

**PORT OF SEATTLE**  
**MEMORANDUM**

**COMMISSION AGENDA**

**Item No.** 6b

**Date of Meeting** March 23, 2010

**DATE:** March 11, 2010

**TO:** Tay Yoshitani, Chief Executive Officer

**FROM:** Michael Ehl, Director Airport Operations  
James R. Schone, Director, Aviation Business Development  
James Jennings, Property and Facility Manager

**SUBJECT:** Tenant Reimbursement for Delta Air Lines (CIP # C800336)

**Amount of This Request:** \$5,440,000      **Source of Funds:** ADF

**Estimated amount of Sales Tax:** \$250,000      **Estimated Construction Jobs:** 100

**ACTION REQUESTED:**

Request for authorization for the Chief Executive Officer to authorize \$5,440,000 of tenant reimbursement budget associated with the build-out of an airline lounge on the roof of the South Satellite at Seattle-Tacoma International Airport ("Airport") and to execute a Tenant Reimbursement Agreement with Delta Air Lines ("Delta") under the Airport's AV-2 policy.

**SYNOPSIS:**

Delta has requested that the Port of Seattle ("Port") approve a tenant improvement project to build 6,800 square feet of new airline lounge space on the roof of the South Satellite. This project benefits both Delta and the Port. Delta will enhance its competitive position by having an expanded Sky Club lounge, and the Port will obtain an additional \$615,000 in annual incremental rent from Delta. Additionally, the Port will relocate and improve a common-use airline lounge for smaller carriers when Delta vacates its current lounge. This improved common-use lounge will assist the Port in marketing to new international carriers and routes.

The impact of this project will be an increased cost per enplanement of \$.02 and a slightly reduced average terminal rental rate due to the increased total square footage of leased space. The other airlines have been briefed on this overall project and are expected to support it.

With Commission authorization, staff will finalize negotiations, execute a Tenant Reimbursement Agreement, add the Premises to the existing Lease, award the Regulated Materials abatement contract, and authorize Delta to begin construction. This is expected to be

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the final authorization apart from any unexpected scope or budget changes that would fall outside of the requested budget.

### **BACKGROUND:**

On January 1, 2006, the Port and Delta entered into Signatory Lease and Operating Agreement No. 000734 ("Lease") for certain Premises within the Airport. The Airport shares a common Lease with all signatory carriers that operate at the Airport. The Lease expires on December 31, 2012, and a new lease will be renegotiated with all airlines. It is expected that Delta will retain this Lounge as part of the new lease.

Delta sent a Letter of Intent dated November 9, 2009, to the Port, requesting to build a new airline lounge on the roof of the South Satellite as a tenant improvement project. The new airline lounge will add 6,800 square feet to Delta's leased space. Delta indicates that this expanded airline lounge is needed to accommodate increased passengers resulting from its merger with Northwest Airlines, as well as to accommodate the prospect of future growth in volume of international passengers traveling through Seattle.

The Port has provided conceptual approval of the tenant project and Delta is in the midst of the design process. Commission previously authorized the associated Regulated Materials Abatement scope on February 9, 2010, and staff is awaiting Commission's authorization of this project prior to any award that would initiate the abatement work.

The terms of the reimbursement will be guided by the Port's new Tenant Reimbursement Procedure AV-2 (attached), which was reviewed by the Legal Department and formalized in 2009 to provide a mechanism for ensuring compliance with Section 2.4 of Resolution No. 3605. Generally, a tenant improvement project qualifies for reimbursement from the Port when the tenant's construction project creates a new Port asset and/or increases the ability for the Port to collect increased rent above and beyond what it would have collected prior to the tenant improvement. If a project qualifies, the Port and the tenant negotiate the split of scope and costs and ultimately sign a Tenant Reimbursement Agreement prior to construction. After construction is completed, the tenant may request an increase in reimbursement based on approved change orders, unforeseen conditions or Port-driven scope changes. According to Resolution No. 3605, the Commission must approve any Tenant Reimbursement Agreements above \$200,000, or authorize the CEO to execute such Agreements. If actual costs to the Port look to exceed the authorized amount, staff will return to the Commission to outline the circumstances and request additional funding.

Although the Aviation Division currently has a Tenant Reimbursement CIP (CIP #C800154) that was previously authorized, this particular project was not identified at that time, and there is not adequate budget to cover this large-scale project. Therefore, it is necessary to establish a new separate capital project to reimburse Delta. The Aviation Division's 2010 capital budget and

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Plan of Finance carried \$4,000,000 of this budget as a business plan prospective project. This project will require a MII vote from the Airline Airport Affairs Committee (AAAC), and has been presented to the AAAC on two occasions (April 22, 2009 and June 18, 2009) and received supportive comments.

Delta's request to build an airline lounge is the first major tenant improvement project under the new AV-2 procedure. The requirement to have an Agreement in place prior to construction has created some schedule challenges. It has been very difficult to align detailed cost information and necessary Commission approval processes with the tenant's aggressive design and construction schedule. Because of this challenge, the Port is utilizing Delta's 90% design estimate (not Delta's final construction estimate or actual construction bids which are not yet available) as the basis for the requested reimbursement budget of \$5,440,000. Therefore, this total number includes design development and construction contingencies, as well as the Port's expected overhead for review and construction management. This budget will allow the estimated costs to be further defined as the tenant completes design and the Port and Delta finalize negotiations. Once negotiations are completed, a Tenant Reimbursement Agreement will be executed and Delta will be authorized to begin construction.

There are additional benefits to the Port resulting from Delta's proposal to build this lounge and vacate the existing Northwest World Club. The Port intends to relocate the existing Port common-use lounge "Club International" to this newly vacated location. Club International provides a common-use airline lounge for carriers that are too small to build out and independently lease their own lounge. This new location would suspend the need for the Port to make major re-investments into the existing Club International facility. This improved facility and location will further assist the Port in marketing to new international airlines and routes. Delta will benefit from the Port's vacation of the existing Club International footprint, located on the Mezzanine Level of the South Satellite, which is expected to meet some of Delta's unmet office space needs.

### **PROJECT DESCRIPTION/SCOPE OF WORK:**

The scope of work for this tenant project includes creation of a new building shell, upgrading of structural support to the roof, installation of a new elevator, and addition or expansion of existing building systems. See attached Exhibit A, which depicts the project area that will be added to Delta's Lease.

### **STRATEGIC OBJECTIVES:**

This project supports the strategy of "Ensuring Airport Vitality" through expanding the footprint of the Airport and leasable space and adds to the Airport's asset base. Staff is working with Delta to incorporate "Environmental Stewardship" elements within the project design. Additionally, hazardous materials currently in place at the South Satellite will be removed,

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decreasing future risk of exposure. The project also supports the “Be a Catalyst for Regional Transportation Solutions” strategy by helping to provide the airline with a facility that will augment its customer service initiatives as well as contribute to a competitive environment between carriers, that will ultimately benefit the traveling public.

### **SCOPE OF AGREEMENT:**

Proposed Effective Date:	April 1, 2010
Use:	Authorization to construct a 6,800 square foot airline lounge and associated terms for reimbursement.
Gross Rent:	\$1,500,000/year.
Incremental Rent From Delta	\$ 615,000/year.
Capital Reimbursement:	The total project is currently estimated at \$5,440,000.
Term of Lease:	Expires December 31, 2012.
	Note: A new signatory lease will be negotiated with all airlines prior to 2012. It is expected that Delta will keep this lounge as part of that new lease.

### **FINANCIAL IMPLICATIONS:**

Under the financial methodology negotiated with the airlines, as described in the Lease with the Port, the revenue generated from this increase in leased premises will lower the terminal rental rates for all airlines.

### **Budget/Authorization Summary:**

Original Budget	\$5,440,000
Budget Transfers	
Revised Budget	\$5,440,000
Previous Authorizations	\$0
Current request for authorization	\$5,440,000
Total Authorizations, including this request	\$5,440,000
Remaining budget to be authorized	\$0
Total Project Costs to be authorized	\$5,440,000

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### **Source of Funds:**

This project was included in the approved 2010 Capital Budget and Plan of Finance as a business plan prospective project (CIP #C800336) with a budget of \$4,000,000. The funding source is the Airport Development Fund.

### **Financial Analysis Summary:**

<b>CIP Category</b>	Revenue/Capacity Growth
<b>Project Type</b>	Business Expansion
<b>Key risk factors</b>	Delta is the largest airline in the world, as measured by passengers, thus the risk of default is low, however, its Lease expires December 31, 2012, and Delta could theoretically return the premises at that time. We feel the likelihood of this is low.
<b>Project cost for analysis</b>	\$5,440,000.
<b>Business Unit (BU)</b>	Terminal Cost Center.
<b>CPE Impact</b>	<p>Under the financial methodology negotiated with the airlines, as described in the Signatory Lease and Operating Agreement with the Port, the revenue generated from this Lease will lower the terminal rental rates for all airlines.</p> <p>2011 Cost Per Enplanement (“CPE”) impact = \$.02; however, minor change compared to business plan forecast as this CIP was included. As noted above, the likely impact of this project will be to reduce average terminal rental rates per square foot for all airlines due to increased total square footage of leased space.</p>

### **OPERATION AND MAINTENANCE IMPLICATIONS:**

Electrical systems maintenance cost \$10,000 annually (ongoing expense). Anticipated Mechanical systems maintenance costs \$10,000 annually (ongoing expense) for support of HVAC system and Plumbing system.

### **ECONOMIC IMPACTS:**

This project will enable Delta to more effectively market their overseas flights and grow the market that serves the Puget Sound region, which in turn benefits local businesses and travelers. Construction of this project will generate sales tax revenues and construction jobs. Because the construction estimate is not yet finalized, an assessment of taxes and jobs created are estimated. It is estimated that this Commission authorization will generate sales taxes that may exceed \$250,000, generate up to 5 tenant operating jobs, and generate greater than 100 construction jobs

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that vary in length over the project. Please note that this project is exempt from the Project Labor Agreement since it is a tenant project.

### **ENVIRONMENT, SUSTAINABILITY, AND COMMUNITY BENEFITS:**

The project was reviewed by Airport staff, analyzing various environmental and sustainability performance measures. There were several discussions with Delta on LEED certification interests, but Delta was not interested in seeking any formal certification. Therefore, staff will ensure existing Port environmental standards are followed on Port paid infrastructure, but because this is a tenant project, there is minimal influence on the type of materials used within their space.

### **TRIPLE BOTTOM LINE SUMMARY:**

This project provides a new, comfortable facility for Delta's traveling customers as they wait for flight departures, and it gives them an opportunity for sanctuary from what can be a very busy airport concourse. The facility will be located on the roof of the South Satellite so the building envelope does not take up additional valuable ramp space on a busy airport with a small overall footprint. Delta will use this lounge as a customer marketing tool in their plan to build their local viability to ultimately provide more overseas flights to and from the Airport.

### **PROJECT SCHEDULE:**

Design (by Delta)	4 <sup>th</sup> Qtr 2009 – 1 <sup>st</sup> Qtr 2010
Construction (by Delta)	2 <sup>nd</sup> Qtr 2010 – 1 <sup>st</sup> Qtr 2011
Completion	1 <sup>st</sup> Qtr 2011

Delta would like to begin construction as early as the 2nd Quarter of 2010. In order to facilitate this aggressive schedule, the Commission earlier approved of the Port's related Regulated Materials Management (RMM) request for Delta's airline lounge footprint on February 9, 2010.

### **ALTERNATIVES CONSIDERED/RECOMMENDED ACTION:**

**Alternative 1:** Authorize the Chief Executive Officer to authorize \$5,440,000 of tenant reimbursement budget associated with the build-out of an airline lounge on the roof of the South Satellite at the Airport and to execute a Tenant Reimbursement Agreement with Delta under the Airport's AV-2 policy. **This is the recommended alternative.**

**Alternative 2:** Do not authorize the budget or Agreement required to reimburse Delta a portion of their costs for construction of their airline lounge. This would be inconsistent with past Port tenant reimbursement practice, and could result in Delta cancelling the tenant project, forcing the airline to maintain its existing undersized airline lounge. This would hamper Delta's ability to

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grow the Seattle market, decrease Delta's long-term rent to the Airport and eliminate the ability for the Airport to relocate its Club International shared lounge to Delta's existing facility. This alternative is not recommended.

### **OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:**

Exhibit A – Delta Air Lines Sky Club Drawing

Exhibit B – AV-2 Tenant Reimbursement Procedure and Tenant Reimbursement Guidelines

### **PREVIOUS COMMISSION ACTIONS/REVIEW:**

On February 2, 2010, Port Commission was provided a briefing on Delta Air Lines Growth Plans, Sky Club and other potential future aviation projects.

On February 9, 2010, the Port Commission approved the Delta Air Lines Sky Club Regulated Materials Management Abatement project, which is in support of Delta's airline lounge tenant project at Seattle-Tacoma International Airport in the amount of \$1,750,000.