Control efforts related to the Lower Duwamish Waterway Superfund site within Ecology's Voluntary Cleanup Program (VCP). Under the VCP, the Port has performed independent investigation and source control strategy evaluations. Ecology is evaluating the data and may request additional investigation and clean-up in the future.

## **MARKET CONDITIONS**

### ***Industrial Market Overview***

The Port and CGI each completed an appraisal of the Site in 2012. The rent estimated in the Port's appraisal report was predicated upon the hypothetical condition that the Port of Seattle would provide new surface drainage systems and asphalt paving for all of the surfaces on Terminal 108 and paving for Terminal 106 (Kidder Mathews, Summary of Appraisal, 2012). Alternatively, CGI appraisal was for the Site "as is" and without any improvements.

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<sup>1</sup> Electrocoagulation (EC) is an advanced and economical water treatment technology; a technique used for treatment of industrial processed water (and other wastewater). Electricity-based EC technology removes contaminants that are generally more difficult to remove by filtration or chemical treatment systems.

## **COMMISSION AGENDA**

Ted Fick, Chief Executive Officer

November 18, 2014

Page 4 of 8

The region's industrial market continues to be very active and the forecast for the Seattle close-in market for the next six months is for lease rates to hold steady. According to industry market reviews, the Seattle close-in market, particularly with the presence of the Port in the SODO district, has a large amount of yard area available for lease. Depending on size of the yard and improvements, rates will vary from \$0.15/sf/month to \$0.21/sf/month. Recent market rent evaluations completed by Port staff to determine market rates in the neighboring Georgetown north industrial submarkets show that market land rates for unimproved land can range from \$0.12 to \$0.15/sf/month. Considering the Site has many factors that make it a challenge in securing a long-term lease, particularly the need for a stormwater system and a potential cleanup action, the Port has negotiated a stepped rent structure which allows the tenant to amortize its storm water improvement costs in the early years of the lease, yet still achieving a market rental rate range in the latter years of the lease.

## **FINANCIAL IMPLICATIONS**

### ***Budget Status and Source of Funds***

The proposed lease requires no Port funding.

## **COMMISSION AGENDA**

Ted Fick, Chief Executive Officer

November 18, 2014

Page 5 of 8

### ***Financial Analysis and Summary***

<b>CIP Category</b>	Not applicable																										
<b>Project Type</b>	Not applicable																										
<b>Risk adjusted discount rate</b>	7.0%																										
<b>Key risk factors</b>	<ul style="list-style-type: none"> <li>• Tenant does not properly maintain the facility, mitigated by: <ul style="list-style-type: none"> <li>○ Lessee’s maintenance and repair responsibilities under the terms of the lease.</li> </ul> </li> <li>• Risk of tenant default, mitigated by: <ul style="list-style-type: none"> <li>○ Good standing status as a current Port tenant</li> <li>○ Security deposit equivalent to three months’ rent</li> </ul> </li> <li>• Risk of early termination if environmental cleanup is required, mitigated by: <ul style="list-style-type: none"> <li>○ Limiting the early termination fee – it only applies during the first 5 years of the 12-year lease term.</li> <li>○ Rents the Port receives prior to early termination</li> </ul> </li> </ul>																										
<b>Project cost for analysis</b>	Not applicable																										
<b>Business Unit (BU)</b>	Seaport Lease & Asset Management - Industrial																										
<b>Effect on business performance</b>	<p>The following table summarizes the impact of the proposed lease to Net Operating Income (NOI) for years 2015 through 2019, the first 5 years of the 12-year lease term:</p> <table border="1"> <thead> <tr> <th><b>NOI (in \$000's)</b></th> <th><b>2015</b></th> <th><b>2016</b></th> <th><b>2017</b></th> <th><b>2018</b></th> <th><b>2019</b></th> </tr> </thead> <tbody> <tr> <td>Revenue</td> <td>\$1,132</td> <td>\$1,189</td> <td>\$1,248</td> <td>\$1,310</td> <td>\$1,376</td> </tr> <tr> <td>Expenses</td> <td>\$0</td> <td>\$0</td> <td>\$0</td> <td>\$0</td> <td>\$0</td> </tr> <tr> <td>NOI</td> <td>\$1,132</td> <td>\$1,189</td> <td>\$1,248</td> <td>\$1,310</td> <td>\$1,376</td> </tr> </tbody> </table> <p>For comparison, the existing lease will generate \$1,358K in 2014.</p>			<b>NOI (in \$000's)</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	Revenue	\$1,132	\$1,189	\$1,248	\$1,310	\$1,376	Expenses	\$0	\$0	\$0	\$0	\$0	NOI	\$1,132	\$1,189	\$1,248	\$1,310	\$1,376
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<b>IRR/NPV</b>	<table border="1"> <thead> <tr> <th><b>NPV (in \$000's)</b></th> <th><b>IRR (%)</b></th> <th><b>Payback Years</b></th> </tr> </thead> <tbody> <tr> <td>\$11,879</td> <td>NA</td> <td>NA</td> </tr> </tbody> </table> <p>The Net Present Value is based on revenues generated over the 12 year term of the lease plus an estimate of the residual value of the stormwater facility built by CGI, assumed to have a 20 year useful life. The NPV does not factor in the underlying value of the land and improvements. The basis for establishing market rates for the lease is described in the memo under “Market Conditions.”</p>			<b>NPV (in \$000's)</b>	<b>IRR (%)</b>	<b>Payback Years</b>	\$11,879	NA	NA																		
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### ***Lifecycle Cost and Savings***

Once CGI departs from the Site, the stormwater facility built by CGI will remain onsite and become property of the Port.

## COMMISSION AGENDA

Ted Fick, Chief Executive Officer

November 18, 2014

Page 6 of 8

### MAJOR BUSINESS TERMS

Below are the major business terms of the proposed new lease agreement.

<i>Provision</i>	<i>Summary</i>																																																				
<b>Term:</b>	12 years commencing upon lease execution. The effective date is expected to be January 1, 2015. Concurrently, the current lease would terminate effective December 31, 2014.																																																				
<b>Rent:</b>	The average rental rate will be \$0.15 per square foot (\$1,501,444/year). The proposed rent is a stepped rent structure (as shown below), which allows the tenant to amortize its storm water improvement costs in the early years of the lease.																																																				
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<b>Use:</b>	Shipping container depot: storage, repair, and modification of containers.																																																				
<b>Port Termination Rights:</b>	The Port will retain termination rights for major capital improvements, such as site cleanup triggered by Ecology. Two years advance notice required from the Port to CGI. If the Port terminates the lease during the first five years, the Port will reimburse CGI based on actual storm water improvements (not to exceed \$3 million) as follows: year 1 at 100%; year 2 at 80%; year 3 at 60%; year 4 at 40%; and year 5 at 20%.																																																				
<b>Tenant-Funded Improvements:</b>	CGI will install a storm water system at the Site and will be responsible for all maintenance and repair of the system. These improvements will stay with the Site and become property of the Port upon lease expiration.																																																				
<b>Maintenance:</b>	CGI will lease the Site in its "as is" condition and will be responsible for all maintenance and repairs.																																																				

### TRIPLE BOTTOM LINE

#### *Economic Development*

Continuing to lease the Site as an operating container depot is critical to the Port's container business. A container depot is a key business that supports the container industry, which is important for the Port to meet its Century Agenda strategy of increasing container volume in Seattle to 3.5 million TEUs and doubling the value of exports from Seattle.

## **COMMISSION AGENDA**

Ted Fick, Chief Executive Officer

November 18, 2014

Page 7 of 8

### ***Environmental Responsibility***

CGI has been a good partner with the Port in working toward solving its stormwater and compliance issues at the Site. CGI has worked hard to implement changes at the Site, has learned quickly from mistakes, and has sought out advice from the Port in its efforts to comply with environmental requirements. This action will allow CGI to take corrective action to comply with its Ecology ISGP permit. CGI strives to be a responsible corporate citizen by adhering to current environmental regulations and developing internal programs to ensure that all company facilities are following protocols. Periodic internal and external audits are performed at CGI locations by a national environmental consulting firm. CGI also has an active recycling program for waste produced by its operating activities. CGI uses cross training and education of workforce to mitigate exposure to properly handle and dispose of any by-products of its operations.

### ***Community Benefits***

CGI maintains a Seattle job base of approximately 31 direct positions related to container depot operations, facility maintenance, security, and local management oversight.

## **ALTERNATIVES AND IMPLICATIONS CONSIDERED**

**Alternative 1)** – Allow the current lease to continue through its scheduled expiration date while simultaneously negotiating with the existing tenant and offering the combined sites for lease on the open market. In this scenario, the Port would make the necessary Site improvements for environmental industrial permit compliance and lease the site at full market rates. This alternative could put the Port at risk of having the current tenant find a different Site and the Site sitting vacant for an extended period while a new tenant is identified. In addition, given the unknowns associated with the Site, it is difficult to offer the Site for a defined period and still be able to fully amortize Site improvement costs. In this alternative, the Port risks losing its revenue stream while a new tenant is located assuming the existing tenant does not continue. If the current tenant does not remain, releasing 100% of the site could take between 12 and 24 months. Over the 20-year life of the stormwater improvements, the NPV for this alternative would range between \$10.8 million (assuming existing tenant would agree to these terms) to \$8.2 million (assuming site is vacated and 100% releasing takes 24 months). *This is not the recommended alternative.*

**Alternative 2)** – Offer the sites on the open market via a Request for Proposal (RFP) process. Terminal 106 and Terminal 108 are effectively general industrial storage yards, and are not connected to each other; each can be accessed by crossing over the west-end of Oregon Street before it dead-ends at the Duwamish River. These sites are generally not more desirable than other sites on the market. Accordingly, the RFP process for these sites does not make it more probable for finding a replacement tenant and could actually serve as being more restrictive or limiting. Another disadvantage of the RFP alternative in this situation is the upfront investment required coupled with the environmental complexities of the Site. The NPV for this alternative

## **COMMISSION AGENDA**

Ted Fick, Chief Executive Officer

November 18, 2014

Page 8 of 8

would have the same NPV range as Alternative 1 above. *This is not the recommended alternative.*

**Alternative 3)** – Execute a new 12-year lease agreement where CGI makes storm water improvements to the Site with no rent abatement, and takes on all foreseen and unforeseen maintenance and repair items, including maintenance of the new storm water system by incorporating a stepped rent structure which allows the tenant to amortize its storm water improvement costs in the early years of the lease, yet still achieving a market rental rate range in the latter years of the lease with the Port retaining lease termination rights in the event the Port needs the Site for a major capital improvement. The NPV for this alternative over the 12-year term of the lease is \$11.9 million (as reflected in the financial section of this memo) and is \$15.6 million over a 20-year life of the stormwater improvements (assuming existing tenant renews for an additional 9 years at a rate that grows by CPI). **This is the recommended alternative.**

### **ATTACHMENTS TO THIS REQUEST**

- Computer Slides – Site Exhibit and Alternatives Financial Comparison
- Draft Lease Agreement

### **PREVIOUS COMMISSION ACTIONS OR BRIEFINGS**

- None