

LEASE AND CONCESSION AGREEMENT AUDIT

Cruise Terminal of America – (CTA)

BACKGROUND

The Port of Seattle owns cruise terminals at Piers 66 and 91. Cruise Terminals of America (CTA) has entered into a lease agreement with the Port to lease and operate the cruise terminal facilities in exchange for percentage rent payable to the Port. The lease agreement establishes a landlord tenant relationship between CTA and the Port.

Prior to May 2003, the Port of Seattle contracted with CTA to manage the Port’s cruise operations. In 2003, Port Management and CTA transitioned the management agreement to a lease agreement. In 2005, the Port and CTA entered into a new lease agreement that provided greater financial benefit to the Port in exchange for an extended lease term to CTA. In 2012, the Port and CTA amended the agreement to simplify certain lease provisions, further advance the Port’s financial benefit and extend the term of the lease thru December 31, 2019.

In 2015, according to portseattle.org/cruise, cruise ship terminals at Pier 66 and Terminal 91 served seven major cruise lines. Each ship call brought approximately \$2.5 million to the local economy. Overall, the Seattle cruise industry generates approximately 3,647 jobs and \$441 million in annual business revenue.

FINANCIAL HIGHLIGHTS

AGREEMENT YEAR	PERCENTAGE RENT PAID	T91 FACILITY CHARGE	TOTALS
2013	\$11,575,806	\$1,235,469	\$12,811,275
2014	\$11,491,310	\$1,146,758	\$12,638,068
2015	\$12,998,190	\$1,093,904	\$14,092,094
TOTALS	\$36,065,306	\$3,476,131	\$39,541,437

Data Source: PeopleSoft Financials

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AUDIT OBJECTIVES AND SCOPE

The purpose of the audit was to determine whether:

1. Maritime Cruise Operations and Finance monitoring controls were adequate and effective to ensure:
 - Cruise Terminals of America completely and accurately reported percentage rent to the Port.
 - Capital and Per Passenger maintenance allowance expenses were reviewed and approved.
2. Lessee complied with significant lease provisions, as amended.

We reviewed and analyzed records for the period January 01, 2013 - December 31, 2015.



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HIGHLIGHTS AND ACCOMPLISHMENTS

During the course of the audit, we noted that Maritime Cruise Operations and Finance achieved the following significant accomplishments.

- Amended and simplified key provisions within the Cruise Facility Lease Agreement, which eliminated the need for the Port of Seattle to monitor CTA's detailed accounting records.
- Built and maintain strong working relationships with Cruise Terminals of America management through the establishment of weekly and quarterly operations and finance meetings.



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AUDIT RESULT

Monitoring controls performed by Maritime Cruise Operations and Finance are designed appropriately and operating effectively. The lessee materially complied with significant provisions of the Lease Agreement. Management's preventative controls over the lease process are not adequate.

There was one reportable finding:

1. There is no formal process to evaluate whether lease agreement rent security is adequate to protect the Port from risk of loss.
 - The rent security provision in the Cruise Facility Lease agreement deviated from state law and Port procedure guidelines.
 - **RCW 53.08.085** - Lease of Property - Security of Rent - requires rent security of one-sixth the total rent, but not less than one year's rent or more than three years' rent with the port commission having the discretion to adjust or waive rent security.
 - **Port Procedure RE-2** - provides a guideline that agreements of five years or more shall require rent security of six months' rent with the Executive Director or designee having the discretion to adjust the amount or form of security in appropriate circumstances.
 - The deviation was not documented or expressly approved by the Port Commission.

LIMITED OPERATIONAL AUDIT – Capital Program

2015 Construction Activities - Runway 16C-34C Reconstruction project

BACKGROUND

This capital construction project includes reconstruction of 9,246 foot Runway 16C - 34C, the center runway, and portions of interconnecting taxiways. Related work includes pavement demolition, excavation, grading, Portland cement concrete and asphalt paving, storm drainage, water mains and flush fire hydrants, electrical duct-banks, LED airfield lighting systems and guidance signs, an automated electronic Foreign Object Debris (FOD) detection system, and other miscellaneous work.

FINANCIAL HIGHLIGHTS

Aviation Division Capital Budget (in millions)					
2016	2017	2018	2019	2020	Total
\$360	\$457	\$454	\$416	\$363	\$2,050
Source: 2016 Capital Budget					

The project budget was \$106.5 million. The estimated project cost is \$80 million. The project is still in progress. The Port was approved for \$25 million in FAA grants. The remaining funding was allocated from Airport Development Funds and future revenue bonds.



LIMITED OPERATIONAL AUDIT – Capital Program

2015 Construction Activities - Runway 16C-34C Reconstruction project

AUDIT OBJECTIVES AND SCOPE

The purpose of the audit was to ensure:

1. The contractors have complied with key contract deliverables such as:
 - providing materials of the specified quality and quantity, including quality control
 - meeting affirmative action goals
 - meeting apprenticeship goals
 - paying wage rates per the Project Labor Agreement
 - complying with safety and operational requirements
2. Management controls were adequate to ensure that:
 - the terms and conditions of the applicable FAA grant are met
 - change orders are appropriately authorized
 - status and regulatory reporting is accurate and timely
 - work oversight and inspection is adequate

We reviewed and analyzed records for the period January 1, 2015 - December 31, 2015.

HIGHLIGHTS AND ACCOMPLISHMENTS

During the course of the audit, we observed the following effective and efficient management practices:

- The project to date has been under budget - \$11.7 million was returned to overall capital program in March 2015 and \$10 million returned to overall capital program in December 2015. That is a \$21.7 million in savings realized to date.
- There were no operational incidents and no incursions – despite challenging demolition and construction work in the middle of an active airfield.
- The contractors exceeded the apprenticeship and affirmative action goals, providing higher paying construction jobs for women and minorities.
- Oversight by Engineering ensured that the contractors and sub-contractors paid the appropriate PLA wage rates, which were higher than the prevailing wage rates.
- Potential quality issues with the concrete for the runway were identified early in the project and satisfactorily resolved, with a resulting unavoidable delay in the schedule.
- There was active and close co-ordination with the FAA who was responsible for some of the construction and for certifying that navigation equipment was properly functioning.

LIMITED OPERATIONAL AUDIT – Capital Program

2015 Construction Activities - Runway 16C-34C Reconstruction project

AUDIT RESULT

The contractors have complied with the key contract deliverables. Management controls over the construction project were adequate.



