

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA

Item No. 5b

Date of Meeting October 4, 2011

DATE: September 27, 2011

TO: Tay Yoshitani, Chief Executive Officer

FROM: Nick Harrison, Senior Manager, Airport Operations
James Schone, Director, Aviation Business Development
Wayne Grotheer, Director, Aviation Project Management Group

SUBJECT: Common-Use Lounge Remodel at Seattle-Tacoma International Airport (Airport)
(CIP #C800203)

Amount of This Request: \$740,675

Source of Funds: Airport Development Fund

State and Local Taxes Paid: \$62,000

Jobs Created: 13

Total Project Cost: \$1,061,000

ACTION REQUESTED:

Authorization for the Chief Executive Officer to increase the project budget by \$740,675 and advertise and execute a construction contract for the common use lounge at the South Satellite at the Seattle-Tacoma International Airport (Airport) for a total project cost of \$1,061,000.

SYNOPSIS:

There is a strong demand for an Airport-operated common use lounge to serve first and business class passengers traveling on various airlines that do not have their own branded lounges. A premium common use lounge (Club International) for airlines serving the Airport is a much needed facility that helps both existing and prospective carriers, without branded lounges, flying international routes meet their business plan objectives. Specifically, it will help with the growth and profitability of routes and allows airlines to offer their passengers a superior pre-boarding experience comparable to what competitors offer in their branded lounges for premium passengers.

The availability of a common use lounge may be a decisive factor in a prospective carrier's decision to serve this Airport or another destination. Interest in new international routes to this Airport is now at a level that justifies acceleration of this project so that the new lounge facility will be ready for business by the second quarter of 2012. Acceleration is currently estimated to add approximately \$90,000 to the overall cost of the lounge renovations. Several current airlines have expressed strong interest in using an improved Club International, adding to the Airport's existing customer base. Additionally, the Airport anticipates marketing the club directly to passengers on a pay-per-use basis as a new line of business to increase non-aeronautical revenues.

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This project relocates and remodels the Airport's common-use lounge from the mezzanine level of the South Satellite to the departure level of the South Satellite in space made available by Delta Air Lines' recent relocation to their new rooftop lounge in the South Satellite and the subsequent vacation of its existing departure level facility. The new Club International will be approximately 4,000 square feet, similar in size to the existing location. Improvements consist largely of new finishes, new furnishings and other minor cosmetic improvements. This project does not include creation of any additional floor area.

BACKGROUND:

The request for design authorization for this project previously outlined how a high quality premium passenger lounge is an essential component of the airline services targeted toward premium fare passengers on international flights. The Airport's provision of a common-use lounge in the international terminal ensures that both existing and prospective international airlines can meet their business plan objectives, specifically profitability of routes.

British Airways and Delta Air Lines have branded lounges on the roof level of the South Satellite, but they open them up to smaller airlines for additional revenue. Unfortunately, this accommodation of sub-tenants is still inadequate to accommodate all the international carrier demand at the South Satellite. The Airport is not trying to compete directly with the branded airline lounges; however, we endeavor to improve the financial performance of Club International. This club meets a critical market need for those airlines that cannot be accommodated as sub-tenants in the existing airline branded lounges nor can justify building or leasing their own facility.

The Airport offered an unstaffed no-frills common-use club option to airlines for decades. However, last year the Airport changed the operating and business model for the common-use club in an effort to improve the level of service. The Airport solicited and selected a third party company to manage the club and changed the fee model from a fixed per-flight charge to an individual per-customer charge. The Airport also anticipates marketing directly to passengers on a pay-per-use basis. This direct-to-passenger marketing is an effort to expand our potential customer base.

The viability of Club International's core business and efforts to grow the market is currently hampered by three key facility factors: poor configuration, poor condition, and poor location. The existing Club International is configured into two separate 2,000 square foot lounges. This separation creates challenges in staffing, duplicates maintenance, and impedes the Airport's ability to offer a standard level of service to customers. Condition is a concern because only one portion of the facility was improved by the Airport in the late 1990s. The other portion is still making use of original furniture and finishes from SAS Scandinavian Airline's initial build-out at inauguration of their service to Copenhagen decades ago. Most significantly, the location of Club International does not meet the fundamental criteria our airlines' customers and their premium passengers desire and expect; a location close to the gate boarding area offering outdoor views, daylight, and modern amenities. Relocating Club International to the lounge space recently vacated by Delta Air Lines on the departure level resolves the configuration, condition, and location challenges that exist with the current facility.

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PROJECT JUSTIFICATION:

Project Objectives:

Interest in new international routes to the Airport is now at a level that justifies acceleration of this project so that the new lounge facility will be ready for business by the second quarter of 2012. Acceleration is currently estimated to add approximately \$90,000 to the overall cost of the lounge renovations. A premium passenger lounge is of such importance to airlines considering starting international service to a USA gateway that prospective operators will choose not to select an airport that does not have a lounge suitable for their premium passengers. Airlines find the cost of building and leasing a lounge of their own is not financially justifiable if they are operating only one flight a day. Such carriers look to a partner airline or to the airport authority to provide lounge service. Beyond the urgency generated by prospective new entrant carriers, the original justifications remain as follows:

- Provide an improved common-use lounge facility with services and amenities that meet current and prospective airline customer expectations.
- Improve the financial performance of Club International.
- Provide a key tool for successful marketing for new international air service.
- Improve prospects for marketing directly to passengers on a pay-per-use basis.

PROJECT SCOPE OF WORK AND SCHEDULE:

Scope of Work:

This project is located at the recently vacated Delta lounge on the departure level of South Satellite. The project scope includes replacement of architectural finishes, furnishings, millwork, some restroom fixtures, and the installation of data cable for internet service. Project scope also includes construction of a glass-wall enclosed “first class” lounge area separate from the rest of the lounge space.

Schedule:

Begin Design	1st Qtr 2011
Purchase Furnishings and Fixtures	4th Qtr 2011
Advertise for Major Construction Contract	4th Qtr 2011
Begin Construction	4th Qtr 2011
Project Completion	2nd Qtr 2012

FINANCIAL IMPLICATIONS:

Budget/Authorization Summary:

Original Budget	\$2,000,000
Budget Decrease	\$939,000
Revised Budget	\$1,061,000
Previous Authorizations	\$320,325
Current request for authorization	\$740,675

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Total Authorizations, including this request	\$1,061,000
Remaining budget to be authorized	\$0

The budget for this project decreased in the past prior to design authorization. Scope was reduced from a complete remodel to essentially a replacement of finishes and furnishings. Major restroom improvements and the addition of shower facilities were also removed from the project scope at that time.

Recently, we have increased the budget to accelerate construction of this project to meet Airport business objectives.

Project Cost Breakdown:

	<u>This Request</u>	<u>Total Project</u>
Construction Costs	\$522,000	\$522,000
Airport furnished equipment	\$24,300	\$173,000
Sales tax	\$47,875	\$62,000
Outside professional services	\$28,000	\$100,000
Aviation PMG and other soft costs	\$118,500	\$204,000
Total	\$740,675	\$1,061,000

Budget Status and Source of Funds:

This project is included in the 2011-2015 Capital Budget and Plan of Finance as a business plan prospective project, CIP # C800203. The funding source will be the Airport Development Fund.

Financial Analysis and Summary:

CIP Category	New/Enhancement
Project Type	Renewal & Replacement
Risk adjusted Discount rate	9%
Key risk factors	<ul style="list-style-type: none">• Project delays would in turn delay potential increased revenue generation and reduce the NPV of the project.• Project delays could cause the Airport to miss opportunities to attract new airlines eager to have new service in place by early 2012.• Potential cost overruns would reduce the NPV.• Revenue from the club is based upon actual use via a per passenger fee. Airline participation in club use can fluctuate, thus the projected revenue stream could change based on carriers' decisions on use of the lounge.

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Project cost for analysis	\$1,061,000
Business Unit (BU)	AV Business Development
Effect on business performance	<ul style="list-style-type: none">• First year (2012) Net Operating Income (NOI) projected at \$430,000.• Based on conservative assumptions related to projected growth in expenses, number of passengers, and lounge use fee, long-term annual NOI is expected to be approximately \$400,000.
IRR/NPV	IRR: 17% NPV: \$1,600,000
CPE Impact	None, non-aeronautical project.

The Internal Rate of Return (IRR) and Net Present Value (NPV) calculations are based upon the conservative assumption of *three* carriers participating as regular customers. In fact, the Airport has received written interest in the relocated club from *six* different carriers. IRR and NPV projections would drop to 1% and a negative \$430,000, respectively, with only *two* carriers as regular customers. Conversely, *four* participating carriers would increase the IRR and NPV to 22% and \$2,900,000, respectively.

It's important to note, when reviewing IRR and NPV, that each carrier's passenger usage is different. The addition or removal of different carriers has a varying effect on calculations. For example, some larger carriers may have up to 1,000 monthly customers, while a smaller carrier may only have 200 monthly customers. Additionally, the opportunity for direct to passenger sales is conservatively understated in this analysis.

Lifecycle Cost and Savings:

This project relocates an existing service into a new location of similar size and function. Operations and maintenance costs are assumed to be similar to those in Club International's current location. Maintenance costs may decrease marginally since there are currently two kitchens being maintained in Club International's separated configuration, while the new facility has only one.

ENVIRONMENT AND SUSTAINABILITY:

This project demonstrates environmental sustainability by reusing existing facilities and prolonging the life of existing Airport assets. Minimal remodeling of an existing lounge reduces the potential environmental impact of new construction that would occur if a new Airport lounge were built or individual air carriers built their own lounge facilities.

STRATEGIC OBJECTIVES:

The Common Use Lounge Remodel project supports two of the Port's Strategies and Objectives. It promotes the Port's strategic goals to "Ensure Airport Vitality" and "Be a Catalyst for Regional Transportation Solutions" by providing international airlines with one of the facility amenities they need to be profitable and grow their business. Additionally, attractive and functional lounge

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facilities create an environment that can assist in marketing to new international travelers and positions the Airport to compete for international growth as air carriers expand or change their flight routes.

BUSINESS PLAN OBJECTIVES:

Moving Club International to a more desirable location with the attractive finishes and furnishings expected by airlines' premium passengers will better meet the needs of current airline customers, support marketing for new airline customers to the Seattle market, and improve the prospects of marketing directly to passengers on a pay-per-use basis.

Airport staff projects potential growth in airline customers from one to three additional carriers with a move to an improved club on the departure level. The number of annual lounge users grows from 9,400 to 36,500 annually based on increased usage from additional airlines. In its present condition Club International is not profitable and is at risk of losing current customers. Neither market expansion nor improved financial performance is feasible without reinvestment into a relocated Club International on the departure level within the former Delta lounge space.

TRIPLE BOTTOM LINE SUMMARY:

This project demonstrates environmental sustainability by reusing and updating a recently vacated airline club facility and converting it to an Airport lounge that provides our airline customers with the amenities they need to support and grow their business. It also provides pay per use customers with a comfortable space to relax and recharge. Current customer demand, as well as a new business plan, supports the need for investment in Club International to increase club use and create a positive net operating income.

ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS:

1. The Port could perform minimal improvements to Club International in its existing mezzanine level location. Minimally required improvements would include health code upgrades to the kitchen, new furnishings, finishes, and data cabling. Although more expensive than the proposed remodel on the departure level, this would be a relatively low cost alternative at \$1,127,000. This alternative would improve the condition of the lounge, but would not improve the existing split configuration nor remedy the less than desirable location. Additionally, this alternative would not allow the existing mezzanine space to be utilized for a future remodel of the Federal Inspection Services (FIS) area. This alternative is not recommended.
2. The Airport could completely remodel and update Club International in its existing mezzanine level location. The initial cost estimate of \$3,582,000 for a full renovation is expensive, but would improve both the condition and configuration of the facility. It would not, however, improve the undesirable location. The mezzanine level location would still suffer from a lack of natural daylight and separation from gate hold rooms even with a significant capital investment. Additionally, as in Alternative 1, the opportunity to utilize this space for a future remodel of the FIS area would be lost. This alternative is not recommended.

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3. The Airport could create a new Club International facility on the roof of the South Satellite, similar to the British Airways and Delta Air Lines lounges. A new facility on the roof of the South Satellite is estimated to cost \$5,419,000. This option would add new leasable space to the South Satellite and still allow remodel of the vacated mezzanine space for FIS. This alternative, however, is not recommended because of the significant capital cost and the availability of the vacated Delta Air Lines lounge on the departure level. This alternative is not recommended.
4. The recommended alternative is to relocate Club International to the vacated Delta Air Lines lounge on the departure level of the South Satellite. At \$971,000, this is the most cost effective and best strategic alternative because it remedies all the configuration, condition, and location challenges of the existing facility. This option also has the potential to generate the most new revenue based on the significantly improved location. This recommended action also frees up space in the former Club International facility for use by FIS for customs inspections. This alternative is recommended.

OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:

Exhibit A – Sea-Tac International Airport South Satellite Terminal.

PREVIOUS COMMISSION ACTION:

November 30, 2009: Commission Authorization for Architectural IDIQ for use by staff at Seattle-Tacoma International Airport.

March 1, 2011: Commission Authorization for design, and procurement of furnishings and casework for the Common Use Lounge at Seattle-Tacoma International Airport.