PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA – STAFF BRIEFING

Item No. 7a

Date of Meeting August 2, 2011

DATE: July 14, 2011

TO: Tay Yoshitani, Chief Executive Officer

FROM: Eric Hanson, Manager, Seaport Planning
Mark C. Griffin, Director, Real Estate Development

SUBJECT: Terminal 91 Strategic Planning Briefing

SYNOPSIS:

In 2010, the Seaport and Real Estate Divisions began preparing a "Development Options Study" to guide investment in and development of Terminal 91. Guided by the Century Agenda recommended principles, staff's work to date has focused on the following objectives:

- Accommodate expansion of "core mission" customers at the site.
- Define the area available for new industrial and commercial tenants that are permissible under the site's existing industrial zoning.
- Ensure any new development is as financially self-sustaining as possible.

Some of the questions that require Commission direction were posed by staff in the April 13, 2010, Commission meeting and include:

- What is the appropriate level of Port investment in new infrastructure?
- What is the optimal balance in achieving regional economic benefits, environmental benefits, and desired financial goals?
- How should any new investment be funded?

This briefing discusses the key findings of the analysis to date and poses policy questions for which staff seeks Commission guidance. Next steps in the planning process are also summarized.

OVERVIEW OF WORK COMPLETED:

The approved scope of work for the Development Options Study encompasses several tasks: a market assessment of the potential for new industrial and commercial development at Terminal 91; alternative site development plans distinguished by varying levels of development density; construction cost estimates for the utility infrastructure needed to support new development and building cost estimates of any Port constructed facility or structure; financial analysis; and an economic benefits analysis of the site development options.

Expansion by Existing Tenants. Staff met with the major current Terminal 91 tenants to understand their expected growth. From these meetings, staff determined potential needs for additional warehouse, marine industrial, and cold storage facilities. In all, existing tenants may need as much as 400,000 square feet of new development to satisfy their anticipated growth.

Industrial Market Assessment. Kidder Mathews, a local brokerage firm, prepared a market analysis of the potential for new industrial and commercial development at Terminal 91. The study concluded that segments of the industrial market that are not reliant on immediate access to highways (e.g., incubator, small industrial and "flex" space unlike distribution uses) may find Terminal 91 an appealing location. However, to attract these industrial uses, the land must be priced competitively with industrial land located outside Seattle. The study further concludes that the current "highest and best use" of the land is open storage, because there appears to be demand for open storage, which requires little capital investment and as a result provides the best financial return on investment.

Development Zones. For planning and analytic purposes, Arai Jackson, the consulting team lead, divided Terminal 91 into six development zones (see attachment 1) and analyzed each for its best functional use given the existing tenants' needs and the market assessment. The overall planning approach was to meet the needs of existing customers while simultaneously seeking ways to make more land available for other industrial uses. For example, construction of a parking garage consolidates existing surface parking into a smaller footprint. Additionally, new pier structures would allow activity that currently occurs north of the bridge to move south of the bridge. A utility plan for the area north of the bridge needed to support new developments was also created (see attachment 2).

Construction Cost Estimates. Port staff estimated construction costs for investments anticipated to be made by the Port in developing the site. These estimates include a variety of buildings for existing tenant expansion needs, new pier structures, a parking garage and the utility improvement plan. Cost estimates include: raw construction costs; all related Port management costs; risk factor contingencies; and mitigation costs. Third party development costs north of the bridge were not estimated as it is expected the construction costs will be borne by the developer/tenant that would ground lease the land from the Port.

Financial Analysis. Staff developed a financial model with the intent of determining the financial performance of the planned developments. Due to the conceptual nature of this planning effort, the model is appropriately meant to be a high-level projection of the return on the Port's potential investment in the site. To identify overall financial performance, results were aggregated by each development zone (shown in attachment 1) and by each site plan option (see attachment 3). Financial modeling includes capital costs required to develop the property and the revenue associated with such development. The capital costs are inflated based on the anticipated year of construction. The revenue streams accrue over a 50-year period, inflate over time, are based on current lease rates, and assume a certain percentage of vacancy dependent upon asset type. Revenues are generated from a variety of sources including building leases, ground leases, yard storage, moorage, and parking. It is important to note that the model does not include operating and maintenance costs, insurance, capital reserves, leasing costs, or land value. These factors would clearly add additional expenses to the cost side of the financial model.

Economic Impact Analysis. Kidder Mathews also performed the economic benefits analysis. Their analysis estimates the benefits at full build-out of each of the four development options analyzed. The analysis assumes all the developments attract new activity to the region rather than a redistribution of existing economic activity. It does not include temporary economic benefits derived from construction activity.

KEY MESSAGES AND ISSUES:

Pier 90. To meet core mission customer expansion needs, the planning process evaluated a new freeze facility building shell and a rebuilt existing warehouse onto totally rebuilt pier structures. The timber pilings underneath Berth 6 / 8 on Pier 90 today are degrading and require strict observance of load limitations in certain locations. High level conceptual estimates for replacing timber pilings range from $35 to $41 million. Because the Port placed protective wrappings around some of the timber piles, degradation throughout this section of Pier 90 is not consistent. The methods and phasing options available for replacing all the timber pilings are numerous. The Seaport is currently assessing this situation through its Asset Management Program. These are the last berths to be reconstructed as part of an investment program which has steadily invested $129 million in dock replacements since 1987.

- Key Messages.
  1. Positive net present value (NPV) results from Port constructed industrial buildings are unlikely. Future considerations in accommodating existing tenant expansion should include ground leasing as a possible alternative.
  2. The cost for replacing the timber piling introduces a significantly negative impact to the NPV performance of each of the four development options analyzed.

- Key Issue. Should the financial modeling associated with this planning process remove the cost of rebuilding Berths 6 and 8 and instead consider these costs from an asset management perspective? This would significantly improve the financial results of the four development options analyzed (shown in the financial tables below).

Shortfill. The uses considered for this area include maintaining the current parking and yard storage activity, adding additional pier structures and building a garage with an office complex. The strategy associated with new investments here was to relocate activities that currently occur north of the bridge to this area south of the bridge to increase the land available for third-party development.

- Key Messages.
    1. Existing revenue from cruise lease and open storage provides a positive NPV.
    2. New investments in piers and a garage contribute to significant negative financial results. Although these investments create additional land north of the bridge for new tenants, the financial analysis indicates this may be a costly strategy to pursue.

West Yard. The market assessment concluded the highest and best use for this area is for new commercial office space. Each development option assumed office use in the form of a ground lease with a third-party developer.

- Key Messages.
    1. Current market conditions suggest that it may take five to seven years for any office space demand to materialize.
    2. A zoning modification (associated with aggregation of allowable office space at Terminal 91) approved by the City Council is needed for any non-accessory office development in this area.
    3. Once office demand does materialize, ground leasing the site may provide a positive NPV.

- Key Issue. A separate briefing will discuss the potential land swap with Seattle Parks & Recreation and how King County's need to site a combined sewer overflow facility might be accommodated either on Port or Parks' land.

Tank Farm. Because of its ideal size and location, the planning process evaluated a new warehouse on this site to meet the needs of existing customers.

- Key messages.
    1. Due to additional costs associated with building on a remediated tank farm, this location may be better suited for open storage rather than a building.
    2. The best location of a warehouse built to meet core customer needs requires further evaluation.

3. Positive NPV results from Port constructed industrial buildings are unlikely. Future considerations in accommodating existing tenant expansion should include ground leasing as a possible alternative.

Utilities and the NW Yard and Upland Zones north of the Magnolia Bridge.

Attachment 2 shows the utilities planned to support new developments north of the bridge. Major components of this plan include a new perimeter roadway, upgrades to existing electrical substations, upgrades to existing water, power, natural gas and sewer utilities and a new storm water treatment vault. Conceptual cost estimates for this utility plan range from $20 to $24 million, depending on the scale and type of development that might occur north of the bridge.

A variety of uses were considered for the uplands areas north of the bridge: expansion area for existing tenants; construction of a parking garage; providing land for new tenant development and open storage for use by existing customers.

Planning options north of the bridge intended to make available increasing amounts of land for new tenants. Staff's current thought is to consider ground leasing areas intended for new tenants to a third-party developer. The development options created to date depict a range of industrial uses a developer may seek for the site. These options range from limited new buildings and open storage at the low end to a high end that includes a high-tech research and development campus that meets the requirements of the existing industrial zoning.

- Key message.
    1. Today, the surface parking lot for cruise passengers covers 10.5 acres of land. Building a garage requires 2.5 acres. Therefore, an additional eight acres could be made available for other uses.
    2. It is exceptionally difficult to forecast uses and revenues associated with a new garage at Terminal 91 and new leasing strategies would have to be explored.
    3. The NPV associated only with building a garage is negative. However, combining the garage revenue (including off-cruise season revenue) with 8 acres of additional land lease revenues produces a slightly positive NPV ($0.8 million). If the Port pursues development of the NW Yard and Upland zones, a parking garage may be worthy of consideration and may be essential to efficiently use the land and thereby maximize the economic benefits associated with any Port-funded infrastructure in the area.
    4. Ground leasing land north of the bridge (i.e., the NW Yard and Uplands zones) under the current assumptions at best roughly breaks even given the cost of the utilities needed to support new development. At worst, a negative NPV of $5 million would result.

- Key Issues.
    1. What should be the Port's targeted financial return from the property north of the bridge?
    2. Should the Port seek other public partners to share in the cost of any infrastructure investments?
    3. Should the Port invest in the needed infrastructure before ground leasing to a developer or attempt to identify a developer willing to take the property as is?
    4. What should be the timing of any Port investment given the "status quo" scenario discussed below?

FINANCIAL RESULTS:

The table below summarizes the financial performance by zone and by total of each of the four development options. As currently constituted, all four of the options in total have negative NPVs. The financial projections for each option; however, are best understood by separately examining the different development zones as summarized above. In preparing the four development options, staff envisioned that any recommended option would likely be a hybrid of two or more of the initial options rather than one of initial development options in total.

Zone		*Option 1*	*Option 2*	*Option 3*	*Option 4*
Pier 90	Scenario	Berth & Buildings	Berth & Buildings	Berth & Buildings	Berth & Buildings
	Port Investment	$73.9	$73.9	$73.9	$73.9
	NPV	($40.4)	($40.4)	($40.4)	($40.4)
Shortfill	Scenario	Yard with No Fill	Yard with No Fill	Apron Extension - Notches	Full Apron with Garage
	Port Investment	$0.0	$0.0	$8.8	$111.3
	NPV	$3.3	$3.3	($4.3)	($67.8)
NW Yard	Scenario	Existing Cruise Parking	Existing Cruise Parking	Garage & Leases	Development & Yard
	Port Investment	$0.4	$0.4	$33.6	$0.5
	NPV	$2.6	$2.6	$0.8	$10.1
Tank Farm	Scenario	Warehouse	Warehouse & Office	Warehouse & Office	Warehouse
	Port Investment	$22.0	$26.7	$26.7	$22.0
	NPV	($9.7)	($10.4)	($10.4)	($9.7)
West Yard	Scenario	Development & Yard	Development & Yard	Development & Yard	Development & Yard
	Port Investment	$0.5	$0.5	$0.5	$0.5
	NPV	$3.3	$3.3	$3.3	$3.3
Uplands	Scenario	Development & Yard	Development & Yard	Development	Development
	Port Investment	$0.9	$0.9	$0.9	$0.9
	NPV	$15.1	$15.1	$13.4	$13.4
Utilities	Scenario				
	Port Investment	$22.7	$23.4	$25.3	$26.6
	NPV	($17.4)	($17.9)	($19.4)	($20.4)
Total	**Port Investment**	**$120.4**	**$125.8**	**$169.7**	**$235.6**
	NPV	**($43.2)**	**($44.4)**	**($56.9)**	**($111.5)**
	IRR	**5.8%**	**6.0%**	**6.5%**	**4.5%**

Note: $ (000,000's)

STATUS QUO:

Current short-term leases for yard storage, which in the short run require minimal new capital investment, provide positive financial returns. However, at some point in time there will be a need to make more significant capital investments to maintain current operations:

1. Evolving regulations are expected to lead to requirements for substantial storm water system upgrades. For the purpose of this planning process, an integrated storm water system was developed to meet city code requirements associated with new developments north of the bridge. This system is preliminarily estimated to cost approximately $3.25 million. Regardless of whether the Port seeks new development, there remains a likely need to make improvements to the storm water system throughout the entire terminal.

2. As previously discussed, Berths 6/8 will require some action at a future date. Costs for reconstructing the berths were included in the Seaport's 2011 Ten Year Capital Plan and are being evaluated as part of the Seaport's proposed 2012 Ten Year Capital Plan.

3. Other expected future costs accrue from: extensive building maintenance associated with older structures (example: roof replacements); re-paving large portions north of the bridge; and upgrading water lines and electrical systems.

The financial performance of the four development options improves significantly when estimated asset management costs (berth 6/8 replacement and storm water improvements) are excluded from the financial analysis (see table below). However, even when excluding these costs, projected returns for the four options remain negative.

		Option 1	Option 2	Option 3	Option 4
Total (excluding Berth & Stormwater costs)	**Port Investment**	**$68.0**	**$73.4**	**$117.7**	**$183.8**
	NPV	**($4.5)**	**($5.6)**	**($18.5)**	**($73.3)**
	IRR	**10.3%**	**10.1%**	**9.0%**	**5.8%**

Note: $ (000,000's)

- Key message. One alternative, should the Port not pursue substantial infrastructure investment to attract new industrial development at the site, would be to execute longer term open storage leases for uplands area that is currently vacant. Longer term leases will likely generate more interest from potential tenants to lease the vacant area compared to the month-to-month and short-term leases currently in place.

- Key issue. What is the optimal balance in achieving regional economic benefits, environmental benefits, and desired financial goals?

ECONOMIC IMPACTS:

The economic benefits for each development option are shown in the table below.

	Option 1	Option 2	Option 3	Option 4
Jobs				
Direct	388	506	783	3,198
Induced	323	437	648	3,936
Indirect	218	295	458	3,050
Total	929	1,238	1,890	10,185
Income ($1000)				
Direct	$22,797	$30,746	$44,367	$241,422
Induced	$11,676	$15,804	$23,431	$142,611
Indirect	$9,947	$13,568	$21,351	$159,580
Total	$44,420	$60,118	$89,149	$543,613
Direct Business Revenue ($1000)	$75,064	$103,049	$157,231	$1,191,319
State and Local Taxes ($1000)	$4,131	$5,591	$8,291	$50,556

NEXT STEPS:

The intent of this planning process is to arrive at a strategy and plan to guide investment in the development of Terminal 91. After Commission feedback and outreach to existing tenants, the community and other stakeholders, the planning work will be refined to identify a recommended development option. Staff anticipates early fall as the next briefing for this planning process.

OTHER DOCUMENTS ASSOCIATED WITH THIS BRIEFING:

- Attachment 1: Map of development zones
- Attachment 2: Utility map
- Attachment 3: Four development options
- Attachment 4: Existing Condition Aerial Photo
- Attachment 5: PowerPoint presentation

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:

Staff briefed Commission on the intent of this planning endeavor on April 13, 2010. Funds to proceed with the work were approved by Commission on July 13, 2010.