PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6b

Date of Meeting June 28, 2016

DATE: June 20, 2016

TO: Ted Fick, Chief Executive Officer

FROM: James R. Schone, Director, Aviation Business Development
Wayne Grotheer, Director, Aviation Project Management Group

SUBJECT: Airport Dining & Retail (ADR) Infrastructure Modifications – Budget Increase (CIP #C800638)

Amount of This Request:	$7,325,000	**Source of Funds:**	Airport Development Fund, Future Revenue Bonds
Est. Total Project Cost:	$21,278,000		
Est. State and Local Taxes:	$1,073,000		

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to (1) increase authorized funds for the Airport Dining and Retail Infrastructure Modification project (CIP #C800638) in the amount of $7,325,000 and (2) transfer $1,500,000 of budget from Baggage Optimization (CIP #C800612) back to ADR (CIP #C800638). Total ADR Infrastructure Modification project authorization would be $21,278,000.

SYNOPSIS

The ADR Infrastructure Modification project has encountered delays and disruptions that have led to increased costs. The causes for these increases can be placed into three categories: Scope Changes, Schedule Changes, and Soft Cost Increases. These causes are covered in more detail below.

This request is for an increase of $7,325,000 to the budget that Commission approved in the fall of 2014. Part of this amount will be added to the project in the form of a budget increase of $5,825,000. The remainder will come from a budget transfer of $1,500,000 back from the Baggage Optimization project. Funds were previously transferred to Baggage Optimization to construct elevator pits for the ADR project. The elevator pits are costing less than estimated which allows for funds to be transferred back to ADR.

The ADR redevelopment program will increase revenue to the Port by utilizing previously unused space and by strategically placing food and beverage and retail locations. While the project is now costing more to complete, the increased revenue will offset the cost of construction. However, if there are further delays that require re-work of the master plan, this may generate additional costs.

BACKGROUND

The ADR Program comprises approximately 100 dining, retail and passenger service locations throughout the Airport. Over the next several years, new locations will be constructed and nearly all of the existing locations will have construction in order to optimize the size, location and use to meet forecasted demand. The ADR Master Plan, which details all of these changes to units and the associated schedule for construction and leasing activities, served as the basis for the ADR Retail Infrastructure Modification Project, approved by the Commission in October 2014.

The ADR Infrastructure Modification Project will impact the full breadth of the Main Terminal. To date, designs for 13 individual ADR space and utility modifications have been completed; designs for the south side of the Central Terminal and two elevators have been completed; and a Job Order Contract has been awarded for construction of ADR space and utility modifications.

In addition, the Port has executed leases associated with Lease Group #1 (Hudson and Host units) and is in the process of awarding leases for the opportunities in Lease Group #2. However, numerous issues have affected the execution of the ADR Master Plan. These issues have led to a forecasted increase in costs above what Commission previously approved. The two main drivers for these cost increases are: changes in schedule and in scope. These changes have resulted in a corresponding increase in soft costs.

Schedule Changes:

Commission approved the leases with Host and Hudson (Lease Group #1) in December, 2014. The original schedule in the ADR Master Plan was to have construction on these units begin in May 2015. However, this schedule was disrupted by several factors: the departure of two key ADR staff in August 2015 who were the primary designers of the ADR Master Plan and the lead negotiators on the new leases with Hudson and Host; the ruling by the Washington State Supreme Court in August 2015 that the City of SeaTac's Ordinance 13-1020 (commonly referred to as Proposition 1) that set a $15.00 per hour minimum wage, does apply to ADR tenants at the Airport; and the Commission's subsequent approval of a change to the Airport's street pricing policy in November, 2015. The leases with Host and Hudson were not executed until March 31, 2016, approximately one year later than expected.

As a result of the delay in lease signing, not only was work delayed in units that were included in the new leases with Host and Hudson, but utility modification work in Hudson and Host units that were to be returned to the Port before lease expiration was also delayed. Then, in the summer of 2015, there was delay to the planned schedule for Lease Group #2 while additional outreach activities were conducted and changes made regarding which units to include in order to better align the leasing opportunities with the Port's goals for increasing the participation of small, local and disadvantaged businesses in the program. These delays led to construction cost escalation as well as more Port resources needed to handle a work load that became concurrent (Lease Group #1 and #2) instead of consecutive. The revised schedule has construction on the units in Lease Group #1 beginning in May 2016, one year later than originally planned.

In addition, there was significant re-work on the overall Master Plan to ensure that an adequate airport customer level of service was available during construction of all lease groups due to significantly higher enplanements than originally forecast. This rescheduling affected planned construction efficiencies and delayed the closure of several spaces to ensure adequate service levels. For example, there are contiguous locations that will change from dining to retail units. Previously, the water service would have simply been extended from one unit to the other. Now, due to the rescheduling, a new water service will be required since the existing dining unit's closure has been delayed to maintain airport customer Level of Service. Similar types of efficiencies were lost throughout the terminal as a result of the re-scheduling.

Scope Changes:

There are two major components to the additional costs associated with scope changes: scope validation and airport customer level of service due to the rapidly increasing passenger levels.

With the departure in August 2015 of two ADR staff persons who were the primary designers of the ADR Master Plan, there was a need to review and validate key assumptions regarding which utilities were needed at which spaces. This work led to significant scope changes including: natural gas installation at select dining locations, demolition of abandoned utilities to their source (no cutting and capping per previous assumptions), reconfiguration of a Concourse C bar due to an inability to tie into an existing grease interceptor as planned, and extension of Concourse D retail and food and beverage locations into adjacent storage areas requiring floor level modifications.

The second major component of the scope changes to the ADR Master Plan pertains to maintaining airport customer levels of service in light of continuing rapid increases in passengers beyond what was forecast in the initial ADR Master Plan. It is critical that the travelling public have access to an adequate amount of food and beverage locations during the construction of the ADR program, and that the Airport achieves the optimum balance of dining, retail and passenger services. As part of the Master Plan rework exercise, Port staff evaluated the highest and best use for each space and made changes where appropriate.

An example of such a change is a new Children's Play Area planned for Concourse D in what is currently a news and gift store location. Given a forecast of increased demand for food and beverage service on Concourse D, staff determined that the airport would be better served if the planned Children's Play Area location was converted into an additional dining unit. This required that new utilities be run to this location and a new Children's Play Area location found elsewhere. The team creatively identified a space for the Children's Play Area that is not suitable for dining and retail leasing due to elevation changes within the space. This elevation change that would make a dining and retail space unfeasible can be accommodated in a Children's Play Area by provision of a ramp. This new location for the Children's Play Area is both larger and more complicated to develop than the prior assumed location because of the elevation changes within this space.

Soft Cost Increases:

Included in the revised budget are also additional soft costs. These soft cost increases are due to additional design for revised scope, additional Engineering support for the management and inspection of the project, additional Project Management time for higher levels of involvement for the Project Manager and Project Scheduler, additional Building Department inspections for the additional scope, and additional Facilities and Infrastructure design reviews for the changed scope of work.

The ADR capital program is unique in that it has a relatively small budget when compared to the project duration. The capital budget is to be spent over the course of eight years (2014-2021). While the overall capital budget is relatively low for an eight year project, the cost to administer a project for eight years is a higher percentage of the project cost as compared to a project of similar size which would typically be completed in two years. Because of the need for extended administration, the ADR team has revised the method of pricing soft costs. Rather than applying a historical percentage rate to the construction budget, we have budgeted soft costs based on actual costs we expect to incur over the remaining duration of the project. Tenants are expected to spend a significant amount during this time. When tenant costs to design and construct their units and the Port costs to support these tenant projects are included with this ADR capital project, the overall total cost reaches approximately $90 – $95 Million.

The budget increase being requested is a reflection of all of the above issues and ADR's dedication to accomplishing the Commission's Century Agenda goal of creating 100,000 jobs by enhancing the Airport's profile as the preferred gateway to the Pacific Northwest, by creating new opportunities for small, local and disadvantaged businesses and by meeting the expectations of the travelling public for quality food service, retail products and personal services.

PROJECT JUSTIFICATION AND DETAILS

Airport staff recently updated the ADR sales projections through 2025 based on newly updated enplanement forecasts. With the revised program and the associated facility investments to support it, ADR gross sales are anticipated to grow by an additional $50 million, reaching $400 million in the year 2025 (the original projection was approximately $350 million). These gross sales are anticipated to generate an additional $7 million in revenue to the Port, reaching a total of $70 million in the year 2025 (the original projection was approximately $63 million).

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 increased 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 re-purpose existing dining and retail space to better 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 ADR offerings in every area of the Airport
- Ensure that necessary utility points of connection and other required infrastructure are in place for each leased unit to support operations
- Carefully phase work that could impact ongoing revenue generation and airline operations in the terminal and maintain an adequate Level of Service for airport customers.

Scope of Work

This project can be characterized as a collection of smaller projects to create new ADR spaces as well as provide infrastructure to existing tenant spaces in the Airport's main terminal.

Schedule

Activity	End
Design	Second Quarter 2017
Construction	First Quarter 2021

FINANCIAL IMPLICATIONS

Budget/Authorization Summary	Capital	Expense	Total Project
Original Budget	$10,900,000	$0	$10,900,000
Previous budget increase	$6,453,000	$0	$6,453,000
Budget Transfer to Baggage Optimization (CIP #C800612)	($3,400,000)	$0	($3,400,000)
Budget to be transferred back from Baggage (CIP #C800612) (In Progress)	$1,500,000	$0	$1,500,000
Current budget increase	$5,825,000		$5,825,000
Revised budget	$21,278,000		$21,278,000
Previous Authorizations	13,953,000		13,953,000
Current request for authorization	$7,325,000	$0	$7,325,000
Total Authorizations, including this request	$21,278,000	$0	$21,278,000
Remaining budget to be authorized	$0	$0	$0

Project Cost Breakdown	This Request	Total Project
Construction	$4,588,000	$13,936,000
Design	$2,444,000	$6,269,000
State & Local Taxes (estimated)	$293,000	$1,073,000
Total	$7,325,000	$21,278,000

Budget Status and Source of Funds

This project has been included in the 2016-2020 capital budget under CIP#C800638. The budget had been previously increased primarily due to the addition of the central terminal elevators and stairs as well as communications infrastructure to the project scope. The source of funding is the Airport Development Fund and future revenue bonds.

Financial Analysis and Summary

CIP Category	Capacity/Revenue Growth
Project Type	Business Redevelopment and Expansion
Risk adjusted discount rate	7.5%
Key risk factors	• 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	$23,178,000 (includes $1.9M transferred to Baggage project)
Business Unit (BU)	Non-Aeronautical (Airport Dining and Retail)
Effect on business performance	NOI after depreciation will increase
IRR/NPV	12.3%/15.6 million
CPE Impact	No direct impact. However, potential reduction in CPE due to increased 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, this project is consistent with guidance provided by the Commission in February 2012 and November 2014 regarding the redevelopment of the ADR Program.

The project manager will coordinate with the small business program manager to maximize the participation of qualified small business firms.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Utilize Current Budget without cost increase

Cost Implications: $0 Additional Capital Spent

Pros:

(1) Prevents the expenditure of an additional $7.3 million of non-aeronautical funds

Cons:

(1) Does not address issues of providing adequate airport customer Level of Service
(2) Limits PMG involvement in scheduling and managing the overall program
(3) Projects would likely take twice as long with limited project management support
(4) Extended project time could reduce anticipated revenues by up to approximately $5 Million to $6 Million.
(5) Tenants would incur higher buildout cost with missing infrastructure
(6) Extended project time would delay the additional jobs created from the new lease packages
(7) With variations in infrastructure within each unit, not all tenants would be treated equally

This is not the recommended alternative.

Alternative 2 – Request Authorization only for Infrastructure Validation Scope

Cost Implications: $2.9 million

Pros:

(1) Reduces request for additional funds from $7.3 million to $2.9 million
(2) Mitigates risk that tenants will require "relief" due to excessive build costs
(3) All utility infrastructure would be in place for tenant build out
(4) Reduces tenant infrastructure buildout costs, while providing more equitable treatment to tenants

Cons:

(1) Does not address growing airport customer Level Of Service issues

(2) Limits PMG involvement in scheduling and managing the overall program
(3) Projects would likely take twice as long with limited project management support
(4) Extended project time could reduce anticipated revenues by up to $1 Million to $3 Million.
(5) Tenants could incur higher buildout costs due to extend project timing.
(6) Extended project time would delay the additional jobs created from the new leasing packages.

This is not the recommended alternative.

Alternative 3 – Authorize Proposed Budget Increases

Cost Implications: $7,325,000

Pros:

(1) Allows for ADR Master Plan to be executed. Execution of plan will accommodate passenger growth.
(2) Adhering to the redeveloped ADR Master Plan maximizes gross sales
(3) New schedule and planning helps to maintain Level of Service to the traveling public.
(4) Allows PMG heavy involvement in the scheduling and management of the overall $90-$95 million program

Cons:

(1) Uses an additional significant sum of non-aeronautical funds.

This is the recommended alternative.

ATTACHMENTS TO THIS REQUEST

- Computer slide presentation.

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- June 14, 2016 – Request for authorization of Airport Dining and Retail Lease Group 3
- May 24, 2016 – (Briefing) Proposed 12 new opportunities encompassing 24 units in Airport Dining and Retail Lease Group 3
- May 17, 2016 – Request for authorization to advertise and execute a Public Works contract for the Central Terminal Elevators, Stairs, and Infrastructure Modifications
- December 8, 2015 – Request for authorization to conduct competitive solicitations and execute lease and concession agreements with selected proposers for new small business-oriented opportunities under Lease Group 2 in the Airport Dining and Retail program
- November 24, 2015 Request for Airport Dining and Retail Lease Group Authorization
- August 4, 2015 Request for Airport Dining and Retail Group Lease Authorization
- April 14, 2015 – (C800638-Design) Airport Dining and Retail Infrastructure
- February 24, 2015 – (Briefing) Airport Dining and Retail Outreach and Leasing Plans

- December 9, 2014 – Phasing Proposal for Hudson Group Leased Units
- December 9, 2014 – Phasing Proposal for HMSHost Leased Units
- December 9, 2014 – Amendment to Lease and Concession Agreement Anton Airfoods
- November 25, 2014 – Airport Dining and Retail Quality Jobs Motion/Guidance
- November 11, 2014 – (Briefing) Airport Dining and Retail Quality Jobs
- October 28, 2014 – Authorization to Design Airport Dining and Retail Infrastructure Modifications
- 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