PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA | **Item No.** 6a
Date of Meeting September 7, 2010

DATE: August 19, 2010

TO: Tay Yoshitani, Chief Executive Officer

FROM: James R. Schone, Director, Aviation Business Development
Deanna Zachrisson, Manager, Aviation Concessions Business

SUBJECT: Preparation of Duty Free/Specialty Retail Concessions Spaces within Concessions Unit Readiness Project (CIP # C800147)

Amount of This Request: $229,000

Source of Funds: Airport Development Fund

State & Local Taxes Paid: $17,000

Jobs Created: 8 (Eight)

Total Estimated Project Cost: $2,087,000

ACTION REQUESTED:

Request Port Commission authorization for the Chief Executive Officer to authorize Port Construction Services (PCS) to perform work in conjunction with small works contractors and issue small works contracts in support of the Concession Unit Readiness Project (CIP# C800147) at Seattle-Tacoma International Airport (Airport). This authorization is for $229,000 of a total estimated project cost of $2,087,000.

SYNOPSIS:

The purpose of the Concessions Unit Readiness Project (formerly the "Renewal & Replacement Project") is to reconfigure and prepare concession spaces for new tenancy. The Commission authorized design for the project in August 2008. This authorization request is for construction work to prepare two units (in the North Satellite and Central Terminal) for an anticipated new tenant on January 1, 2011.

BACKGROUND:

In August 2008, the Commission authorized $357,000 to design shell space improvements for specific concession spaces at the Airport. The ten total spaces (eight in-line units and two kiosk locations) are shown on Exhibit A. All units were intended for use by future specialty retailers. Shortly after this initial authorization, the economy began to decline which affected consumer spending, and the Airport also learned of imminent airline relocations. Both of these events caused Port staff to reevaluate the scope and timing of the project.

While design moved forward, staff planned for delay of construction until economic conditions stabilized. In a rapidly changing Airport environment, staff also eliminated one in-line and two kiosk locations from the scope because of changed space use or business considerations. Due to the changes in the scope of the project, Port staff did not use a portion of the design funds. The total unused portion of the original authorization is $168,000. Staff would like to retain the flexibility to engage these design funds, if other units become viable for development as a result of future airline relocations.

Both the economy and operational impacts have stabilized in 2010. The interest in new concessions opportunities also has improved. In light of this improvement, and the significant opportunity for the Port to increase its revenues, Port concessions staff issued its Request for Proposals (RFP) in July 2010 for a new concessionaire to offer both duty free and specialty retail merchandise. The Port plans to make a total of five units available for a new duty free/specialty retail concessionaire on January 1, 2011 (see Exhibit B). At this point in time, Port staff is seeking authorization to move forward with construction work on two of the units included in this RFP.

Transitions for new tenants into existing spaces are complex. In some cases, a new tenant will operate in a previous tenant's existing space while planning for renovation of a unit, and then operate out of a temporary location during construction. In this case, two of the five units in the duty free/specialty retail RFP are within the scope of the Concessions Unit Readiness Project and would be subject to initial construction work before the new tenant takes occupancy. The remaining units would be turned over to the new tenant for occupancy "as-is," but would undergo tenant renovation at a later date.

PROJECT DESCRIPTION/SCOPE OF WORK:

The new duty free/specialty retail concession contract will include five units. Two of these units are intended to be improved prior to new tenancy within the scope of the Concession Unit Readiness Project.

North Satellite:
This duty free/retail space is 2,019 square feet (Exhibit A, NS-11 and NS-2 combined). It is occupied by the current duty free operator, and it has not been upgraded since the early 1990s. The tenant would be required to develop the existing space into two separate spaces. One space would be 1,344 square feet, and a smaller adjacent space of 675 square feet.

The current unit serves domestic travelers with retail/duty paid merchandise, and international travelers bound for Canada and Japan with duty free tobacco and alcohol. The flight service to Japan is operated once-daily by United Airlines. Due to the possibility that the carrier mix in the

North Satellite may change (i.e. United Airlines relocates to another part of the Airport) and thereby reduce the number of duty free customers, the Port project will add utilities on the outside wall of the larger shell space to allow for a small duty free wall-unit kiosk which can be opened or closed for service of a specific flight or time period. This would provide the operator with the flexibility to focus on specialty retail in both in-line units and duty free on an as-needed basis, which also would optimize revenue to the Port.

Since early 2009, enplanement levels have grown dramatically in the satellite as a result of Alaska Airlines consolidation of operations to the North Satellite and Concourse C. The North Satellite has no other specialty retail offerings beyond the opportunities afforded by the two proposed new locations. Two gate area kiosk locations in the original scope of the project (Exhibit A, NS-12, NS-13) were removed because Alaska Airlines now leases these areas.

The work will specifically include installing utilities (power, electrical meter, communications) on the outside wall of unit NS-11 for the wall unit kiosk. Utilities also will be installed in a nearby Port-controlled area near Gate N9 which could serve as the temporary location for the duty free business, if necessary.

Central Terminal:

The location is an undeveloped concessions space created, but not finished to a shell standard, by the Central Terminal Expansion project in 2005 (Exhibit A, CT-28). This unit is included in the recent Request for Proposals for a new duty free/specialty retail operator. It is not currently occupied by a tenant. The unit had been under contract with Clear Channel Airports (CCA) as a planned advertising exhibit space, however, CAA was not successful in securing an advertiser, and staff recommends that it be developed as a retail concessions space, as originally intended.

The location is on the northern flank of the Central Terminal, near the confluence of Concourses C and D, and in close proximity to an existing duty free unit operated by Host (Exhibit A, CD-15). Due to unpredictable changes in air carrier operations with international service (primarily to Canada), these two adjacent units provide the new operator the flexibility of offering duty free merchandise with specialty retail in either of the units.

The work will specifically include raising the level of the unit floor which is currently 12” below the granite flooring of the terminal. It will also include the installation of electrical utilities to the lease line of the unit.

Other Duty Free/Retail Units:

There are additional locations included in the duty free/specialty retail RFP; however, they are not in the scope of the Concessions Unit Readiness Project. A 1,600 square foot unit, mentioned above and located on Concourse D (Exhibit A, CD-15) has been renovated within the last five years and thus does not need any base building improvements.

The remaining unit is the largest duty free location at the Airport, and is situated at the west end of the South Satellite (Exhibit A, SS-4). Infrastructure changes in the satellite following the relocation of Delta Airlines will impact this unit and result in a loss of square footage. Port staff plans to return to the Commission in late September with a proposal to address these impacts to the duty free location, as well as add much-needed new food and beverage restaurant capacity, and address operational problems presented by the increase in passenger volumes that have resulted from Delta's move and new international flight service.

Next Steps:
Port staff issued an RPF on July 9, 2010 for a new duty free/specialty retail concessionaire. Proposal responses are due on September 28, 2010. The pre-proposal conference in August drew a strong group of potential proposers, and staff expects to receive as many as six duty free companies as proposers. Proposal interviews will be conducted in early October with the intent to award the business in late October or early November. The current authorization would allow work to begin in advance of the new tenant's first day of occupancy. In particular, beginning the work on the Central Terminal unit as quickly as possible will allow the new operator to complete their build-out work and begin generating revenue earlier in 2011. While there is a slight risk associated with beginning work before contract award, it is appropriate to move forward given the high level of certainty that the Port will be able to select a new concessionaire as a result of this process. The RFP document designates the spaces with this future configuration, and proposers are proposing accordingly.

STRATEGIC OBJECTIVES:

Ensure Airport and Seaport Vitality

The purpose of this work is to bring existing base building infrastructure up to Port standards so a future tenant can complete their construction in ready concession spaces. The new units will enhance the concession program and generate additional income to the Port. The estimated payback is five years.

Exhibit Environmental Stewardship through Our Actions

This project has no specific impacts to the Port's environmental goals.

FINANCIAL IMPLICATIONS:

Budget/Authorization Summary	N. Sat & CT	Total Project
Original Budget		*2,231,000*
Budget Decrease		($144,000)
Revised Budget		$2,087,000

Previous Authorizations	$79,000	$357,000
Current request for authorization	$229,000	$229,000
Total Authorizations, including this request	$308,000	$586,000
Remaining budget to be authorized	$0	$1,501,000

Project Cost Breakdown	**This Request**	**Total Authorizations (including this request)**
Construction costs	$178,000	$183,000
Port furnished equipment	$0	$0
Sales tax	$17,000	$17,000
Outside professional services	$0	$186,000
Aviation PMG and other soft costs	$34,000	$200,000
Total	$229,000	$586,000

Source of Funds

The funding source will be the Airport Development Fund. The project is included in the 2010 capital budget and will be included in the 2011 capital budget.

Financial Analysis

CIP Category	Revenue/Capacity Growth
Project Type	Business Expansion/New Business Development
Risk adjusted Discount rate	9%
Key risk factors	The financial risk is the possibility that the lease-up does not occur as planned and revenue generation is delayed.
Project cost for analysis	$229,000
Business Unit (BU)	Aviation Business Development
Effect on business performance	NOI after depreciation increases $100K-$200K per year
IRR/NPV	Total project NPV of $1,096,739. Based on projected build-out costs and sales projections, payback is two (2) years.
CPE Impact	None.

ECONOMIC IMPACTS:

This project will create new business and employment opportunities. Due to the complex and highly regulated nature of the duty free business (sales of primarily alcohol, tobacco and luxury brand goods), the industry is dominated by large, non-U.S. based companies (the predominant players in the U.S. market are based in the U.K., Spain, Switzerland and Hong Kong). There are a limited number of U.S.-owned duty free companies operating in large airports, none of which are located in Washington State. Therefore, this is not anticipated to be an opportunity for a local small business. However, the Port's Request for Proposals requires proposers to demonstrate in their proposals how they intend to support the local and small business community through purchasing, partnerships or other means. Points will be awarded for this part of the proposal.

ENVIRONMENTAL SUSTAINABILITY/COMMUNITY BENEFITS:

There are no negative environmental impacts anticipated as a result of this project. Upgrades will be constructed using carefully chosen materials with demonstrated long life and durability in an airport environment. Recycled materials for construction will evaluated and used wherever appropriate and available.

TRIPLE BOTTOM LINE SUMMARY:

This work will develop new economic and employment opportunities by enhancing the concessions program; generate additional non-aeronautical revenue; and allow for the quickest possible tenant build-out of new concession concepts. The traveling public will have a greater range of choice in duty free and retail shopping.

PROJECT SCHEDULE:

- Commission Authorization to Construct — September 2010
- Construction Complete — December 2010

ALTERNATIVES CONSIDERED/RECOMMENDED ACTION:

Alternative 1: Do not develop these concession spaces. This alternative means that the Concessions Unit Readiness Project would not move forward with preparation of these units for the concessionaire. Port staff would instead issue an addendum to the Airport's current RFP to eliminate the North Satellite wall kiosk and Central Terminal unit. The Central Terminal unit would remain unoccupied and without any revenue stream. The RFP addendum could necessitate an extension of the bid period, and the extension of the existing duty free agreement with Host beyond December 31, 2010. Without a lease extension, a loss of current duty free revenue of approximately $1 million in 2011 could result. Host has already committed to end the lease of its bonded off-site warehouse, which could make continued operation difficult.

Alternative 2: Require the future tenant to make infrastructure improvements. This alternative would require no Port expenditures. The future tenant would be required to perform the base building infrastructure improvements, in addition to their concession build-out construction. This course of action would result in higher costs borne by the tenant. Tenant sponsored construction could lead to lower proposed rent to the Port over the life of the lease term, and thus lower the Net Present Value. This alternative would require issuing an addendum the RFP to include the new requirement, and also would likely necessitate the extension of the bidding period and of the existing duty free agreement, similar to Alternative 1.

Alternative 3: Authorize construction to improve the duty free/specialty retail spaces. The airport's duty free concession is the last significant business from the former master concessionaire era that has not benefited from major revitalization. A new operator, along with new units that appeal to the traveling public, has the potential to substantially increase revenues to the Port. Additionally, the North Satellite has seen dramatically increased enplanement activity which bolsters the business opportunity. The investment payback for the three units in this request is two (2) years. This is the recommended alternative.

OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:

Exhibit A: Units originally included in the project scope for the Concessions Unit Readiness Project in August 2008

Exhibit B: Units included in the Port's 2010 Request for Proposals for Duty Free/Specialty Retail

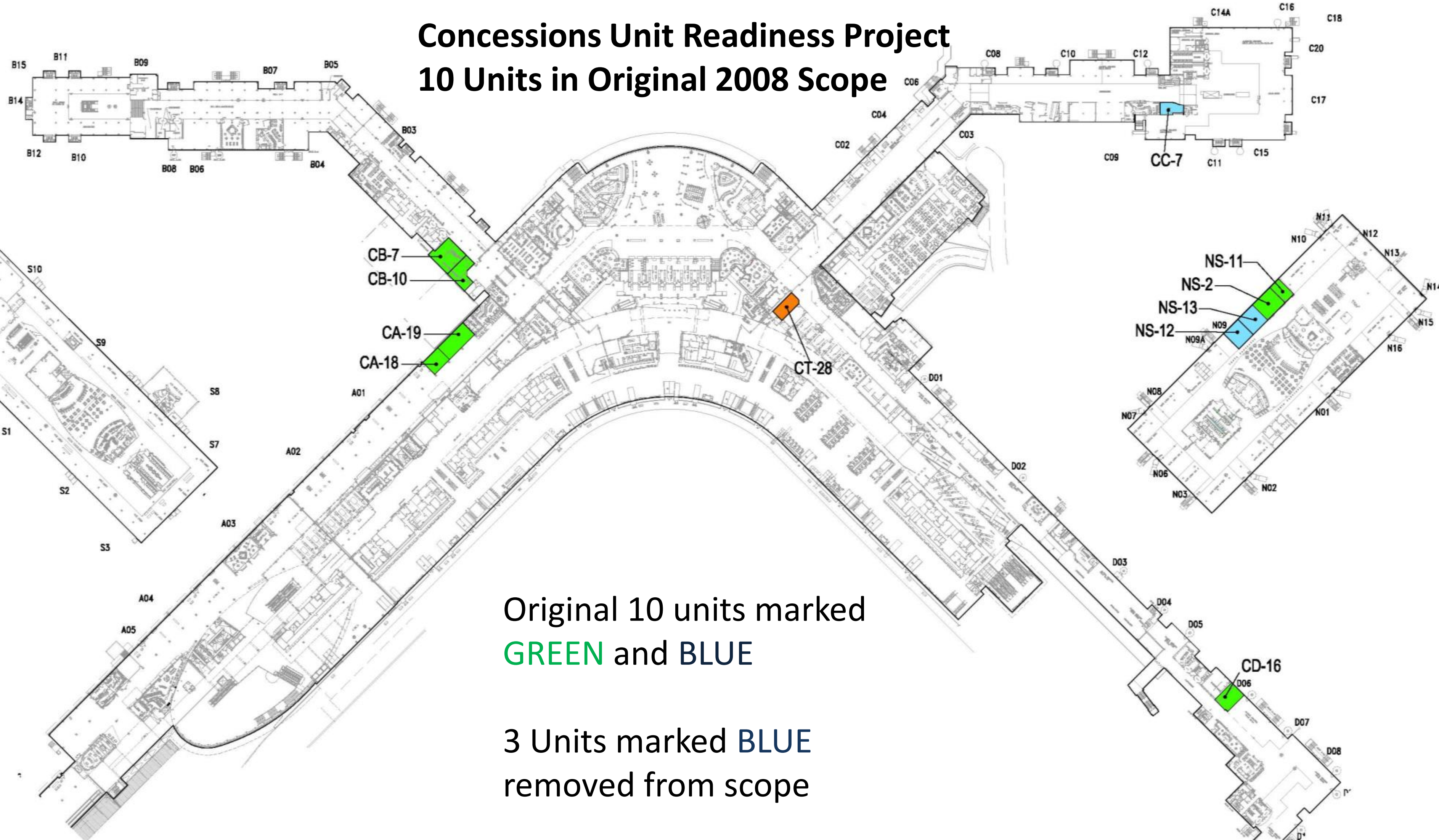
Power Point Presentation

PREVIOUS COMMISSION ACTION:

On August 26, 2008, Commission authorized $357,000 for project work on multiple concessions shell spaces in preparation for new retail concession development.

EXHIBIT A

Concessions Unit Readiness Project
10 Units in Original 2008 Scope

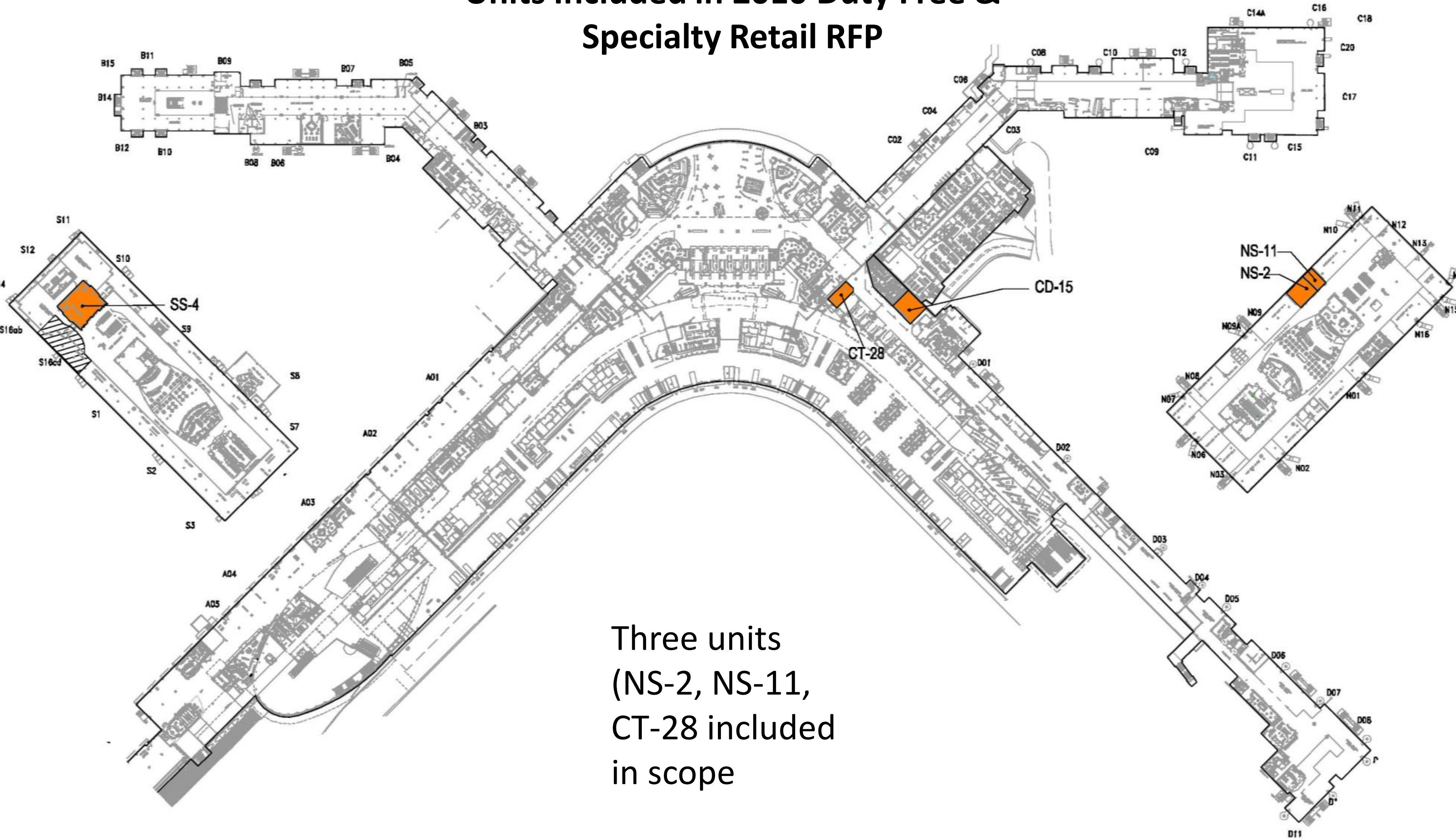


Original 10 units marked GREEN and BLUE

3 Units marked BLUE removed from scope

1 Unit marked ORANGE added to scope

Units Included in 2010 Duty Free & Specialty Retail RFP



Three units (NS-2, NS-11, CT-28 included in scope