

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No.	<u>6f</u>
Date of Meeting	<u>December 2, 2014</u>

DATE: November 24, 2014
TO: Ted Fick, Chief Executive Officer
FROM: James R. Schone, Director, Aviation Business Development
Jolene Culler, Senior Property Manager, Aviation Properties
SUBJECT: ATZ Lease Amendment for Doug Fox Parking Lot

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to amend the lease with ATZ Inc. for the operation of the Doug Fox Parking Lot located north of South 170th Street and east of the Northern Airport Expressway to extend the term nine months, defer increases in the concession fee and Minimum Annual Guarantee, and provide other modest relief for operational impacts and delays caused by construction of the Doug Fox Parking Lot Services Upgrades Project.

SYNOPSIS

On July 9, 2013, the Commission approved the Doug Fox Parking Lot Services Upgrades Project as well as a lease with ATZ for operation of the parking facility commonly known as the Doug Fox Parking Lot. Port staff returned to Commission on October 8, 2014, for additional authorization to construct this project based on a low bid that was more than 10% over the engineer's estimate. Following Commission approval of that request, total project authorization was \$6,503,000.

The lease with ATZ commenced on October 1, 2013. The lease specified that construction of the project would be substantially complete by the end of summer 2014. The delay in award of the contract after Commission authorization for the high bid resulted in the beneficial occupancy date shifting to the end of September 2014. When compared to later years, the lease included a lower percentage rent (55%) and Minimum Annual Guarantee (MAG) (\$1.5 million) for the first year to account for the impact of construction on the facility. Due to a number of reasons, the project is going to be completed significantly later than expected. The lease specifies that ATZ is due relief for construction that materially deviates from the original schedule and negatively impacts operations.

ATZ submitted a claim for the harm suffered from changes in the schedule, and the Port and ATZ have negotiated revised terms that account for the negative impacts of the delayed construction and that reflect both parties' roles in these delays. With the additional costs associated with the project (as requested under separate action), the adjustments to the lease

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related to relief for ATZ as presented in this request to Commission, and using updated transaction and revenue forecasts provided by ATZ, the Net Present Value (NPV) for the Port's investment is now \$1.24 million compared to a NPV of \$3.5 million estimated when Commission approved the additional project funding on October 8, 2013.

BACKGROUND

The Doug Fox Parking Lot is currently operated by ATZ as an off-site surface parking lot at Seattle-Tacoma International Airport. The lot has been used primarily for automobile parking since its development well over 20 years ago.

In February 2012, the Port Commission authorized the design and construction of the Doug Fox Site Improvements Project that included stormwater and pavement improvements. In May 2012, the Commission authorized the design of the Doug Fox Parking Lot Service Upgrades Project that included pavement restoration, lot lighting, improved signage, and potentially operations and customer service facilities. At that time, the two projects were consolidated into one combined project for a total project budget of \$6,123,000. The project implementation was based on the tenant remaining operational during construction.

Following Commission approval of design funds, staff initiated a public request for proposals (RFP) process for a new operator in anticipation of the expiration of the then-current lease agreement. At the conclusion of that RFP process, ATZ was selected and Port staff initiated negotiations that concluded in early 2013. The Commission approved the new lease with ATZ in July 2013, and the new agreement commenced on October 1, 2013. That agreement is for five years with two, five-year options at the mutual consent of both parties. This lease includes lower percentage fees (55%) and Minimum Annual Guarantee (\$1.5 million) for the first year of the lease (October 1, 2013 – September 30, 2014) to account for impacts to operations during the construction of the project. Starting in year two of the lease, October 1, 2014 – September 30, 2015, the percentage fee increases to 60% with a MAG of \$2.5 million.

The lease also included a provision requiring the owner of ATZ to divest of his interest in another parking facility located in the City of Tukwila. This was a requirement of the RFP that stipulated that any respondent chosen to operate the lot could not have a financial or management interest in any other parking facility located within three miles of the Airport. ATZ did not complete this divestiture within the originally agreed timeframe but has taken significant steps towards this and has committed to having the divestiture completed by December 1, 2014.

In July 2013, the Port Commission also authorized the construction of the project that included stormwater management facilities, pavement restoration, lot lighting, improved signage, a new operations building, a new covered entrance and exiting facility, demolition of the existing building, and supporting utilities. In September 2013, the bids were opened for the project, and since the lowest responsive bid exceeded the engineer's estimate by more than ten percent, additional authorization by the Commission was required. In October 2013, the Commission authorized the additional budget to support the bid, for a total project budget of \$6,503,000, and the contract was executed with the successful bidder on October 29, 2013.

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The lease and the project specifications envisioned that construction of improvements to the lot would begin in the fall of 2013 and be completed by the end of summer 2014. There have been a number of issues encountered during construction that will delay completion of the project by up to six months attributed to value engineering, modular building approvals and inspections, and anticipated delays with the remaining work that include paving in the winter, possible unknown conditions, and the complexity involved with completing the new entry while maintaining tenant operations.

The lease states that in the event that the Port materially deviates from the project schedule and, despite its commercially reasonable efforts, the lessee's operations are substantially and negatively impacted, the Port agrees to negotiate a further equitable adjustment in the Minimum Annual Guarantee or to bear reasonable costs of any modifications to the premises reasonably necessary to permit the lessee to continue to operate its business. The lease also states: "the Port generally intends to follow the phasing plan set forth in the design documents, with construction continuing, as weather permits, through the summer of 2014."

This delay in completion of the project has negatively impacted ATZ's operations. Therefore, ATZ has requested relief for not only the delay in completion of the project but also for the delay associated with the completion of specific project elements. At the time the lease was signed, the project bid documents included five phases for project completion within which key project elements, specifically signage (Phase 1), a new operations building (Phase 2) and a new entrance and exiting facility (Phase 3) were designated for completion. Having these elements completed early in the project was critical for ATZ's plan to build the business in anticipation of the increased percentage fees and higher MAG effective in year two, or October 1, 2014. ATZ had planned to launch a marketing campaign once the new entrance and exiting facility and signage work were completed. However, the signage was not installed until early November 2014, the operations building was not completed until mid-November 2014, and the new entrance/exit facility will not be completed until late January or early February 2015 – all well after the project was originally understood by all parties to be completed.

The Port agrees that the project is going to be completed late and that the phasing plan for completion of key project elements was essentially inverted resulting in these elements (the signage, operations building, and entrance and exiting facility) being completed much later than expected. Port staff evaluated ATZ's claim for MAG and concession fee relief including both the Port's and the tenant's role in causing the delays to completion of key project elements and then tried to quantify the appropriate compensation due ATZ for the delay. To do so, staff used the contractor's initial project schedule as the basis for the analysis. While this schedule was submitted after lease negotiations were completed, it is the best tool available to assist in quantifying the amount of relief to be considered.

<u>Deliverable</u>	<u>Phasing Plan</u>	<u>Actual</u>	<u>Difference</u>
Signage	Mid March 2014	Early November 2014	7 ½ months
Operations Building	Mid April 2014	Mid November 2014	7 months
Entrance/Exiting Facility	Mid July 2014	Late Jan/Early Feb 2015	7 months

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The parties have mutually agreed on the proposed terms for relief as summarized below:

- Nine-month extension of the lease term and an equivalent deferral of the increases in the MAG and percentage fee. This extension is predicated on the currently scheduled completion of the entrance/exiting facility and is subject to a one-month extension for each month the facility may subsequently be delayed beyond the end of January 2015. With this change, the new MAG and percentage fee would begin July 1, 2015 (rather than October 1, 2014) and would increase every 12 months thereafter. This deferral is likewise subject to extension for subsequent delay in the completion of the entrance/exit facility. This provides relief for the late completion of key project elements and gives ATZ time to launch a marketing campaign and build the business before the MAG and percentage fee go up.
- Rent and utility credits for the period April 1, 2014, through October 31, 2014, for a total of approximately \$25,000. This is due to the delay in providing the new operations building, which is less square footage, and thus less rent (\$1,500 per month compared to \$2,904 per month) than the existing operations building and lower utility charges as it will be connected to the local sewer system.
- Completion of tenant improvements including infrastructure for the ATZ security camera system and the upgrade of the two exit control signs to variable message signs. The lease calls for the Port to provide infrastructure for the ATZ security camera system, and the upgrade to the variable message signs is a negotiated item. The estimated cost for these items is \$55,000.

Lease Summary and Financial Analysis:

Below is a comparison of the key business terms of the current lease and the amended lease.

	Current Lease	Amended Lease
Term	Five (5) years	Five (5) years plus 9 months
MAG	Year 1: \$1.5M Year 2: \$2.5M Year 3: \$2.6M Year 4: \$2.7M Year 5: \$2.8M	Month 1-21 \$1.5M Month 22-33 \$2.5M Month 34-45 \$2.6M Month 46-57 \$2.7M Month 58-69 \$2.8M
Percentage Fee	Year 1: 55% Year 2: 60% Year 3: 61% Year 4: 62% Year 5: 63%	Month 1-21 55% Month 22-33 60% Month 34-45 61% Month 46-57 62% Month 58-69 63%
Building Rent	\$1,500.00 Effective On Occupancy	\$1,500.00 Effective On April 1, 2014

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The new lease commenced on October 1, 2013 with a base term of five years and additional provisions for two five-year term extensions. The original financial analysis associated with the October 8, 2013 memo resulted in an NPV of \$3.5 million and was based on activity forecasts provided by the tenant associated with the original construction completion anticipated for the end of summer 2014.

The financial analysis shown below adjusts the October 8, 2013 financial results to include 1) the increased Project costs for a total of \$6.93 Million (requested of the Commission under separate action), 2) the agreed upon relief included in the proposed Amendment as outlined above, and 3) updated parking activity forecasts associated with the facility as provided by the tenant which incorporate the Project delays. The overall NPV remains positive at \$1.24 million with an IRR of 9% and payback of 10 years.

CIP Category	Revenue/Capacity Growth
Project Type	Business Expansion/New Business Development
Risk adjusted Discount rate	8%
Key risk factors	<ul style="list-style-type: none">• Construction risks: the Project may encounter unexpected delays due to unforeseen issues which may increase the cost of the project and/or cause schedule delays.• Financial risks: general economic conditions will impact the parking market and if general economic declines occur in the future, incremental revenues may fall short of forecasts.• A timeframe of 15 years was included in the financial analysis, covering the initial five-year lease and two five-year extensions. There is risk associated with a potential future conversion of the property to non-parking use, and lease terms associated with future extensions.
Project cost for analysis	\$6.93 million
Business Unit (BU)	Landside
Effect on business performance	The financial analysis assumes that with construction of the project improvements at the facility, annual revenues to the Port will increase. Current revenues to the Port are approximately \$2 million per year. Within five years of implementation of the improvements, annual revenues are anticipated to increase by approximately \$1.5 million. Within ten years, annual revenues are anticipated to exceed \$5 million.
IRR/NPV	NPV: \$1.24 million IRR: 9% Payback: 10 years
CPE Impact	None

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STRATEGIES AND OBJECTIVES

This project aligns with the Port's Century Agenda strategy of advancing the region as a leading tourism destination and business gateway.

ENVIRONMENTAL SUSTAINABILITY

Environmental sustainability elements related to this project are described in associated Project memos.

BUSINESS PLAN OBJECTIVES

Approval of this lease amendment authorization request in conjunction with associated upgrade Project funding request will contribute to achievement of the airport's business plan objective of "maximizing non-aeronautical net operating income" by generating increased non-aeronautical revenues.

TRIPLE BOTTOM LINE SUMMARY

The project supports economic development by investing in an upgraded parking lot to serve the public's parking needs at the Airport. Environmental sustainability principles will be employed consistent with Port policy.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Do not amend the lease. This would likely result in legal action by the Lessee, and the Port's financial responsibility could increase beyond what is proposed. Further the Lessee may find the terms untenable and could default on the Lease thus putting the projected revenues at risk. This is not the recommended alternative.

Alternative 2) – Negotiate a different lease settlement of less magnitude with ATZ. This may or may not be successful, and would delay the prompt resolution sought by both parties. It could result in legal action by the Lessee and the Port's financial responsibility could increase beyond what is proposed. Further the Lessee may find the terms untenable and could default on the Lease thus putting the projected revenues at risk. This is not the recommended alternative.

Alternative 3) – Authorize this lease amendment. This would enable both parties to proceed in good faith and give assurance that the financial returns set forth in the business case are realized.

This is the recommended alternative.

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PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- October 8, 2013, the Port of Seattle Commission authorized the Chief Executive Officer to execute a major public works construction contract with the low responsive and responsible bidder for an additional \$1,385,000 for a total authorization of \$6,503,000.
- July 9, 2013, the Port of Seattle Commission authorized the Chief Executive Officer to: (1) advertise, award, and execute a major public works contract for the Doug Fox Site Improvements project; and (2) execute a Developer Extension Agreement with the Valley View Sewer District for an additional \$3,322,000, for a total authorization of \$5,118,000.
- July 9, 2013, the Port of Seattle Commission authorized the Chief Executive Officer to execute a lease with ATZ, Inc., for a term of 5 years with two 5-year extension options upon mutual agreement.
- June 4, 2013, the Doug Fox Site Improvements project was presented to the Port Commission but no final action was taken.
- March 5, 2013, the Port Commission postponed consideration of the Doug Fox Site Improvements project.
- May 22, 2012, the Port Commission authorized the Chief Executive Officer to: (1) increase the scope of the Doug Fox Site Improvements project to include resurfacing, lighting, building, and road signage; (2) to execute utility agreements; and (3) to complete the design of the project for an additional \$768,000, for a total authorization of \$1,796,000.
- February 4, 2012, the Port Commission authorized the Chief Executive Officer to complete the design and to utilize Port Construction Services crews for the construction of the Doug Fox Site Improvements project in the amount of \$1,028,000.