

**PORT OF SEATTLE**  
**MEMORANDUM**

**COMMISSION AGENDA**

**Item No.** 6c

**Date of Meeting** May 24, 2011

**DATE:** May 16, 2011

**TO:** Tay Yoshitani, Chief Executive Officer

**FROM:** Michael Ehl, Director, Airport Operations  
Wayne Grotheer, Director, Aviation Project Management  
James Jennings, Manager, Aviation Properties, Aviation Business Development

**SUBJECT:** Additional Tenant Reimbursement for Delta Air Lines (CIP # C800336)

**Amount of This Request:** \$ 3,490,000

**Source of Funds:** Airport  
Development Fund

**State and Local Taxes Paid:** \$ 238,000

**Estimated Construction Jobs:** 65

**Total Program Cost:** \$8,930,000

**ACTION REQUESTED:**

Request Commission authorization for the Chief Executive Officer to 1) approve a tenant reimbursement to Delta Air Lines (Delta) and additional Port costs totaling \$3,490,000 associated with the build-out of an airline lounge on the roof of the South Satellite at Seattle-Tacoma International Airport (Airport) for a total program cost of \$8,930,000 and 2) modify a Tenant Reimbursement Agreement with Delta per the Port of Seattle's AV-2 Policy.

**SYNOPSIS:**

Delta has requested that the Port of Seattle (Port) approve additional tenant reimbursement funds to accommodate a 1,300 square-foot expansion of the Delta Sky Club, as well as accommodate various change orders to the Port's share of the project. The expansion of the new lounge is driven by Delta's continued international growth in the Seattle market, improving their level of service in Seattle by having a lounge commensurate with their expected growth. The additional square footage will increase Delta's rent by \$300,000, totaling \$1,800,000 per year for the entire facility.

The impact of this additional tenant reimbursement request will be an increased cost per enplanement of \$.03 and will further reduce the average terminal rental rate due to the increased

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total square footage of leased space. The airlines approved the original Delta Sky Club tenant reimbursement project through a Majority In Interest (MII) vote in December 2010.

With Commission authorization, staff will finalize an adjustment to the current tenant reimbursement agreement and add the additional 1,300 square feet to the existing lease.

### **BACKGROUND:**

On March 23, 2010, the Commission approved \$5.44 million of funding to reimburse Delta for base building construction of a 6,800 square-foot airline lounge and for Port project support to assist in building this facility on the roof of the South Satellite. Delta moved forward with design of the project after Commission approval, but soon thereafter put the project on hold before the design work was completed. Delta at that time was considering a proposal to move their operation back to Concourse A from the South Satellite. After a brief delay, Delta decided to commit to the South Satellite location and signed the Port's tenant reimbursement agreement. Delta was concurrently considering an expansion of the lounge footprint to accommodate their anticipated growth as part of their location analysis.

Delta decided to add 1,300 square feet to their partially designed lounge, increasing the footprint from 6,800 square feet to 8,100 square feet. The Port was only committed to costs associated with the original scope, but the proposed change included additional shell construction that the Port would typically pay for under the Tenant Reimbursement Policy AV-2. At Delta's request, and at their financial risk, they proceeded with this additional expansion work as a change order to the project, with the understanding that the Port could not commit to additional compensation for the lounge expansion unless approved by the Commission. Costs were provided to the Port in late March 2011. Total costs are now anticipated to exceed the established budget for the project, and are therefore part of this request for additional authorization.

In addition to the expansion scope, Delta also notified the Port of several change orders based on unidentified project conditions as they prepared to submit their expanded lounge costs to the Port in March. These necessary changes were identified as the tenant contractor investigated the existing roof structure after construction began. Those change order costs further exceed the established budget for this project and are also included in this request.

### **PROJECT SCOPE OF WORK AND SCHEDULE:**

#### ***Expansion Scope of Work:***

- Additional 1,300 square feet of new building shell
- Addition or expansion of existing building systems into the expanded building shell
- Special inspection and commissioning of new Port infrastructure systems

#### ***Unidentified Project Conditions Scope of Work:***

- Resolve structural steel conflicts with existing or proposed infrastructure in the ceiling of the South Satellite

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- Resolve new elevator shaft conflicts with existing or proposed infrastructure
- Additional modifications of the structural support system on the existing roof for the new lounge
- Corrective measures to resolve incorrect elevation data used for the new lounge floor level
- New fireproofing to replace asbestos containing fireproofing on existing structural steel removed during installation of new structural steel for the lounge

See attached Exhibit A depicting the additional project area to be added to Delta's lease.

### ***Schedule:***

Design (by Delta): 4<sup>th</sup> Qtr 2009 – 3<sup>rd</sup> Qtr 2010

Construction (by Delta): 4<sup>th</sup> Qtr 2010 – 3<sup>rd</sup> Qtr 2011

Completion: 3<sup>rd</sup> Qtr 2011

### **SCOPE OF AGREEMENT:**

Use: Authorization to construct an 8,100 square foot airline lounge and support space, with associated terms for reimbursement.

Gross Rent: \$1,800,000/year

Incremental Rent From Delta Expansion \$ 300,000/year

Capital Reimbursement: The total project is currently estimated at \$7,106,797

Port Project Support Costs: \$1,823,203

Term of Lease: Expires December 31, 2012

Note: A new signatory lease will be negotiated with all airlines prior to 2012. With Delta's own investment of \$5,250,000 and recent expanses in international service, it is fully expected that Delta will keep this lounge as part of that new lease.

### **FINANCIAL IMPLICATIONS:**

#### **Budget/Authorization Summary:**

Original Budget	\$5,440,000
Budget Increase	\$3,490,000
Revised Budget	\$8,930,000
Previous Authorizations	\$5,440,000
Current request for authorization	\$3,490,000
Total Authorizations, including this request	\$8,930,000
Remaining budget to be authorized	\$0

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### **Budget Status and Source of Funds:**

This project was included in the 2011 – 2015 capital budget and plan of finance for \$5.44 million (CIP #C800336). The funding sources include the Airport Development Fund and the 2010 revenue bonds. Upon Commission approval, the budget increase will be transferred from the aeronautical allowance CIP, resulting in no net change to the Aviation Capital Budget.

### **Financial Analysis and Summary:**

<b>CIP Category</b>	Revenue/Capacity Growth
<b>Project Type</b>	Business Expansion
<b>Key risk factors</b>	Delta is the second largest airline in the world, as measured by passengers, thus the risk of default is low. However, Delta's lease expires December 31, 2012, and Delta could theoretically return the premises at that time. Port staff believes the likelihood of this is low, especially in light of their own \$5,250,000 investment.
<b>Project cost for analysis</b>	\$8,930,000
<b>Business Unit (BU)</b>	Terminal Cost Center
<b>CPE Impact Effect on business performance</b>	This project will increase CPE by \$.03 in 2012; however, there will be no change to the forecasted CPE as this project (and the needed budget transfer from the aeronautical allowance CIP) was included.

### **Lifecycle Cost and Savings:**

Airport maintenance of new electrical and mechanical systems for Delta's lounge is estimated at \$20,000 annually (ongoing expense). Additional lifecycle costs for maintenance of electrical and mechanical systems extended to the expanded area of the lounge are minimal.

### **ENVIRONMENT AND SUSTAINABILITY:**

Staff will ensure existing Port environmental standards are followed on Port infrastructure included in this additional scope. However, because this is a tenant project, the Port has minimal influence on the type of materials used within the additional space included in the expanded lounge.

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### **STRATEGIC OBJECTIVES:**

Like the original tenant reimbursement request, this project supports the strategy of “Ensuring Airport Vitality” through expanding the footprint of the Airport and leasable space and adds to the Airport’s asset base. Staff is working with Delta to incorporate “Environmental Stewardship” elements within the project design. Additionally, hazardous materials formerly in place at the South Satellite have been removed, decreasing future risk of exposure. The project also supports the “Be a Catalyst for Regional Transportation Solutions” strategy by helping to provide the airline with a facility that will augment its customer service initiatives as well as contribute to a competitive environment between carriers, that ultimately benefits the traveling public.

### **BUSINESS PLAN OBJECTIVES:**

Similar to the original reimbursement request, this additional project scope enables Delta to more effectively market their overseas flights and grow the market that serves the Puget Sound region. This, in turn, benefits local businesses and travelers. The added square footage that drives a portion of this reimbursement request resulted from Delta putting the project on hold during the later stages of design to specifically evaluate whether a larger lounge was needed to support their projected future growth. The expanded lounge is a direct result of that positive analysis.

The construction included in the expansion and additional structural work will generate sales tax revenues and construction jobs. It is estimated that this Commission authorization will generate sales taxes that may exceed \$238,000 and generate greater than 65 construction jobs that vary in length over the project. Please note that this project is exempt from the Project Labor Agreement since it is a tenant project.

### **TRIPLE BOTTOM LINE SUMMARY:**

This project provides a new, comfortable facility for Delta’s traveling customers as they wait for flight departures, and gives them an opportunity for sanctuary from what can be a very busy airport concourse. The facility will be located on the roof of the South Satellite. The building envelope does not take up additional valuable ramp space at a busy airport with a small overall footprint. Delta will use this lounge as a customer marketing tool in their plan to build their local viability to provide more overseas flights to and from the Airport.

### **ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS:**

**Alternative 1:** Authorize the Chief Executive Officer to authorize \$3,490,000 of additional tenant reimbursement budget associated with the build-out of an airline lounge on the roof of the South Satellite at the Airport and to execute an updated tenant reimbursement agreement with Delta under the Airport’s AV-2 policy. This alternative allows the Port to reimburse Delta for all work associated with the building shell of their new lounge as per the original Tenant Reimbursement Agreement. **This is the recommended alternative.**

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**Alternative 2:** Do not authorize the budget or Agreement required to reimburse Delta for the additional portion of Port costs for construction of Delta's airline lounge. This would be inconsistent with past Port tenant reimbursement practice, conflict with the original Tenant Reimbursement Agreement negotiated for this project, and could result in Delta halting the tenant project mid construction, forcing the airline to maintain its existing undersized airline lounge. This would hamper Delta's ability to grow the Seattle market, decrease Delta's long-term rent to the Airport and eliminate the ability for the Airport to relocate its Club International shared lounge to Delta's existing facility. This alternative is not recommended.

### **OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:**

Exhibit A- Updated Delta Air Lines Sky Club Lounge drawing.

### **PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:**

On February 2, 2010, Port Commission was provided a briefing on Delta Air Lines Growth Plans, Sky Club, and other potential future aviation projects.

On February 9, 2010, the Port Commission approved the Delta Air Lines Sky Club Regulated Materials Management Abatement project, in support of Delta's airline lounge tenant project at Seattle-Tacoma International Airport in the amount of \$1,750,000.

On March 23, 2010, the Port Commission approved Tenant Reimbursement for Delta Air Lines, in support of Delta's airline lounge tenant project at Seattle-Tacoma International Airport in the amount of \$5,440,000.

On May 3, 2011, the Commission was briefed on this request.