



**COMMISSION
AGENDA MEMORANDUM**

Item No. 10c

ACTION ITEM

Date of Meeting May 10, 2022

DATE: May 3, 2022

TO: Stephen P. Metruck, Executive Director

FROM: Jeff Moken, Interim Director AV Business & Properties
Wayne Grotheer, Director Aviation Project Management

SUBJECT: Budget increase request – Concourse A Building Expansion for Lounges (C801205)

Amount of this request: \$26,500,000

Total estimated project cost: \$105,000,000

ACTION REQUESTED

Request Commission authorization for the Executive Director to (1) authorize a budget increase for the Concourse A Building Expansion for Lounges project at Seattle-Tacoma International Airport by Delta Air Lines, Inc; and (2) authorize an increase to the reimbursement amount to Delta. Total cost of this request is \$26,500,000 of an estimated total project cost of \$105,000,000.

EXECUTIVE SUMMARY

Delta Air Lines, Inc. (Delta), in preparation to construct the Concourse A Building Expansion for Lounges project at the Airport, has notified the Port of increased and escalating costs in establishing the final contract value with their contractor. Delta staff indicated this is a result of scope additions and schedule changes during design development from 60% design to 100% design, escalating costs for construction materials and labor, and volatility in the construction market and global supply chain.

This project constructs a building expansion towards the end of Concourse A that will incorporate a new passenger lounge for Delta and provide a new buildout space for the Port of Seattle common-use lounge: The Club at SEA. This project is expected to meet existing (pre-COVID-19) passenger demand for Delta's lounge. This project also supports Century Agenda Goal #2 to advance this region as a leading tourism destination and business gateway.

To achieve this, Delta has designed and endeavors to construct an approximately 52,000 square foot (SF) building expansion at the east side of Concourse A, across from Gate A11 and directly south of the International Arrivals Facility (IAF), using a Tenant Reimbursement Agreement (TRA) with the Port. Approximately 36,000 SF of the new space will be leasable, including the space

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that will be directly leased by Delta for their lounge. Delta is investing an additional \$35 million in the tenant buildout of their lounge.

JUSTIFICATION

Delta has requested to construct a new lounge on Concourse A to accommodate passenger demand that shifted from the South Satellite to Concourse A upon the opening of the IAF. The Port currently lacks sufficient space to meet this demand. Thus, to satisfy this request for additional leased space, the Port agreed to permit Delta to design and construct the lounge addition in undeveloped space governed by a TRA. In December 2021, Port Commission authorized the construction of this project. The value of the December TRA was based on 60% design documents. Today’s request is to increase the budget to incorporate additional costs based on the 100% design.

Diversity in Contracting

The Port collaborated with Delta and has included in the TRA a WMBE goal of 10%, an apprentice hiring goal of 15%, a women apprentice hiring sub-goal of 12%, a minority apprentice hiring sub-goal of 21%, and a priority worker goal of 20% for the construction contractor. Delta has stated that they will strive to exceed these goals.

DETAILS

Existing national and local construction market and global supply chain conditions have created significant cost uncertainty and volatility within the construction industry. As a result, Delta and the Port are eager for Delta to execute a Fixed Guaranteed Maximum Price (FGMP) with their contractor to reduce the risk of market volatility. The value of the request incorporates known and potential costs currently identified by Delta and their contractor. The division of those costs are still being negotiated between the Port and Delta, with both teams expediting their efforts to stave off future cost escalations.

To secure a reasonable level of cost certainty, the Port and Delta are requesting an increase of \$26.5 million for the total project. The value of the TRA will be increased from the previously authorized value of \$65.92 million to \$89.96 million. Delta’s original request to the Port was for an increase of the TRA value to approximately \$93 million. The Port and Delta continue to negotiate over the approximate \$3 million difference. The Port will retain that amount within the Port controlled portion of the budget until these negotiations can be completed.

The increased project costs fall into five categories:

<u>Issue Type</u>	<u>Value</u>
Scope Additions	\$8,000,000 (new items not previously estimated)
Market Conditions/Supply Chain	\$8,500,000 (material price increases)
Buyout Contingency/Risk Contingency	\$5,600,000 (risks due to volatile construction mkt.)
Delta Soft Costs	\$800,000 (design fees for scope adds + Delta PM

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Port Costs	\$3,600,000 (Port PM and contingencies)
TOTAL	\$26,500,000

After the Commission’s authorizations on April 27, 2021, and December 14, 2021, the Port and Delta entered into the TRA for this project on August 11, 2021, with an updated reimbursement letter issued on January 20, 2022, reflecting a maximum reimbursement amount to Delta by the Port of \$65,920,000. If this Commission request is authorized, the Port will issue an updated reimbursement letter that reflects an updated maximum reimbursement amount of \$89,960,000.

The project has been identified as a Tier Two project under the Port’s Sustainable Evaluation Framework. The project team analyzed concepts to reduce energy and carbon emissions, along with other initiatives to reduce solid waste, promote public transportation, and support employees. The team also calculated the total cost of ownership for the different sustainability concepts. The project will implement (1) triple-glazed electrochromic façade (“smart glass”); (2) all electric appliances (no natural gas); (3) low-flow water fixtures in the Delta lounge; (4) signage for public transportation options; (5) an employee breakroom; and (6) three new electric vehicle charging stations. The sustainability work and recommendations were reviewed by the Commission Sustainability, Environment and Climate Committee on November 18, 2021. The cost increases Delta has notified the Port about include unanticipated scope changes during design development notably to address the relocation of the Port’s maintenance shop and escalating costs for construction materials and labor.

Delta will be responsible for the cost and construction of the interior buildout of their lounge within the new building shell. The Port’s common use lounge, authorized by Commission for design on December 14, 2021, will be completed by the Concourse A Port Shared Use Lounge project.

Scope of Work

- (1) Construct a building addition of approximately 52,000 SF that will provide shell space for two lounges and associated building systems.
- (2) Reconfigure existing spaces to provide additional leasable office area, an entry foyer, a replacement restroom, and vertical circulation.
- (3) Demolish an existing airport building deemed unfit to renovate and construct a new building in its place to house the relocated Aviation Maintenance Department Passenger Loading Bridge shop that is being displaced by this project. The expense cost to move the shop is included in the budget.
- (4) Provide temporary restrooms for the Port common use lounge to keep the lounge operational during construction of the building expansion.

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Schedule

Activity

Commission design authorization	2021 Quarter 2
Design start	2021 Quarter 2
Construction start	2022 Quarter 3
In-use date	2024 Quarter 1

Cost Breakdown

	This Request	Total Project
Design	\$0	\$6,300,000
Construction	\$26,500,000	\$98,700,000
Total	\$26,500,000	\$105,000,000

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Limit the budget increase to \$23,500,000.

Cost Implications: \$102,000,000

Pros:

- (1) This is the lower cost alternative.

Cons:

- (1) This alternative unilaterally eliminates some of the design development and risk contingency built into the request from Delta. Port staff may not be able to reach an agreement at this cost with Delta.
- (2) Reducing the contractor risk contingency available to the project will hinder Delta’s ability to reach a Fixed Guaranteed Maximum Price (FGMP) with their contractor.
- (3) Market volatility may result in a need to return to the Commission for additional authorization in the future, risking further cost increase.

This is not the recommended alternative.

Alternative 2 – Increase the budget by \$26,500,000. Increase the TRA value to \$92,890,000.

Cost Implications: \$105,000,000

Pros:

- (1) Passenger lounge spaces will be expanded to accommodate anticipated return of demand.
- (2) Location of the lounge on Concourse A will support Delta’s operations on Concourse A.
- (3) The expanded lounges (Delta’s and the Port’s common use) will provide passengers an alternative to waiting for flights in crowded hold rooms, and the Club at SEA will support international airlines who do not possess their own branded lounge.

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Cons:

- (1) This alternative commits the highest amount to the TRA. Approximately \$3,000,000 of this amount is still under review and may not be necessary.
- (2) Funds are unavailable for other uses.
- (3) This is a higher cost alternative.

This is not the recommended alternative.

Alternative 3 – Increase the budget by \$26,500,000 for the project. Increase the TRA value to \$89,960,000.

Cost Implications: \$105,000,000

Pros:

- (1) Passenger lounge spaces will be expanded to accommodate anticipated return of demand.
- (2) Location of the lounge on Concourse A will support Delta’s operations on Concourse A.
- (3) The expanded lounges (Delta’s and the Port’s common use) will provide passengers an alternative to waiting for flights in crowded hold rooms and the Club at SEA will support international airlines who do not possess their own branded lounge.
- (4) This alternative authorized the full amount of the estimated project costs but retains Port control of the portion of the contractor request increase still under negotiations. This provides the flexibility to adjust the TRA value once those potential costs are realized in a timely fashion.

Cons:

- (1) Funds are unavailable for other uses.
- (2) This is the higher cost alternative.

This is the recommended alternative.

FINANCIAL IMPLICATIONS

<i>Cost Estimate/Authorization Summary</i>	Capital	Expense	Total
COST ESTIMATE			
Original estimate	\$60,000,000	\$0	\$60,000,000
Previous changes – net	\$18,450,000	\$50,000	\$18,500,000
Current change	\$26,500,000	\$0	\$26,500,000
Revised estimate	\$104,950,000	\$50,000	\$105,000,000
AUTHORIZATION			
Previous authorizations	\$78,450,000	\$50,000	\$78,500,000
Current request for authorization	\$26,500,000	\$0	\$26,500,000
Total authorizations, including this request	\$104,950,000	\$50,000	\$105,000,000
Remaining amount to be authorized	\$0	\$0	\$0

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Annual Budget Status and Source of Funds

This project, CIP C801205, was included in the 2022-2026 capital budget and plan of finance with a budget of \$71,400,000. A budget increase of \$33,600,000 was transferred from the Aeronautical Reserve CIP (C800753) resulting in zero net change to the Aviation capital budget. The funding source will include the Airport Development Fund and future revenue bonds. This project was approved Majority-In-Interest by the airlines on December 7, 2021.

Financial Analysis and Summary

This project is an investment in additional terminal space that is intended to be used for both aeronautical and non-aeronautical purposes. As a hybrid project, the financial analysis looks at the projects as both a standalone non-aero investment and a terminal investment that flows through airline rates and charges.

Aeronautical Rate Base Impacts

	2024		
	Aero	Non-aero	Total
	(\$000s)		
Rentable sqft without Conc A sqft	76.78%	23.22%	100%
Rentable sqft WITH Conc A sqft	76.89%	23.11%	100%
Project cost	\$ 80,731	\$ 24,269	\$ 105,000
Incremental Revenues WITHOUT Conc A SF	\$ 6,655		
Terminal distribution	<u>10</u>		
Incremental Revenues WITH Conc A SF	6,665		
Incremental Debt Service	6,665	2,002	8,667
Incremental Amortization	2.6	0.8	3.4
Incremental CPE			0.26
Incremental Terminal Rental Rate			4.61

With the Concourse A expansion, the net terminal square footage distribution has a minor impact on the analysis as the existing project space allocation is reasonably close to the existing allocations.

The table above shows that before Concourse A expansion, 76.78% of the terminal costs are allocated to the aeronautical rate base, which equates to incremental revenue of \$6,655,000. After adding the incremental square footage of this project, the percentage of terminal costs increases to 76.89%; this reflects an \$10,000 increase to Aeronautical revenue. Thus, in 2024 the net impact of the Concourse A expansion project is to contribute \$6,665,000 in incremental revenue to the aeronautical rate base.

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Terminal rents are established based on the total cost center costs. The project would be completed in Q1 2024. The full year of debt service and equity amortization begin in 2024. The incremental terminal rent would be \$4.61 and CPE of \$0.26 in 2024.

Non-aeronautical Investment Analysis

The purpose of this section is to demonstrate that the Port has a compelling business case as a non-aero investment. The non-aeronautical investment includes both the cost of new space included in this authorization request and cost of the interior build-out and furnishings (\$24.7 million) included in CIP C801207 (note that C801207 has not changed).

The table below shows the allocation of capital costs based on rentable square footage. For non-aero purposes, 18.17% of the rentable square footage, equating to \$19 million in capital cost, establishes the basis of the non-aero portion of the project. The lower part of the table identifies an incremental revenue increase of \$4.3 million in 2027. This new revenue, attributed to the airport lounge generates the positive Net Present Value of \$240K, which signifies a good investment. Given that the existing space is currently generating revenues, the NPV is netted against a base case (do nothing).

Non-aero Investments	Non-aero	Aero	Total
Concourse A rentable sqft	6,499	29,264	35,763
Concourse A rentable sqft %	18.17%	81.83%	
	\$ in 000s		
Base Building, C801205	\$ 19,081	\$ 85,919	\$ 105,000
Furnishings, C801207	\$ 24,726	\$ -	\$ 24,726
Total Capital	\$ 43,807	\$ 85,919	\$ 129,726
Non-Aero Analysis			
Payback (years from opening)	8		
NPV (through 2043)	\$ 40,330		
NPV Incremental to Base	\$ 240		
	2024	2027	
Incremental Non-aero Revenue	\$ 1,114	\$ 4,948	
Incremental Non-aero O&M	\$ (337)	1,210	
Debt service TERMB to Non-aero	\$ (2,004)	(2,004)	
Non-aero Net Cashflow	\$ (553)	\$ 1,734	

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Future Revenues and Expenses (Total cost of ownership)

The tenants would pay operating and maintenance annual costs in their space since maintenance of exclusive premises is the responsibility of the lessee. Those costs are not included in the amount shown below. This project provides 29,264 SF of aeronautical rentable space, as well as 6,499 SF of rentable non-aeronautical space.

Facility elements outside of or supporting the exclusive premises, such as custodial services, domestic water, power, and HVAC will generate some additional demand for Aviation Maintenance services, and those annual operating and maintenance costs for the new space are estimated to be \$340,000, according to the cost breakdown below:

Custodial services	\$275,000
Facilities services	30,000
Electrical systems	18,000
Mechanical systems	17,000

ATTACHMENTS TO THIS REQUEST

- (1) Presentation slides

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

December 14, 2021 – The Commission authorized construction and reimbursement to Delta Air Lines and utilization of Port crews for construction and support.

April 27, 2021 – The Commission authorized design and execution of a TRA for this project.