PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA — **Item No.** 5a

FURTHER CORRECTED COPY — **Date of Meeting** **August 9, 2011**

DATE: August 8, 2011

TO: Tay Yoshitani, Chief Executive Officer

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

SUBJECT: Preparation of Specialty Retail Concessions Spaces within Concessions Unit Readiness Project (CIP # C-800147)

Amount of This Request: $578,000

Source of Funds: Airport Development Fund

State & Local Taxes Paid: $4,000

Jobs Created: 8 (Eight) (Construction Only)

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 in support of the Concession Unit Readiness Project (CIP# C800147) at Seattle-Tacoma International Airport (Airport). This authorization is for $578,000 of a total estimated project cost of $2,087,000.

SYNOPSIS:

The purpose of the Concessions Unit Readiness Project is to reconfigure and prepare concession spaces for new tenancy. The Commission authorized design for the project in August 2008 and some construction in September 2010. This authorization request is for construction work to prepare four specific units for future tenants on Concourse A and the North Satellite. Port staff has determined that the “highest and best use” of these units would be as specialty retail locations because they will meet an untapped or under-served retail need. Retail use is also the most likely to generate incremental sales and increase the Airport’s non-aeronautical revenues. The Port plans to tap the expertise of its third-party leasing consultant to conduct business outreach and negotiate leases. Although these leases will also create new jobs, the new tenants will not be in place until late 2012 or early 2013.

BACKGROUND:

In August 2008, the Commission authorized design of shell space improvements for specific concession spaces at the Airport. Due to the downturn in the economy, Airport staff elected to delay the first request for construction activity authorization until September 2010. At that time, Commission authorized funding for improvements to prepare for a presumed new operator of the Airport's duty free business. These improvements have been completed and await new tenancy.

This second request for authorization supports the next phase in concessions unit preparation for future tenants. Each individual space is described below and all are intended for development as future specialty retail. Staff intends to utilize its future concessions planning and leasing consultant process to identify and negotiate lease agreements with new retail tenants. The Airport also plans to conduct extensive business community outreach to provide information to business owners about the opportunity to propose specialty retail concepts for these locations. The outreach and leasing activity will not commence until sometime in early 2012, subsequent to the completion of the current stakeholder involvement process for the concessions program.

While the concepts of each individual space have not yet been defined, careful consideration will be given to adding concepts that meet an untapped or underserved retail need and have the greatest likelihood of generating incremental sales. Increasing non-aeronautical revenues whenever possible is critical to the Port's ability to invest in its strategic priorities.

PROJECT DESCRIPTION/SCOPE OF WORK/SCHEDULE:

The following units are included in this request (see Exhibit A):

Concourse A:

Unit CA-18 – This unit is 888 square feet and is anticipated to be developed as a specialty retail location. The space was originally created as a concessions space as part of the Concourse A expansion, but was built out as office space for the Transportation Security Administration (TSA). The TSA vacated this space in 2009. The high traffic volumes of this location make the space desirable for its intended purpose as a concessions unit. Based on the experience of comparable airports, this size and location could be successful as an electronics, computer and/or gaming store. The exact concept to be featured in the unit will be determined as part of the leasing process.

Unit CA-19 – This unit is 1,396 square feet and is anticipated to be developed as a specialty retail location. This unit is located next to CA-18, on the southern flank of the Central Terminal and also was part of the TSA's former office space.

Units CA-18 and CA-19 both require demolition of existing office finishes and partitions, installation of a demising wall between the spaces, as well as system adjustments to lighting, HVAC and fire sprinklers in order to make these units into individual retail spaces. In order to provide shell spaces suitable for tenancy, both spaces also will require communications and electrical demarcation panels/pathways and the supporting infrastructure.

North Satellite:

Unit NS-2/11 – This space is 2,019 square feet and is currently one unit with a small 'pass through' between the units. In 2010, the Port included this space in its then-issued 'Request for Proposals' for a duty free/specialty retail operator. The transition of this business has been delayed to such an extent that the sole remaining international flight will be in the process of relocating to Concourse A before a new duty free operator is selected. Consequently, there will be no passenger need for duty free in this location, and thus no need to award this square footage to a duty free operator for that purpose.

Instead, the work would include fully separating the space into two specialty retail units, and installing separate power and communications service to both. There is no existing specialty retail in the North Satellite, and the addition of specialty retail in these locations could help recapture Central Terminal specialty retail revenue lost to the Port when Alaska reallocated a substantial portion of its enplanements from Concourse D to the North Satellite. The work entails the installation of a demising wall between the two units and electrical/communications demarcation packages and supporting infrastructure.

PROJECT SCHEDULE:

- Commission Authorization to Construct — August 2011
- Construction Complete — December 2011

DETERMINING HIGHEST AND BEST USE:

In an airport environment, there is often keen competition for terminal space between a variety of uses. Whenever a particular use is evaluated for a certain space, the Airport looks at the myriad of possible uses in order to assure the "highest and best use" is made of that space. Sometimes this highest and best use may generate incremental non-aeronautical revenue, while other times it may not. In the instance of these four units, Concessions staff has proposed development as specialty retail locations. The base building configuration for all four spaces intended their use as concessions spaces and no other operational needs compete for their use.

In evaluating a concessions space for its highest and best use, the final determination is a combination of financial analysis, knowledge of passenger needs and the surrounding passenger flow and other nearby competing concessions. It is important to ensure that any additional concessions capacity does not cannibalize existing businesses. The best choice will be one that complements existing operations and raises overall sales.

Airport concession businesses generally fall into three categories: food and beverage, retail and services. Each category has its unique sales and revenue potential, as well as associated investment and operating costs, and all serve passenger needs. In the North Satellite, where two new specialty retail units are proposed, there is already adequate food and beverage service by multiple operators, as well as available services such as massage and shoeshine. Concessions staff does not believe that there is a higher or better use for these spaces than for specialty retail, particularly because significant investment would be required to add infrastructure to support food and beverage operations. On Concourse A, both proposed locations for specialty retail are located immediately adjacent to food and beverage service in the Central Terminal. While the Central Terminal houses the majority of the Airport's specialty retail locations, there is still 20% more square footage devoted to food and beverage than retail in this area. Yet, retail operators in the Central Terminal are generating nearly as much sales as their food and beverage neighbors, which confirms this central area is a strong location for specialty retail offerings. Future tenants for these four spaces will be selected in a collaboration between a third-party leasing consultant and Concessions staff.

The financial analysis below illustrates the anticipated performance and payback on investment in these concession locations. The analysis does not include the anticipated services of the future leasing consultant. Due to the unique percentage rent structure and high sales volumes of airport retail locations, it may be misleading to use standard retail brokerage fees as illustrative of the cost to lease these units. However, as part of the planning and leasing consultant procurement, staff will work to negotiate a cost structure that will not negatively impact the justification for this investment.

FINANCIAL IMPLICATIONS:

Budget/Authorization Summary	**Total Project**
Original Budget	*2,231,000*
Budget Decrease	($144,000)
Revised Budget	$2,087,000
Previous Authorizations	$586,000
Current request for authorization	$578,000
Total Authorizations, including this request	$1,164,000
Remaining budget to be authorized	$923,000

Project Cost Breakdown	**This Request**	**Total Authorizations (including this request)**
Construction costs	$437,000	$620,000
Port furnished equipment	$0	$0
Sales tax	$4,000	$21,000
Outside professional services	$0	$186,000
Aviation PMG and other soft costs	$137,000	$337,000
Total	$578,000	$1,164,000

Source of Funds

The funding source will be the Airport Development Fund. The project is 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 (by January 1, 2013) and revenue generation is delayed.
Project cost for analysis	$578,000
Business Unit (BU)	Aviation Business Development
Effect on business performance	NOI after depreciation increases $300K-$500K per year.
IRR/NPV	Total project NPV of $1.7 million. Based on projected build-out costs and sales projections, payback is three (3) years.
CPE Impact	None.

ECONOMIC IMPACTS AND BUSINESS PLAN OBJECTIVES:

This project will create new business and employment opportunities and provide passengers with a greater selection of merchandise than was previously available. In addition, the future tenants can be expected to employ approximately 10-15 employees per location.

ENVIRONMENTAL SUSTAINABILITY AND 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 be evaluated and used wherever appropriate and available.

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 three years.

Exhibit Environmental Stewardship through Our Actions

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

TRIPLE BOTTOM LINE:

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 retail shopping.**ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS:**

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 new tenants. No new revenue would be generated. No new business or employment opportunities would be created. *This is not the recommended alternative.*

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. The business opportunity would be less attractive in the marketplace, which potentially could make leasing of the space more difficult. Tenant sponsored construction could lead to lower negotiated rent to the Port over the life of the lease term, and thus lower the Net Present Value. *This is not the recommended alternative.*

Alternative 3: Authorize construction to prepare these concession unit spaces. This alternative would add to prime locations for non-aeronautical revenue generating leasable space and benefit the concessions program at the Airport. **This is the recommended alternative.**

OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:

Exhibit A: Map of concession locations.
Exhibit B: Concept rendering of Concourse A locations

PREVIOUS COMMISSION ACTION:

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

On September 7, 2010, the Commission authorized $229,000 for construction work to prepare certain units for new tenants.

On July 26, 2011, the Commission authorized the procurement of Concessions Planning and Leasing Services.