Memo revised February 8, 2010

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA | **Item No.** 6e
Date of Meeting February 9, 2010

DATE: February 8, 2010

TO: Tay Yoshitani, Chief Executive Officer

FROM: Michael Burke, Senior Manager, Container Leasing and Operations
Michael Campagnaro, Manager, Container Leasing and Operations

SUBJECT: Term Lease with Kinder Morgan Liquids Terminals, LLC at Terminal 18, Harbor Island Central.

ACTIONS REQUESTED:

1. Request for authorization for the Chief Executive Officer to execute a ten-year lease, with options to renew for two additional five-year terms, with Kinder Morgan Liquids Terminals, LLC, at Terminal 18 Harbor Island Central.

2. Request for authorization for the Chief Executive Officer to execute a Conditional Consent to Sublease Agreement for Kinder Morgan Liquids Terminals, LLC, at Terminal 18 Harbor Island Central to sublease a portion of the premises to Chevron USA, Inc.

BACKGROUND:

Kinder Morgan Liquids Terminals, LLC (“KML”), previously known as GATX Terminals, is an industrial site (petroleum bulk storage and distribution facility) located on Harbor Island. The facility has been in operation since 1944 under three different owners.

On September 14, 1976, the Port entered into a twenty-five year lease (total term including renewal options), with Shell Oil Company (“Shell”), a Delaware corporation. On December 16, 1994, GATX Terminals Corporation (“GATX”) acquired Shell and assumed the above-referenced lease between the Port and Shell. On December 27, 1994, the Port consented to the subleasing by Shell of a portion the leased premises to Chevron USA, Inc., subject to the overriding terms and conditions of the lease between the Port and Shell. It is standard Port practice to only consent to subleasing on a conditional basis. The conditional nature of the sublease primarily pertains to the Lessee remaining liable and responsible under all terms of the lease despite the Port’s consent of sublease to Lessee.

On December 31, 2002, the above-referenced lease expired and the agreement has been on holdover since this date. The lease has been on holdover due to ongoing negotiations on specific lease conditions. The Port has been getting the proposed revenue during the holdover status.

Therefore, the Port had no reason to compromise with KML for the new lease on conditions. KML has finally agreed to the Port's standard lease and the Port is ready to finish fulfilling the 2003 agreement with KML.

The lease continued under GATX until 2001. In March 2001, Kinder Morgan Energy Partners, L.P. ("KMP") completed acquisition of GATX property and pipeline assets held by GATX. In addition to the new acquisition by KMP, the lease boundaries also changed in 2001 in order to accommodate the Terminal 18 expansion project.

In 2003, the Port and Kinder Morgan completed a comprehensive agreement to relocate the Terminal 18 fuel pipelines from the center of Terminal 18 to the north end, fulfilling a lease commitment to SSA Terminals. In addition, as part of that agreement, Kinder Morgan agreed to quit claim any rights it had for street right of way in 11th Avenue and the Port agreed to execute a new lease for the truck fueling area for ten years, with two five year options. The pipeline agreement and the terms of the general agreement with Kinder Morgan were approved by the Commission on May 27, 2003 (attached). The new lease for the truck fueling area was to be a separate Commission action.

Port staff and Kinder Morgan entered in negotiations for the lease of the truck fueling area but were unable for some time reach agreement on insurance and liability issues. The Port has had Kinder Morgan on a month-to-month lease for the area paying the same rate as proposed in the long-term lease. Recently, Kinder Morgan and the Port reached agreement on the long-term lease conditions. KML is currently paying the rate of $1.80 per square foot per year. Once the Lease agreement is signed and fully executed, a rent adjustment will be processed to reflect the new rent amount of $1.9812 per square foot per year effective October 1, 2008.

The Port's Legal Counsel has reviewed the proposed term agreement with Kinder Morgan Liquids Terminals, LLC ("KML"), subsidiary of KMP. As per the previous agreement, the lease is a new ten-year lease agreement with option to renew for (2) additional five (5) year terms. KML also agreed to the environmental terms and conditions required by the Port under the proposed new lease agreement.

KMP/KML is one of the largest independent pipeline transportation and energy storage companies in North America with more than 35,000 miles of pipelines and 170 terminals. KMP/KML transports, stores, and handles energy products such as natural gas, refined petroleum products, crude oil, ethanol, coal and carbon dioxide (CO_2). These products are essential for generating electricity, heating homes, powering cars and much more.

The major elements of the proposed term lease are outlined below.

MAJOR ELEMENTS OF PROPOSED LEASE:

Term: Ten years, effective October 1, 2008, through September 30, 2018.

Renewal Options:	Option to renew lease for two (2) additional five (5) year terms.
Use:	Storage and distribution of petroleum products.
Area:	119,195 square feet (sf) improved land.
Rental:	119,195 at $1.9812/sf/year = $19,679.09/month.
Rent Increase:	Consumer Price Index increase every twelve months.
Port Improvements:	None.
Termination:	12-month major Port improvement clause.
Maintenance:	All maintenance is the sole responsibility of Lessee.
Utilities:	Except for water surface fees which are billed back to Lessee, all utilities are paid by Lessee directly to utility suppliers.
Security:	Bond for $118,074.54 (equal to six months' rent).
Insurance/Liability:	$5 million General Liability/ $1 million Auto Liability/ $5 million Environmental Liability; all with a 45-day cancellation notice.
Assignment/Sublease:	Port written consent required. The Port consents to KML's sublease with Chevron USA, Inc. Sublease is subject to the overriding terms and conditions of the lease between the Port and Lessee.

ADDITIONAL INFORMATION:

The Port and KML currently have a separate license agreement for dockage at Terminal 18 for the operation of the fuel transfer facility for loading and unloading petroleum into and from tankers, barges, and other vessels. The license is for a ten year term and has (4) renewal options of five (5) years each. The proposed term lease is critical for KML continued operations at Terminal 18.

ALTERNATIVES CONSIDERED/RECOMMENDED ACTION:

- Do Nothing: Doing nothing at this time would mean the tenant's current lease agreement would remain on holdover status. This would not be consistent with the previous agreement with Kinder Morgan for relocating their pipeline at Terminal 18, nor would it be consistent with the prior Commission action on May 27, 2003.

- Execute Proposed Lease: Proceeding with the proposed lease agreement will allow the Port to incorporate environmental, security, and other liability language, which otherwise the Port will not be able to incorporate without a new agreement or an amendment. In addition, the new agreement will allow the Port to secure a rent revenue stream. ***This is the recommended action.***

FINANCIAL IMPLICATIONS:

Source of Funds

No funds needed.

Financial Analysis Summary

<table>
<tr><td>CIP Category</td><td>NA</td></tr>
<tr><td>Project Type</td><td>NA</td></tr>
<tr><td>Risk adjusted Discount rate</td><td>7.5%</td></tr>
<tr><td>Key risk factors</td><td>A potential risk factor of any lease is tenant default, however the risk of default mitigated for this lease agreement due to the following factors:

Kinder Morgan has been a tenant of the Port since 2001, with excellent payment history.
Over the term of its tenancy, Kinder Morgan has consistently met its financial and lease obligations to the Port, provided the required liability insurance, and maintained the required lease security per Port lease policy (equivalent to 6 months’ rent under this proposed new agreement).
</td></tr>
<tr><td>Project cost for analysis</td><td>N/A</td></tr>
<tr><td>Business Unit (BU)</td><td>Container Support Properties</td></tr>
<tr><td>Effect on business performance</td><td>The Net Operating Income (NOI) Before Depreciation for years 2010 through 2014 of the proposed lease is shown below.
<table>
<tr><th>NOI (in $000's)</th><th>2010 (a)</th><th>2011</th><th>2012</th><th>2013</th><th>2014</th></tr>
<tr><td>Incremental Revenue</td><td>$265</td><td>$244</td><td>$250</td><td>$256</td><td>$262</td></tr>
<tr><td>Incremental OpExpense</td><td>$0</td><td>$0</td><td>$0</td><td>$0</td><td>$0</td></tr>
<tr><td>NOI Before Depreciation (b)</td><td>$265</td><td>$244</td><td>$250</td><td>$256</td><td>$262</td></tr>
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Note:
(a) Assumes the lease is executed in Feb 2010. 2010 incremental revenue includes the retroactive rent increase payment due at lease execution. Revenue received during hold over status not included.
(b) There is no incremental depreciation associated with this lease.
In addition to this Lease Agreement for premises rent, Kinder Morgan is</td></tr>
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	party to a 10 year License Agreement that generates revenue to the Port via dockage and service & facilities fees based on liquid bulk volume transported through Kinder Morgan's Terminal 18 facility. The License Agreement term continues through May 2015. Additional revenue associated with the License Agreement (of approximately $380,000/yr) is not reflected in the NOI Before Depreciation shown above.
IRR/NPV	**NPV** (in $000's): **$1,643** The Port has no additional investment obligation associated with this lease, so IRR and Payback are not applicable.

PREVIOUS COMMISSION ACTION

On May 27, 2003, the Port Commission approved the easement and funding for the relocation of the Terminal 18 pipeline as part of a comprehensive agreement with Kinder Morgan for issues related to the Terminal 18 expansion, including a commitment to bring to the Commission for approval a long-term lease for the truck fueling area.