

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA

Item No. 5b

Date of Meeting March 1, 2011

DATE: February 17, 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
(CIP # C800203)

Amount of This Request: \$320,325 **Source of Funds:** Airport Development Fund

State and Local Taxes Paid: \$14,125 **Jobs Created During Construction:** 16

Total Estimated Cost: \$971,000

ACTION REQUESTED:

Request Port Commission authorization for the Chief Executive Officer to (1) authorize design of the Common Use Lounge (Club International) and (2) competitively procure furnishings and casework for the lounge. This authorization is for \$320,325 of a total estimated project cost of \$971,000.

SYNOPSIS:

A premium common use lounge (Club International) for airlines serving the Airport is a much needed facility that helps both existing and prospective carriers flying international routes meet their business plan objectives, specifically the growth and profitability of routes, and allows them to offer their passengers a superior pre-boarding experience comparable to competitors offering branded lounges for premium passengers. Several airlines have expressed interest in using an improved Club International, adding to the Port's existing customer base. Additionally, the Port anticipates marketing the club directly to passengers on a pay-per-use basis as a new line of business which would increase non-aeronautical revenues.

This project relocates and remodels the Port's common-use lounge from the mezzanine level of the South Satellite to the departure level of the South Satellite (see Exhibit A). Design will be completed by a consultant on an existing Indefinite Delivery Indefinite Quantity (IDIQ) contract. This project is made possible by Delta Air Lines' construction of a new rooftop lounge and the

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subsequent vacation of its existing departure level facility in late 2011. The Port's common-use lounge will occupy the vacated space. The new Club International will be similar in size to the existing location, approximately 4,000 square feet. 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:

A high quality premium passenger lounge is an essential component of the airline services targeted toward premium fare passengers on international flights. The Port'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 their own branded lounges, but they open them up to smaller airlines for additional revenue. Even with this accommodation of sub-tenants, there is inadequate capacity to accommodate all the international carrier demand at the South Satellite.

The Port is not trying to compete directly with the branded airline lounges; however, we endeavor to improve the financial performance of Club International. The Port's Club International meets a critical market need for those airlines that cannot justify building or leasing their own facility and which cannot be accommodated as sub-tenants in the existing airline branded lounges.

The Port offered an unstaffed no-frills common-use club option to airlines for decades; however, this past year the Port changed the operating and business model for the common-use club in an effort to improve the level of service. The Port solicited and selected a third party company to provide management oversight, staffing, and food and beverage service. The fee model has also changed from a fixed per-flight charge to an individual per-customer charge. We anticipate marketing directly to passengers on a pay-per-use basis in addition to offering a competitive product for current and prospective airlines. This direct-to-passenger marketing is an effort to expand our potential customer base, and factored into the change in fee structure based on an individual customer charge.

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 configuration challenges in the existing Club International are a result of it being divided into two separate 2,000 square foot lounges. These separate facilities create challenges in staffing, duplication of maintenance, and the hamper the Port's ability to offer a standard level of service to our customers. The condition of the space is a concern because while one portion of the facility was improved by the Port 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 the inauguration of 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. Airlines and premium customers expect an airline lounge to be close to the gate boarding area and offer views, daylight, and modern amenities.

Delta's existing facility on the departure level of the satellite will become vacant when it moves to the new lounge on the roof of the South Satellite in 2011. The Port wishes to capitalize on this

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opportunity by renovating this newly vacant lounge and reopening it as the new and improved common-use Club International Lounge. This would resolve the configuration, condition, and location challenges that exist with the current facility. This improved facility will provide an attractive option for existing international airlines, as well as a key marketing tool for Port staff to offer to potential carriers considering Sea-Tac for expansion of new international routes.

Remodeling Club International in its current location would require a much more significant renovation and capital investment and would not solve the problem that the current location of Club International is not suitable for an airline lounge. This opportunity to move Club International, with a modest investment, will allow the Port to offer services equivalent to the other two major airline clubs in the South Satellite. In addition, Delta Air Lines has asked to lease the existing Club International space on the mezzanine and plans to remodel the area into a new operations center and pilots base. This future Delta project would increase lease revenue to the Port.

PROJECT JUSTIFICATION:

Project Objectives:

- 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 an improved lounge which may be key to 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 soon to be vacated Delta lounge on the departure level of South Satellite. The project scope includes replacement of architectural finishes, furnishings, millwork, restroom fixtures and partitions, and the installation of data cable for internet service.

Schedule

Begin Design	1 st Qtr 2011
Purchase Furnishings and Fixtures	2 nd Qtr 2011
Advertise for Major Construction Contract	3 rd Qtr 2011
Begin Construction	4 th Qtr 2011
Project Completion	1 st Qtr 2012

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FINANCIAL IMPLICATIONS:

Budget/Authorization Summary:

Original Budget	\$2,000,000
Budget Decrease	\$1,029,000
Revised Budget	\$971,000
Previous Authorizations	N/A
Current request for authorization	\$320,325
Total Authorizations, including this request	\$320,325
Remaining budget to be authorized	\$650,675

The budget for this project decreased through a reduction of scope 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.

Project Cost Breakdown:

This Request Total Project

Construction Costs	\$0	\$ 453,300
Port furnished equipment	\$148,700	\$ 148,700
Sales tax	\$14,125	\$ 57,000
Outside professional services	\$72,000	\$ 90,000
Aviation PMG and other soft costs	\$85,500	\$ 222,000
Total	\$320,325	\$ 971,000

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.• Potential cost overruns would reduce the NPV.• Revenue from club is based upon

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	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.
Project cost for analysis	\$971,000
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 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: 18% NPV: \$1,700,000
CPE Impact	None, non-aeronautical project

The Internal Rate of Return (IRR) and Net Present Value (NPV) calculations are based upon the assumption of three carriers participating as regular customers. This reflects conservative assumptions because the Port has received written interest from six different carriers in regards to the proposed Club International facility. The IRR and NPV projections would drop to 5% and (\$120,000), respectively, with only two carriers as regular customers. Conversely, four participating carriers would increase the IRR and NPV to 19% and \$2,000,000, respectively. Please note that each carrier's passenger usage is different, and therefore the addition or removal of various carriers has a different effect on the 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, in trying to be conservative, the opportunity for direct to passenger sales is conservatively understated in this analysis.

Lifecycle Cost and Savings:

The lifecycle cost and savings of this project will be determined as an element of design. Annual O&M implications will be validated during this design phase of the project.

ENVIRONMENT AND SUSTAINABILITY:

This project demonstrates environmental sustainability by reusing existing facilities and prolonging the life of existing Port assets. This improved Club International will allow for more suitable utilization of existing lounge facilities at the South Satellite. This reduces the potential environmental impact of new construction that would occur if a new Port lounge were built or individual air carriers built their own lounge facilities.

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STRATEGIC OBJECTIVES:

The Club International Lounge Remodel project supports two of the Port's Strategies and Objectives, notably:

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

BUSINESS PLAN OBJECTIVES:

The Port wishes to improve its common-use Club International lounge so that it meets the needs of current airline customers, supports the marketing for new airline customers to the Seattle market, and improves the prospects of marketing directly to passengers on a pay-per-use basis. Port staff has determined that Club International should be moved to a more desirable location, and have an attractive level of finishes and furnishings on par with airlines' premium passenger expectations to do so. Port staff projects potential growth in airline customers from one to three carriers with a move to the departure level, and with the proposed improvements. The number of annual lounge users would grow from 9,400 to 36,500 annually based on this increased usage from additional airlines. In its present condition, Club International is not profitable and is at risk of losing current customers. Any market expansion and/or improved financial performance is not feasible without reinvestment into Club International.

TRIPLE BOTTOM LINE SUMMARY:

This project demonstrates environmental sustainability by reusing and updating an existing airline club facility and converting it to a Port 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 during air travel. Current customer demand, as well as a new business plan supports the need for investment into 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. This would be a relatively low cost alternative at \$1,127,000. This alternative would improve the condition, but would not improve the existing split configuration and the less than desirable location. Additionally, this alternative would not allow Delta Air Lines to lease the potentially vacated mezzanine level space for their operational needs. This alternative is not recommended.
2. The Port 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

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would improve both the condition and configuration of the facility. It would not, however, improve the undesirable location of the facility. 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 lease the area to Delta Air Lines for their operational offices would be lost. This alternative is not recommended.

3. The Port 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 Delta to occupy the vacant mezzanine space. This alternative, however, is not recommended because of the significant capital cost and the availability of the soon to be vacated Delta Air Lines lounge on the departure level.
4. The **recommended alternative** is to relocate Club International to the soon to be 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 leasable space in the former Club International facility for Delta Air Lines to move a large portion of their operational offices to the South Satellite from the Main Terminal. Delta has specifically requested first consideration for this space. 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.