PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA **Item No.** 6b

Date of Meeting August 9, 2011

DATE: August 8, 2011

TO: Tay Yoshitani, Chief Executive Officer

FROM: Mark Reis, Managing Director, Aviation Division
James Schone, Director, Avation Business Development
Deanna Zachrisson, Manager, Concessions Business

SUBJECT: Lease termination agreement for the Borders Group, Inc. (Borders) bookstore lease and concession agreement at Seattle-Tacoma International Airport (Airport).

Amount of This Request: $70,000 (not including waiver of unpaid rent and charges, totaling approximately $28,000)

Source of Funds: Aviation Development Fund

ACTION REQUESTED:

Request authorization for the Chief Executive Officer to enter into a lease termination agreement for the former Borders bookstore location at Seattle-Tacoma International Airport, including the payment of $70,000 to the Borders Group, Inc., bankruptcy estate in consideration for the lease termination and release of the Airport lease from the bankruptcy liquidation proceedings. The transaction also includes waiver of amounts owed the Port for percentage rent, utility and other charges totaling approximately $28,000. The lease termination proposal has been negotiated directly with the bankruptcy liquidators.

SYNOPSIS:

Borders entered Chapter 11 bankruptcy protection on February 16, 2011. Although an attempt was made to secure a buyer for the company in order to continue operations, a sale was unsuccessful and the company's assets are being liquidated. The Airport Borders location closed on August 5, 2011. Under the terms of the bankruptcy, all Borders retail leases will be sold at auction in order to generate money to compensate creditors. If the lease agreement were to be acquired by an outside bidder and depending on the court's ruling regarding the protection of airport leases under the "shopping mall" provisions of the bankruptcy code, there is a risk that the space could be auctioned off to a bidder intending to use it for other than a bookstore until the lease expires on August 28, 2015.

The Port's bankruptcy counsel, at the directions of the Port staff, initiated discussions with Borders' bankruptcy counsel to pursue the purchase of the Airport lease, prior to auction, in order to preserve the use of this space as a bookstore, and preferably as a locally owned bookstore. The amount presented as the Port's offer, $70,000, was based on a staff assessment of the magnitude of lost revenue due to the shuttering of the store during the period between the lease auction and court approval of a new tenant/operator. This included both lost percentage rent and a reduced minimum annual guarantee in 2012 (which is based on the prior year's sales) under a new operator secured in the auction process. While under the proposed settlement the Port waives the right to collect unpaid percentage rent and other charges (approximately $28,000), that loss does not outweigh the benefits of proceeding with the lease termination. Staff did not take into account the possible value of this lease to other bidders, although staff was aware that a number of large concessionaire companies were interested in purchasing groups of former Borders airport locations, as a means of securing desirable airport locations outside of a competitive process. There are a total of 23 Borders airport locations, including Seattle, that were slated for auction on August 31, with court approval scheduled for September 8, 2011.

By entering into this lease termination agreement, the Airport will have the ability to secure a new locally owned bookstore for the space, provided a lease can be negotiated. Staff recommends acceptance of this negotiated proposal, which is fair and reasonable for the Port.

ADDITIONAL BACKGROUND:

The Airport's Borders store opened on May 31, 2005. The lease agreement with Borders was negotiated as an independent direct lease with the Port by the then-contracted third party leasing consultant. As a result of public outreach, some local bookstores, as well as Borders, examined the retail opportunity at the Airport. The Port preferred to lease to a locally owned bookstore; however, at the time, the location did not have any proven track record of success, as the Central Terminal was a brand-new facility. Given the perceived risk, and high occupancy costs, Borders became the one operator interested in leasing the bookstore location. Borders already operated over a dozen airport bookstores and was familiar with the unique requirements and challenges of airport operations.

In spite of problems that plagued Borders, the Seattle location was a resounding success. It quickly became the Borders airport network's highest grossing location. In its top grossing year, 2008, Borders achieved sales of nearly $5 million. In 2009-2010, Borders began suffering from inventory problems, yet still achieved sales of $3.9 million each year. The Port earned 12% of gross sales; $470,000 in 2010. With this consistent track record of strong sales potential, Airport staff believes that it should be possible to identify a local bookstore operator interested in this space under terms of a new lease and concession agreement.

FINANCIAL IMPLICATIONS:

The Commission's approval of this request will allow Airport staff to shift its attention toward securing a new bookstore tenant as soon as possible. If this process appears to take any significant period of time, Airport staff does have the ability to identify an existing Airport retail tenant that may be willing to operate the store location as a bookstore on an interim basis, thus preserving revenue generation in the short term.

Source of Funds

Aviation Development Fund.

ECONOMIC IMPACTS AND BUSINESS PLAN OBJECTIVES:

This proposal will reduce the loss of revenue to the Port, through leasing to a new tenant, either temporary or permanent, in the short term. It also is consistent with the Port's desire to provide concession opportunities to local operators and/or concepts, when possible.

STRATEGIC OBJECTIVES:

Ensure Airport and Seaport Vitality

The continued operation of this concession location as a bookstore supports the maximization of non-aeronautical revenue for the Port, as well as provides a valuable amenity to the traveling public.

ENVIRONMENTAL SUSTAINABILITY AND COMMUNITY BENEFITS:

This proposal benefits the community through the restoration of jobs lost to the closure of Borders. It is, however, unlikely to result in the re-hire of the same workers as nearly all former Borders employees have already found employment in other Airport retail shops.

TRIPLE BOTTOM LINE:

The Airport's concessions program follows a triple bottom line philosophy that values the concurrent pursuit of positive economic, social and environmental outcomes. The Port's termination of the Borders lease and concession agreement provides for the greatest flexibility in achieving these outcomes.

ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS:

Alternative 1: Allow the Borders lease to be purchased by an outside bidder as part of the liquidation auction. The most likely scenario for the purchase of the Borders lease would be a sale as a group of units to a large airport concessionaire company. Depending on the court's ruling regarding the protection of airport leases under the "shopping mall" provisions of the bankruptcy code, there is a risk that the space could be auctioned off to a bidder intending to use it for other than a bookstore. In such event, it is unlikely that this speciality retail location would be operated by a locally owned business. This is not the preferred alternative.

Alternative 2: Participate in the bankruptcy auction in order to purchase/terminate the Borders lease. There are two significant risks with this approach. First, there is the risk that the competition for this particular location would be very keen, due to the unit's attractive size, sales potential and central location in the Airport. Second, the Airport lease could be grouped with other airport units in order to generate a higher price, and it may be difficult to convince the liquidators to remove one single location from a group of units for auction. This is not the preferred alternative.

Alternative 3: The lease termination proposal restores control of the unit to the Port for a fair and reasonable remuneration. It provides an opportunity for a new bookstore operator in this attractive location, possibly a locally owned bookstore. It also allows the Port to reopen the store as soon as possible under a temporary or permanent operator and restore revenue generation to the Port. **It is the preferred alternative.**

OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:

Exhibit A: Lease Termination Agreement

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:

None.