

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

**COMMISSION AGENDA**  
**ACTION ITEM**

<b>Item No.</b>	4i
<b>Date of Meeting</b>	June 9, 2015

**DATE:** May 27, 2015  
**TO:** Ted Fick, Chief Executive Officer  
**FROM:** James R. Schone, Director, Aviation Business Development  
Jolene Culler, Senior Property Manager, Aviation Properties  
**SUBJECT:** ATZ Lease Amendment for Doug Fox Parking Lot

**ACTION REQUESTED**

Request Commission authorization for the Chief Executive Officer to amend the lease with ATZ Inc. (Exhibit A) for the operation of the Doug Fox Parking Lot located north of South 170<sup>th</sup> Street and east of the Northern Airport Expressway to extend the term nine months, defer increases in the concession fee and Minimum Annual Guarantee, and provide other modest relief for operational impacts and delays caused by construction of the Doug Fox Parking Lot Service Upgrades Project.

**SYNOPSIS**

On July 9, 2013, the Commission approved the Doug Fox Parking Lot Service Upgrades Project as well as a lease with ATZ for operation of the parking facility commonly known as the Doug Fox Parking Lot. Port staff returned to Commission on October 8, 2013, for additional authorization to construct this project based on a low bid that was more than 10% over the engineer's estimate. Following Commission approval of that request, total project authorization was \$6,503,000.

The lease with ATZ commenced on October 1, 2013. The lease specified that construction of the project would be substantially complete by the end of summer 2014. When compared to later years, the lease included a lower percentage rent (55%) and Minimum Annual Guarantee (MAG) (\$1.5 million) for the first year to account for the impact of construction on the facility. Due to a number of reasons, beneficial occupancy for the major works construction contract was completed February 27, 2015, five months later than originally scheduled. The lease specifies that ATZ is due relief for construction that materially deviates from the original schedule and negatively impacts operations.

ATZ submitted a claim in September, 2014, for the harm suffered from changes in the schedule. However, ATZ also failed to complete the divestiture of its ownership in another parking facility located within three miles of the Airport or the leased premises within the timeframe granted to it by the Port. Therefore, the Port and ATZ negotiated revised terms during the past several months that account for the negative impacts of the delayed construction and that reflect both

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parties' roles in these delays as well as the delayed divestiture by ATZ. With the additional costs associated with the project as approved by the Commission on January 6, 2015, the adjustments to the lease related to relief for ATZ as presented in this request to Commission, and using updated transaction and revenue forecasts provided by ATZ, the Net Present Value (NPV) for the Port's investment is approximately \$1.26 million compared to a NPV of \$3.46 million estimated when the Commission approved the additional project funding on October 8, 2013.

A review of this project found numerous problems related to project development, construction management and communications with the Commission. Representatives from the Port departments involved in this project (including Aviation Business Development, Aviation Project Management, Aviation Facilities and Infrastructure, Construction Management and Legal) have reviewed these problems to understand how they occurred with the goal of improving future RFPs, leases and project development. A number of steps have already been taken to make these improvements.

### **BACKGROUND**

The Doug Fox Parking Lot is currently operated by ATZ as an off-site surface parking lot at Seattle-Tacoma International Airport. The lot has been used primarily for automobile parking since its development well over 20 years ago.

#### **Project**

In February 2012, the Port Commission authorized the design and construction of the Doug Fox Site Improvements Project that included storm water improvements. In May 2012, the Commission authorized the design of the Doug Fox Parking Lot Service Upgrades Project that included pavement restoration, lot lighting, improved signage, and potentially operations and customer service facilities. At that time, the two projects were consolidated into one combined project for a total project budget of \$6,123,000. The project implementation was based on the tenant remaining operational during construction.

#### **Lease**

Following Commission approval of design funds, staff initiated a public request for proposals (RFP) process for a new operator in anticipation of the expiration of the then-current lease agreement. At the conclusion of that RFP process, ATZ was selected and Port staff initiated negotiations that concluded in early 2013. The Commission approved the new lease with ATZ in July 2013, and the new agreement commenced on October 1, 2013. That agreement was for five years with two, five-year options at the mutual consent of both parties. The lease included lower percentage fees (55%) and MAG (\$1.5 million) for the first year of the lease (October 1, 2013 – September 30, 2014) to account for impacts to operations during the construction of the project. Starting in year two of the lease, October 1, 2014 – September 30, 2015, the percentage fee was scheduled to increase to 60% with a MAG of \$2.5 million.

The lease also included a provision requiring the owner of ATZ to divest of his interest in another parking facility located in the City of Tukwila. This was a requirement of the RFP that

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stipulated that any respondent chosen to operate the lot could not have a financial or management interest in any other parking facility located within three miles of the leased premises. ATZ did not complete this divestiture within the originally agreed timeframe. The divestiture was completed on December 1, 2014.

In July 2013, the Port Commission also authorized the construction of the project that included storm water management facilities, pavement restoration, lot lighting, improved signage, a new operations building, a new covered entrance and exiting facility, demolition of the existing building, and supporting utilities. In September 2013, the bids were opened for the project, and since the lowest responsive bid exceeded the engineer's estimate by more than 10%, additional authorization by the Commission was required. In October 2013, the Commission authorized the additional budget to support the bid, for a total project budget of \$6,503,000, and the contract was executed with the successful bidder on October 29, 2013.

### Project Completion Delay

The lease and the project specifications envisioned that construction of improvements to the lot would begin in the fall of 2013 and be completed by the end of summer 2014. There were a number of issues encountered during construction that delayed the completion of beneficial occupancy for the major construction contract five months, until February 27, 2015. In January 2015, the Commission authorized the additional budget to complete the construction of the project given the five-month delay described above for a total project budget of \$6,930,000. At that time staff also notified the Commission that construction claims had been received, reviewed, and rejected, but that if validated, would exceed the remaining construction contingency for the project. These claims are currently in dispute; however, since completing the project, staff has determined that sufficient construction contingency remains to cover their resolution.

The lease states that in the event that the Port materially deviates from the project schedule and, despite its commercially reasonable efforts, the lessee's operations are substantially and negatively impacted, the Port agrees to negotiate a further equitable adjustment in the Minimum Annual Guarantee or to bear reasonable costs of any modifications to the premises reasonably necessary to permit the lessee to continue to operate its business. The lease also states: "the Port generally intends to follow the phasing plan set forth in the design documents, with construction continuing, as weather permits, through the summer of 2014."

### Tenant Request for Relief

This delay in completion of the project negatively impacted ATZ's operations. Therefore, ATZ requested relief for not only the delay in completion of the project but also for the delay associated with the completion of specific project elements. At the time the lease was signed, the project bid documents included five phases for project completion within which key project elements, specifically signage (Phase 1), a new operations building (Phase 2) and a new entrance and exiting facility (Phase 3) were designated for completion. Having these elements completed early in the project was critical for ATZ's plan to build the business in anticipation of the

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increased percentage fees and higher MAG effective at the start of year two of the lease, or October 1, 2014. ATZ had planned to launch a marketing campaign once the new entrance and exiting facility and signage work were completed. However, the signage was not installed until early November 2014, the operations building was not completed until mid-November 2014, and the new entrance/exit facility was not completed until February 27, 2015 – all well after the project was originally understood by all parties to be completed.

The project was completed five months late and the Port agrees that the phasing plan for completion of key project elements was essentially inverted, resulting in these elements (the signage, operations building, and entrance and exiting facility) being completed much later than expected. Port staff evaluated ATZ's claim for MAG and concession fee relief including both the Port's and the tenant's role in causing the delays to completion of key project elements and then tried to quantify the appropriate compensation due ATZ for the delay. To do so, staff used the contractor's initial project schedule as the basis for the analysis. While this schedule was submitted after lease negotiations were completed, it is the best tool available to assist in quantifying the amount of relief to be considered.

<u>Deliverable</u>	<u>Phasing Plan</u>	<u>Actual</u>	<u>Difference</u>
Signage	Mid March 2014	Early November 2014	7½ months
Operations Building	Mid April 2014	Mid November 2014	7 months
Entrance/Exiting Facility	Mid July 2014	February 27, 2015	7½ months

### **KEY AMENDMENT TERMS**

Based on the Port's delay in completing the overall project as well as several key elements of the project and ATZ's delay in completing the divestiture of its ownership in another parking facility located within three miles of the Airport or the premises as called for in its lease with the Port, the parties have mutually agreed on the proposed terms for relief as summarized below:

- Nine-month extension of the lease term and an equivalent deferral of the increases in the MAG and percentage fee. With this change, the new MAG and percentage fee would begin July 1, 2015 (rather than October 1, 2014) and would increase every 12 months thereafter. This provides relief for the late completion of key project elements and was intended to give ATZ time to launch a marketing campaign and build the business before the MAG and percentage fee increase.
- Rent and utility credits for the period April 1, 2014, through October 31, 2014, for a total of approximately \$25,000. This is due to the delay in providing the new operations building, which is less square footage, and thus less rent (\$1,500 per month compared to \$2,904 per month) than the previous operations building and lower utility charges as it was to be connected to the local sewer system.
- The Port releases ATZ from any claims related to its not having completed divestiture of another parking facility within the originally agreed timeframe.

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- ATZ releases the Port from any claims associated with the construction of the improvements called for in the lease and the deviation from the schedule called for in the lease.
- ATZ releases the Port from any claims related to the impacts to its operations from the construction of the the nearby improvements described in the lease to the extent such impact has occurred prior to the date of this amendment.

The amendment also includes an increase in the leased premises of 630 square feet to accommodate storage displaced from the operations building as well as the addition of 24 square feet to reflect the location of a monument sign.

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

Below is a comparison of the key business terms of the current lease and the amended lease.

	<b>Current Lease</b>		<b>Amended Lease</b>	
<b>Term</b>	Five (5) years		Five (5) years plus 9 months	
<b>MAG</b>	Year 1:	\$1.5M	Month 1-21	\$1.5M
	Year 2:	\$2.5M	Month 22-33	\$2.5M
	Year 3:	\$2.6M	Month 34-45	\$2.6M
	Year 4:	\$2.7M	Month 46-57	\$2.7M
	Year 5:	\$2.8M	Month 58-69	\$2.8M
<b>Percentage Fee</b>	Year 1:	55%	Month 1-21	55%
	Year 2:	60%	Month 22-33	60%
	Year 3:	61%	Month 34-45	61%
	Year 4:	62%	Month 46-57	62%
	Year 5:	63%	Month 58-69	63%
<b>Building Rent</b>	\$1,500.00 Effective On Occupancy		\$1,500.00  Effective On April 1, 2014	

The value of the proposed relief is largely the same as described in the December 2, 2014, memo, with the exception that the request to install Variable Message Signage (VMS) at a cost of \$25,000 is no longer included. The proposed relief, inclusive of the 9 months of percentage fee and MAG relief along with the rent and utility credits, results in a decrease of approximately \$230,000 in present value to the Port and shall be realized entirely within the first lease term. The impact of removing the VMS installation in the relief package does not fundamentally change the financial analysis shared with Commission on January 6, 2015.

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<b>CIP Category</b>	Revenue/Capacity Growth
<b>Project Type</b>	Business Expansion/New Business Development
<b>Risk adjusted Discount rate</b>	8%
<b>Key risk factors</b>	<ul style="list-style-type: none"><li>• Financial risks: general economic conditions will impact the parking market and if general economic declines occur in the future, incremental revenues may fall short of forecasts.</li><li>• Financial results were analyzed over two timeframes, 1) 5-years and nine months and 2) 15-years and nine months, accounting for the extension period associated with relief. There is risk associated with a potential future conversion of the property to non-parking use, and lease terms associated with future extensions.</li></ul>
<b>Project cost for analysis</b>	\$6.93 million
<b>Business Unit (BU)</b>	Landside
<b>Effect on business performance</b>	The financial analysis assumes that with construction of the project improvements at the facility, annual revenues to the Port will increase. Current revenues to the Port are approximately \$2 million per year. Within five years of implementation of the improvements, annual revenues are anticipated to increase by approximately \$1.5 million. Within ten years, annual revenues are anticipated to exceed \$5 million.
<b>IRR/NPV (based on 15 years and 9 months)</b>	NPV: \$1.26 million IRR: 9% Payback: 10 years
<b>CPE Impact</b>	None

If the baseline revenues used for the above financial analysis are revised to reflect that the facility was actually in such a state of deterioration in 2012 that without the investment in improvements, a more realistic scenario was for the revenues from the facility to decrease by 20% per year through 2016 when the facility would have to be closed. If that baseline scenario is used, the financial metrics for the new investment based on a 15-year, 9-month analysis is: NPV of \$20 million, an IRR of 18% and the Payback Period of 4 years. If based on just a 5-year analysis, the financial metrics are: NPV of negative \$1 million, an IRR of 4.5% and a Payback of 4 years.

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## **STRATEGIES AND OBJECTIVES**

This project aligns with the Port's Century Agenda strategy of advancing the region as a leading tourism destination and business gateway.

## **ENVIRONMENTAL SUSTAINABILITY**

Environmental sustainability elements related to this project are described in associated project memos.

## **BUSINESS PLAN OBJECTIVES**

Approval of this lease amendment authorization request will contribute to achievement of the airport's business plan objective of "maximizing non-aeronautical net operating income" by generating increased non-aeronautical revenues.

## **TRIPLE BOTTOM LINE SUMMARY**

The project supports economic development by investing in an upgraded parking lot to serve the public's parking needs at the Airport. Environmental sustainability principles have been employed consistent with Port policy.

## **ALTERNATIVES AND IMPLICATIONS CONSIDERED**

**Alternative 1)** – Do not amend the lease. This would likely result in legal action by the Lessee, and the Port's financial responsibility could increase beyond what is proposed. This is not the recommended alternative.

**Alternative 2)** – Negotiate a different lease settlement of less magnitude with ATZ. This may or may not be successful, and would delay the prompt resolution sought by both parties. It could result in legal action by the Lessee and the Port's financial responsibility could increase beyond what is proposed. Further the Lessee may find the terms untenable and could default on the Lease thus putting the projected revenues at risk. This is not the recommended alternative.

**Alternative 3)** – Authorize this lease amendment. This would enable both parties to proceed in good faith and give assurance that the financial returns set forth in the business case are realized. **This is the recommended alternative.**

## **ATTACHMENTS TO THIS REQUEST**

- Exhibit A - Amendment to Lease and Concession Agreement.

## **PREVIOUS COMMISSION ACTIONS OR BRIEFINGS**

- April 14, 2015, the Port of Seattle Commission received a briefing and request to authorize the Amendment, but decided to defer the decision.

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- January 6, 2015, the Port of Seattle Commission authorized (1) an additional \$427,000 to complete the construction of the Doug Fox Site Improvements project for a total authorization of \$6,930,000, and (2) the Chief Executive Officer to execute change orders to extend the construction duration by up to 180 days to complete changed work associated with the operations building.
- On December 9, 2014, the Port of Seattle Commission was presented but deferred taking action to authorize the Chief Executive Officer to amend the lease with ATZ for the operation of the Doug Fox Parking Lot to extend the term nine months, defer increases in the concession fee and Minimum Annual Guarantee, and provide other modest relief for operational impacts and delays caused by construction of the Doug Fox Parking Lot Services Upgrade Project.
- December 2, 2014, the Port of Seattle Commission was presented, but deferred taking action to authorize (1) additional \$427,000 to complete the construction of the Doug Fox Site Improvements project for a total authorization of \$6,930,000, and (2) the Chief Executive Officer to execute change orders to extend the construction duration by up to 180 days to complete changed work associated with the operations building.
- October 8, 2013, the Port of Seattle Commission authorized the Chief Executive Officer to execute a major public works construction contract with the low responsive and responsible bidder for an additional \$1,385,000 for a total authorization of \$6,503,000.
- July 9, 2013, the Port of Seattle Commission authorized the Chief Executive Officer to: (1) advertise, award, and execute a major public works contract for the Doug Fox Site Improvements project; and (2) execute a Developer Extension Agreement with the Valley View Sewer District for an additional \$3,322,000, for a total authorization of \$5,118,000.
- July 9, 2013, the Port of Seattle Commission authorized the Chief Executive Officer to execute a lease with ATZ, Inc., for a term of 5 years with two 5-year extension options upon mutual agreement.
- June 4, 2013, the Doug Fox Site Improvements project was presented to the Port Commission but no final action was taken.
- March 5, 2013, the Port Commission postponed consideration of the Doug Fox Site Improvements project.
- May 22, 2012, the Port Commission authorized the Chief Executive Officer to: (1) increase the scope of the Doug Fox Site Improvements project to include resurfacing, lighting, building, and road signage; (2) to execute utility agreements; and (3) to complete the design of the project for an additional \$768,000, for a total authorization of \$1,796,000.
- February 4, 2012, the Port Commission authorized the Chief Executive Officer to complete the design and to utilize Port Construction Services crews for the construction of the Doug Fox Site Improvements project in the amount of \$1,028,000.