Port of Seattle

COMMISSION
AGENDA MEMORANDUM

ACTION ITEM

Item No. 6d

Date of Meeting May 14, 2019

DATE: April 17, 2019

TO: Stephen P. Metruck, Executive Director

FROM: Susie Archuleta, Real Estate Manager
Melinda Miller, Director Portfolio and Asset Management

SUBJECT: Opus Office Expansion at World Trade Center West

Amount of this request:	$151,000
Total estimated project cost:	$151,000

ACTION REQUESTED

Request Commission authorization for the Executive Director to execute a First Amendment to the Opus Lease Agreement at the World Trade Center West, which would extend the original 60-month lease term by 16 months to a 76-month lease term.

EXECUTIVE SUMMARY

The World Trade Center West ("WTCW") is located on Alaskan Way, across the street from the Port's Pier 66 complex. It is situated at the edge of the Seattle waterfront redevelopment project, a massive construction project impacting the majority of Seattle's downtown waterfront. The proximity of the WTCW building to this construction project has been a major leasing hurdle, severely hampering leasing of vacant WTCW office space.

Opus Solutions, LLC ("Opus") is an existing WTCW third-floor office tenant. Opus's lease provides 11,927 square feet of office and a five-year term that expires April 30, 2023. The office tenant adjacent to Opus plans to vacate the building once their lease expires, on August 31, 2019. Strong demand for Opus's marketing services creates their need for more space and this request for an office expansion and extension of lease term.

Port Real Estate Policy RE-1 limits Term Agreements on Port property to a 60-month lease term. *This is a request for Commission approval of a 76-month lease term*, since this term exceeds the lease term permitted by RE-1. The total costs associated with this request are $151,000.

JUSTIFICATION

The Port's High Performance Organization Strategies and Objectives include Customer Satisfaction. Opus is requesting an office expansion to further the growth and financial success of their business. Authorization of the lease extension will support this tenant's growth and financial success, and should increase customer satisfaction.

Additionally, staff has building occupancy and rent rate goals. The WTCW building is currently 92 percent occupied. This occupancy rate will dip to 82 percent with the August 31, 2019, departure of an existing tenant. Approval of this request will enable staff to avoid any disruption to occupancy, keeping an entire floor of the WTCW leased, while also achieving market rent rates including annual escalation.

DETAILS

The Seattle waterfront is in the midst of major construction, including demolition of the Alaskan Way Viaduct and rebuilding of the waterfront. Although the WTCW building is located at the edge of this major development project, the market perceives the entire waterfront as being negatively impacted by construction. Evidence of this attitude is WTCW Suite 230, which has been vacant for over two years despite being represented by two different real estate brokers during that time. It is very difficult to attract new tenants to this building in the current waterfront construction climate.

Opus is an Oregon-based experiential marketing advisor and provider of global brand events. Opus recently expanded into the Seattle market. The existing Opus office lease provides 11,927 square feet of office and a five-year term that expires April 30, 2023. Since their May 2018 lease commencement, rents have been paid timely. They continue experiencing strong demand for their services, requiring more staff and therefore office space, to keep up with demand.

The tenant occupying the suite adjacent to Opus has a lease expiration of August 31, 2019. This tenant purchased their own office building in Seattle's Westlake neighborhood. Once their WTCW lease expires, they will vacate WTCW and move into their own office building.

The proposed First Amendment terms include a Tenant Improvement Allowance of $67,000 to be used by Opus to demise the wall between the expansion space and their existing office, demolish some existing private offices, and replace carpet and paint to match their existing finishes. This allowance will not cover the total cost of Opus's build-out, so Opus will pay out-of-pocket for the cost not covered by the Port's allowance. For this reason, the length of their lease term is important to Opus, as it establishes the amortization period for their out-of-pocket cost.

Port staff's goals for the WTCW include maintaining a high occupancy rate and achieving market rent rates. Leasing of vacant WTCW space while Seattle waterfront construction is in progress is very challenging. Since construction began, WTCW has been represented by two separate brokerage firms. Collectively, they have shown WTCW vacant space to a handful of interested parties and generated no offers on vacant Suite 230. Based upon this leasing experience, staff thinks it unlikely and unreasonable to expect different results from any additional space that becomes vacant in the WTCW building.

This First Amendment would stabilize the WTCW occupancy, enabling staff to achieve occupancy and rent rate goals, and would also achieve the Port goal of customer satisfaction. It preserves continuous rental income to the Port by avoiding an additional WTCW office vacancy and secures the occupancy of the entire third floor of the WTCW for five years at market rates that include annual escalations. Approval of this request provides:

1) expansion into the adjacent 6,641 square foot office space,
2) stable building occupancy,
3) market rent rates including annual escalations,
4) a lease term that continues five years after the expansion date, and
5) administration of only one lease agreement.

The First Amendment would provide Opus a total of 18,568 square feet of office and a lease term expiration of August 31, 2024. This new expiration date provides a 16-month extension of the original 60-month term. Because RE-1 limits lease terms to 60-months, Commission approval of the 16-month term extension is required.

Key Lease Terms:

		First Amendment *(amounts rounded)*
Premises sf		18,568
Original sf	11,927	
Expansion sf	6,641	
Term		76 months
Original	60 months	
Extension	16 months	
Effective date		September 1, 2019
Base Rent Blended Rate ($/sf/yr)		$17.96
Original	$16.82	
Expansion	$20.00	
Escalation ($/sf/yr)		$1.00
Abatement		2 months
Tenant Improvement Allowance		$67,000
Broker Fees		$62,000
Inside	$14,000	
Outside	$48,000	
Security Deposit (avg 3 months' rent)		$148,000
Original	$61,000	
Additional	$87,000	

Cost Breakdown	This Request	Total Project
Abated Rent	$22,000	$22,000
Tenant Improvement Allowance	$67,000	$67,000
Broker fees – inside	$14,000	$14,000
Broker fees – outside	$48,000	$48,000
Total	$151,000	$151,000

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Port offers Opus a separate, five-year agreement for the 6,641 square foot expansion space.

Cost Implications: $135,000

Pros:

(1) The Port saves $16,000 of Opus's broker fees by avoiding a 16-month extension of the term on the existing square footage.

Cons:

(1) The broker fee savings are likely not true savings, just a delay of the broker fees that will be due when the existing space is renewed later.
(2) Port misses the opportunity to lock in the existing Opus office space, which pays market rates, for 16 additional months.
(3) Opus is dissatisfied with the uncertainty of securing their existing premises for a longer term.
(4) Opus does not want to administer two separate office leases.

This is not the recommended alternative.

Alternative 2 – Opus First Amendment that provides only an expansion of space but no extension of term. The premises would increase to 18,568 square feet (original 11,927 square-foot premises plus expansion of 6,641 square feet) but the expiration date would remain April 30, 2023.

Cost Implications: $70,000

Pros:

(1) Lowest up-front costs.

Cons:

(1) Provides the shortest lease term, creating highest WTCW vacancy risk.
(2) Provides the Port with the least amount of rental income.
(3) Forces Opus to choose between high out-of-pocket build-out expense, since a shortened lease term decreases the amount of the Tenant Improvement allowance the Port will provide, or a reduction in the scope of its office build-out.
(4) Term is too short for Opus to achieve satisfactory amortization of its out-of-pocket expense for its office build-out.

This is not the recommended alternative.

Alternative 3 – Approve the Opus First Amendment which provides a 76-month term (original 60-month term plus an additional 16 months) and premises of 18,568 square feet (original 11,927 square-foot premises plus expansion of 6,641 square feet).

Cost Implications: $151,000

Pros:

(1) Provides the longest lease term of all the alternatives, creating the lowest WTCW vacancy risk.
(2) Provides the highest rental income to the Port.
(3) Creates highest customer satisfaction by supporting Opus's continued growth and associated need to expand.
(4) Supports Opus's financial success by providing a lease term that enables a satisfactory amortization period for their out-of-pocket build-out expenses.

Cons:

(1) Highest up-front costs.

This is the recommended alternative.

FINANCIAL IMPLICATIONS

Cost Estimate/Authorization Summary	Capital	Expense	Total
COST ESTIMATE			
Original estimate	$67,000	$84,000	$151,000
AUTHORIZATION			
Previous authorizations	0	0	0
Current request for authorization	0	0	0
Total authorizations, including this request	0	0	0
Remaining amount to be authorized	$0	$0	$0

Annual Budget Status and Source of Funds

The current total project estimate is $151,000. This project will be funded by the General Fund.

Financial Analysis and Summary

Project cost for analysis	$151,000
Business Unit (BU)	Portfolio Management
Effect on business performance (NOI after depreciation)	This project will generate the Total Cash Flow of $889,309 and increase the Net Operating Income by $1,017,887 for a 60-month lease term.
IRR/NPV (if relevant)	NPV = $750,405 with payback period less than 2 years

CPE Impact	N/A

Future Revenues and Expenses (Total cost of ownership)

Modernizing our existing assets readies them for current and future changes, extends their useful life, and preserves the economic vitality of our operations. If approved, it would preserve steady rental income by avoiding an office vacancy and securing the entire third floor of the WTCW for five years at market rates.

ATTACHMENTS TO THIS REQUEST

(1) Presentation slides
(2) First Amendment draft

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

None