

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No.	<u>3b</u>
Date of Meeting	<u>August 11, 2015</u>

DATE: August 7, 2015
TO: Ted Fick, Chief Executive Officer
FROM: Linda Styrk, Managing Director Maritime
Michael McLaughlin, Director Cruise & Maritime Operations
Melinda Miller, Director, Portfolio & Asset Management

SUBJECT: Bell Street Cruise Terminal Lease Agreement

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to finalize negotiations and execute: (1) Lease Agreement with Norwegian Cruise Line Holdings Ltd. at the Bell Street Cruise Terminal at Pier 66; (2) Sublease Agreement with Norwegian Cruise Line Holdings Ltd.; (3) Amended and Restated Cruise Terminal Lease Agreement with Cruise Terminals of America LLC; (4) Second amendment to the Conference and Event Center Management Agreement with Columbia Hospitality Inc.; (5) Lease Agreement with Columbia Hospitality Inc. for premises in the World Trade Center West building; (6) As necessary to meet the Port's obligations under the Bell Street Cruise Terminal Lease Agreement, an authorization for an early lease termination agreement with owners of the Bell Street Deli; with the exception of item #6, all substantially in the form provided with this memo.

SYNOPSIS

The Bell Street Cruise Terminal at Pier 66 opened in 1999 and was originally designed and constructed for much smaller cruise ships than the larger ships of today and is becoming obsolete. The new lease of the Bell Street Cruise Terminal will be with Norwegian Cruise Lines Holdings LTD (NCHL/tenant) for a base term of 15 years with a 5-year option to extend. With authorization, this lease agreement will be effective October 1, 2015. The tenant will immediately start the much needed renovation of the cruise terminal facility to accommodate their growing business needs of continued homeporting their vessels in Seattle. The most critical element of this project is the schedule. NCLH would like to open a new and improved Bell Street Cruise Passenger Terminal at Pier 66 in April of 2017. NCLH will undertake tenant improvements to the premises including design, permitting, and construction. The project scope of work will primarily pertain to improvements specific to the continued use of the facility as a Cruise Passenger Terminal. As an additional element of work during the construction project, some fit and finish improvements will be made to the facility by NCLH that solely pertain to the use of the facility in the off-season as an events venue. The Port will provide a tenant improvement allowance equal to 50 percent of the cost undertaken by NCLH not to exceed

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 2 of 10

\$15 million. As a public-private partnership project, the Port will provide funds estimated at \$2 million for the collective costs related to lease terminations, lease amendments and restatement of existing leases, relocation costs for affected Port tenants, mitigation fund for construction impacts that may affect the conference and event center, and fit and finish items to enhance event use. Plans and specifications are subject to the Port's review and approval. A project labor agreement will be executed before construction begins between NCLH contractors and the building trades.

The Port will sublease the facility back from NCLH annually commencing the end of the 2017 cruise season in order to utilize the facility for event activities. The Port will also reserve a license to conduct events when facilities are available during the cruise season.

The third amendment and restatement of lease to the Cruise Facility Lease Agreement with Cruise Terminals of America (CTA) would remove the Bell Street Cruise Terminal from the lease agreement. CTA will continue to lease Smith Cove Cruise Terminal at Terminal 91.

The redesign of the space at Pier 66 within the building footprint maximizes efficiencies in passenger flow and space utilization. This requires repurposing space inclusive of the Maritime Event Center, Columbia Hospitality Inc. administrative offices, the Bell Street Deli and some existing non-waterfront dependent tenant office space.

The Port of Seattle currently employs Columbia Hospitality Inc. (CHI) as the manager of the Pier 66 conference and event centers. Under the terms of CHI's management agreement, it has rights in certain portions of the Bell Street Cruise Terminals. The new lease would limit CHI's right to make use of the Bell Street Cruise Terminal Lease Area. Therefore, an amendment to the Conference and Event Center Management Agreement and the creation of a mitigation fund is necessary. The current conference center including the additional support kitchen would remain intact.

CHI also has a lease for office space within the footprint of the new design. This authorization includes their relocation to the World Trade Center West building for a term of not more than five years and two months with relocation and improvement allowance not to exceed \$500,000.

Lastly, the renovation includes the installation of an automated luggage conveyer system that would efficiently move passenger luggage from curbside to ship, allowing more overlap between passenger disembarkation and the embarkation process. The need for street-facing space to build improvements to efficiently receive embarking passenger luggage and transfer passenger luggage to the ship will displace the Bell Street Deli. The current lease with the deli runs through June of 2016. We request authorization for an early lease termination agreement with the deli as needed to accommodate the construction schedule.

BACKGROUND

Norwegian Cruise Line was the catalyst for substantial growth in the Seattle-to-Alaska cruise market when it became the first cruise line to homeport a vessel at the Port of Seattle in 2000 at

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 3 of 10

Pier 66. Since that time, cruise lines continue to build bigger vessels. The Port of Seattle and Norwegian Cruise Line have been in discussions around a long-term preferential berthing agreement in recent years and Norwegian Cruise Line has expressed concerns about the aging Pier 66 cruise facility's not being able to continue to meet their cruise line's needs as a homeport facility, considering the changes occurring in the industry with the deployment of larger vessels in all major cruise brands serving markets around the world including Alaska.

In the spring of 2014 Norwegian Cruise Lines began discussions with Port staff regarding feasibility of expansion to improve passenger terminal efficiencies in anticipation of their expected growth in their homeport cruise business serving Alaska from the Bell Street Cruise facility. Throughout the last year, Port staff has worked with NCLH to perform feasibility studies and concept development for expanding the cruise facility. The focus of this work was to address the performance concerns of the aging facility, which is over 15 years old and approaching obsolescence.

In the fall of 2014, Norwegian Cruise Line acquired Prestige Cruise Holdings Inc. and Norwegian Cruise Line Holdings Ltd. is now the parent company of Norwegian Cruise Line Corporation and Prestige Cruise Holdings, which operates global cruise lines under Norwegian Cruise Line, Oceania Cruises, and Regent Seven Seas brands. The Port of Seattle is a homeport to both Norwegian Cruise Line and Oceania and also sees an occasional port of call from a Regent Seven Seas vessel.

In April 2015 formal negotiations commenced between the Port and NCLH for a potential public-private partnership focused on improving the aging Pier 66 facility and securing the cruise business of NCLH in Seattle through a long-term lease of Bell Street Cruise Terminal. NCLH contracted with design consultant Bermillo Ajamil & Partners Inc. to produce conceptual drawings of a proposed renovation project of the Pier 66 cruise facilities inclusive of expansion of the cruise passenger terminal area into areas currently occupied by other uses. Design work included discussions with U.S. Customs and Boarder Protection (CBP) to ensure the proposed design for improvements would also meet the requirements of CBP passenger processing. Through a series of meetings with CBP Area Port Director and Seattle team, CBP has provided input to the re-design of the terminal and expressed support of the project.

A Letter of Intent between the Port of Seattle and NCLH was executed on July 15. Intense lease negotiations, project cost estimating and scheduling, design concept refinements and collaboration with other leasehold tenants currently operating at Pier 66 have occurred over the last month. The results of Port staff working together with our customers has produced an historically unprecedented public-private partnership that protects a major portion of our homeport cruise business in Seattle, grows quality family-wage jobs for many years, allows for public-private partnering on investment in Port facility improvements, and secures significant economic benefits for our region.

The Port has contracted with Cruise Terminals of America (CTA) to manage cruise operations since May 2000 when the Port began its homeport cruise business. With the dramatic growth in

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 4 of 10

cruise business, the Port opened an interim cruise terminal at Terminal 30. The First Amendment to Cruise Facility Lease Agreement was signed in 2006 to reflect the relocation of the second and third cruise berths to the Port's newly built Smith Cove Cruise Terminal at Terminal 91. The current lease agreement with CTA extended their seven-year lease an additional seven years. As a condition of the agreement with NCLH, a third amendment to the Cruise Facility Lease Agreement would remove the Bell Street Cruise Terminal from the lease agreement. The Port and NCLH have cooperatively worked with Cruise Terminals of America to negotiate such an amendment and restatement of the CTA Lease.

Summary Lease Information – Full documents attached

New Lease Bell Street Cruise Terminal Pier 66 with Norwegian Cruise Line Holdings (NCLH). The new lease will include approximately 152,000 square feet of finished space within the Pier 66 facility to be used as a cruise passenger terminal after the completion of the tenant improvements. The lease premises will also include the apron/dock structure/cruise ship berth. The tenant will be responsible to undertake tenant improvements and manage the cruise terminal operations at Pier 66 as described in attached documents.

- a) Premises: Bell Street Cruise Terminal (BSCT) to be expanded per design concept drawings
- b) Term: 15 years through year 2030 Cruise season + 5 year option to extend through 2035
- c) Investment Cost Split: Up to \$15 million from Port, \$15 million plus from NCL for Pier 66 Improvements
- d) Rights & Maintenance: NCLH shall have rights during cruise season;
 - a. The Port will have rights during off-season through a sublease agreement.
 - b. NCLH will be responsible for cruise operations equipment maintenance
 - c. The Port will maintain the terminal building: its systems and the dock structure
- e) A fee structure will be established that includes Port Directed Cruise Fees, Marketing Allowance, Passenger Incentive, and New Business Incentive.
- f) Operational Cost Offset: provision to accommodate NCLH cost of starting up operations
- g) Estimated Net Returns (Adjusted Impacts: Estimated \$73 million to Port; \$11,000 to NCLH over 15 years)
- h) Agreement conditioned on reaching agreement on amendments to the Port's CTA and CHI agreements
- i) NCLH agreed to pay prevailing wage rates for construction contracts to undertake tenant improvements and a Project Labor Agreement (PLA) will be established between NCLH contractor and the building trades unions prior to the commencement of work
- j) Port to provide funds estimated at \$2 million to cover costs of termination agreements, tenant relocation costs, mitigation for construction impacts and additional fit and finish interior work to accommodate event operations.

New Lease in World Trade Center West. Columbia Hospitality Inc. (CHI) occupies approximately 9,500 square feet on the second floor at Pier 66 with leases that run until October 31, 2017. Their leased area will become part of the new cruise terminal redevelopment and so it is important to move them out of the building. In exchange for early termination of their existing

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 5 of 10

lease, we have proposed relocating CHI across the street to the second floor of World Trade Center West Building including the following provisions:

- a) New term lease to expire on October 31, 2020
- b) Port will honor the rent terms of the current Pier 66 lease through October 31, 2017
- c) Rent will escalate on November 1, 2017, to a rate equivalent to similar leases in the building
- d) In order to provide CHI with equivalent space, the Port has agreed to provide a Tenant Improvement Allowance not to exceed \$500,000 to cover design, construction, and relocation costs to be reviewed and approved by Port staff.

Conference and Event Center Management Agreement (CECMA) modifications. The proposed Bell Street Cruise Terminal project will require the Port to remove certain portions of the exclusive and extension premises that are currently under the management of CHI. The impacts from the redevelopment of the terminal will adversely affect the manager's base management fee and incentive management fee for the period of the redevelopment.

In exchange for waiver of the required two-year notification to remove premises from the CECMA, we propose that CHI be guaranteed a "Minimum Assured Income" for three years or, if the project is delayed, six months after substantial completion of the cruise terminal project. "Minimum Assured Income" will be derived using the 2015 Operating Budget or the 2015 Actuals, whichever is greater, as the baseline, and mitigation will be paid only when there is an actual shortfall in operating revenues. Several sections of the agreement have also been modified to allow for the impacts of the project without penalizing CHI.

To improve the efficiency of managing the agreement and its auditability, there are additional process improvements that are proposed by Port staff that will simplify the budgeting process, modify language about "shared employees" and remove the 90-day cap on temporary use of other Port property for events.

Potential Early Termination of Bell Street Deli Lease. The Bell Street Deli occupies 1,936 square feet of retail and storage space on Alaskan Way and is another area that will be affected by the project. The lease expires on June 30, 2016, and the project team's intent is to phase demolition plans to avoid impact to the area. The construction phasing is very complex and, while likely, cannot be guaranteed. So, to expedite the project, the authority to execute an early termination agreement is included in this request. The financial impact is undetermined but would be nominal.

Amended and restated lease with Cruise Terminals of America (CTA). An amended and restated Cruise Facility Lease agreement removes Pier 66 from the lease premises. CTA will continue to lease and manage the two-berth cruise terminal located at Smith Cove Cruise Terminal at Terminal 91.

- a) Term of this agreement shall continue from the restatement date until December 31, 2019.

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 6 of 10

- b) As condition precedent to this amended agreement, the Port shall execute a lease agreement with NCLH under which NCLH will assume management of the Pier 66 Cruise Facility and CTA shall execute an agreement with NCLH for the management of the Pier 66 cruise terminal operations for the 2016 cruise season.
- c) In consideration for tenant agreeing to terminate its right in relation to the Pier 66 facility, the Port agrees to pay the sum of \$1 million, one half of which shall be funded by NCLH

PROJECT JUSTIFICATION AND DETAILS

The long term market outlook of the Alaska cruise itineraries looks strong and there is interest in shorter Pacific Northwest itineraries, but in order for Seattle to remain competitive and continue to serve cruise line needs, the infrastructure at Bell Street Cruise Terminal needs to be updated and configured in a way to accommodate the future growth in ship size and business volume serving the Alaska and Northwest Cruise Market.

In the proposed public-private partnership, NCLH commits to 214,000 revenue passengers in the 2016 cruise season and 276,000 revenue passengers for the remainder of the term for 15 years securing continued growth to our local economy. In 2015 the cruise industry economic impacts on our region are estimated at \$441 million in annual business revenue, 3,647 jobs, and \$17.2 million in annual state and local taxes. It is estimated that each time a homeport ship docks, it contributes \$2.5 million to the local economy.

Project Objectives

Establish a long-term lease agreement with co-investment through public-private partnership to improve a Port-owned facility (Pier 66) that will generate:

- \$2.3 billion in Total Business Revenue over 15 years from the Pier 66 cruise facility
- 898 total jobs over 15 years (Direct, Indirect, Induced)
- \$66.9 million state and local taxes
- Cruise Line Passenger Guarantee: 15 years with a 5-year option to extend
- Cruise Line Investment: \$15 million into a Port-owned facility
- Cruise Terminal Improvements will accommodate larger vessels and increased passenger volumes
- Revenue to the Port from cruise operations at Pier 66 estimated at \$73 million over the base term of the lease with NCLH

Scope of Work

NCLH to perform tenant improvements at the Pier 66 cruise facility that will expand the portion of the existing building used for processing cruise passengers from 44,262 square feet to a new total of approximately 151,471 square feet. The improved space can be used for events through the CHI event management agreement and Port operations in the off-season and on non-cruise days throughout the year. The terminal improvements include the installation of two new passenger boarding gangways with walkway connections from and between the terminal building and the cruise ship berth. The terminal expansion within the building footprint will

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 7 of 10

require repurposing certain areas currently used for offices, retail deli food vendor, and the space formerly used as a maritime events center. Total cost of tenant improvements for the cruise terminal to be completed by NCLH is estimated at \$30,000,000. Relocation of some tenants displaced as part of the expansion will be relocated in the World Trade Center Building.

Schedule

The commencement date of the lease agreement is October 1, 2015. The tenant will begin its improvements to the facility immediately with design, permitting, and demolition. The target completion date is April 1, 2017.

FINANCIAL IMPLICATIONS

Budget Status and Source of Funds

The tenant improvement allowance to offset 50 percent of the cost of the improvements to the Bell Street Cruise Terminal in an amount not to exceed \$15,000,000 was not specifically included in the 2015 Draft Plan of Finance. Funding for the allowance is available under CIP C800002 – Contingency Renewal & Replacement for years 2015-2017.

The project will be funded from the Tax Levy.

Financial Analysis and Summary

CIP Category	Revenue/Capacity Growth
Project Type	Business Expansion
Risk adjusted discount rate	7.00%
Key risk factors	<ul style="list-style-type: none">• Terminal improvements do not sufficiently improve the capacity of the facility. <i>Mitigated by expert facility design.</i>• Impact to financial contribution of Bell Harbor International Conference Center is more significant than currently anticipated.• Obsolescence of Bell Street Cruise Terminal and related loss of cruise passengers and economic benefit if improvements are not made to the Bell Street Cruise Terminal requiring NCLH to deploy the new larger vessels at other ports.• Actual passenger volumes and vessel calls could be less than those assumed in forecast below and tenant is only responsible for volumes equal to the Passenger Guarantee.
Project cost for analysis	\$15,000,000
Business Unit (BU)	Cruise and Central Harbor Management
Effect on business performance	Following is the approximate incremental impact of the new NCLH lease on Net Operating Income (NOI) and NOI After Depreciation for 2016-2020. Depreciation estimates are based on an <u>estimated</u> 20 year average life and a total project cost of \$30 million with an in-

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 8 of 10

	<p>service date of May 2017. Actual depreciable lives of assets to be constructed are not yet available.</p> <p><u>Direct Impact of NCLH Lease</u></p> <table border="1"> <thead> <tr> <th colspan="6">Incremental Incr/(Decr)</th> </tr> <tr> <th>NOI (in \$000's)</th> <th>2016</th> <th>2017</th> <th>2018</th> <th>2019</th> <th>2020</th> </tr> </thead> <tbody> <tr> <td>Revenue</td> <td>\$547</td> <td>\$456</td> <td>\$181</td> <td>\$203</td> <td>\$221</td> </tr> <tr> <td>Operating Exp</td> <td>1,000</td> <td>0</td> <td>0</td> <td>0</td> <td>0</td> </tr> <tr> <td>NOI</td> <td>(453)</td> <td>456</td> <td>181</td> <td>203</td> <td>221</td> </tr> <tr> <td>Depreciation</td> <td>0</td> <td>1,000</td> <td>1,500</td> <td>1,500</td> <td>1,500</td> </tr> <tr> <td>NOI After Depreciation</td> <td>(\$453)</td> <td>(\$544)</td> <td>(\$1,319)</td> <td>(\$1,297)</td> <td>(\$1,279)</td> </tr> </tbody> </table> <p>The following schedule reflects the <u>additional</u> impact to NOI caused the cost to mitigate losses of displaced tenants and opportunity cost of lost leasable space, approximately 13,000 sq. ft., at Pier 66. Schedule also reflects the estimated impact on Conference & Event Center Revenue and management fee mitigation costs for third party manager, Columbia Hospitality.</p> <p><u>Impact to Pier 66 Lease and Conference & Event Center NOI</u></p> <table border="1"> <thead> <tr> <th colspan="6">Incremental Incr/(Decr)</th> </tr> <tr> <th>NOI (in \$000's)</th> <th>2016</th> <th>2017</th> <th>2018</th> <th>2019</th> <th>2020</th> </tr> </thead> <tbody> <tr> <td>Revenue</td> <td>(\$3,934)</td> <td>(\$3,181)</td> <td>(\$1,915)</td> <td>(\$281)</td> <td>(\$288)</td> </tr> <tr> <td>Operating Exp</td> <td>(2,380)</td> <td>(2,623)</td> <td>(1,274)</td> <td>0</td> <td>0</td> </tr> <tr> <td>NOI</td> <td>(1,554)</td> <td>(558)</td> <td>(641)</td> <td>(281)</td> <td>(288)</td> </tr> <tr> <td>Depreciation</td> <td>0</td> <td>0</td> <td>0</td> <td>0</td> <td>0</td> </tr> <tr> <td>NOI After Depreciation</td> <td>(\$1,554)</td> <td>(\$558)</td> <td>(\$641)</td> <td>(\$281)</td> <td>(\$288)</td> </tr> </tbody> </table>	Incremental Incr/(Decr)						NOI (in \$000's)	2016	2017	2018	2019	2020	Revenue	\$547	\$456	\$181	\$203	\$221	Operating Exp	1,000	0	0	0	0	NOI	(453)	456	181	203	221	Depreciation	0	1,000	1,500	1,500	1,500	NOI After Depreciation	(\$453)	(\$544)	(\$1,319)	(\$1,297)	(\$1,279)	Incremental Incr/(Decr)						NOI (in \$000's)	2016	2017	2018	2019	2020	Revenue	(\$3,934)	(\$3,181)	(\$1,915)	(\$281)	(\$288)	Operating Exp	(2,380)	(2,623)	(1,274)	0	0	NOI	(1,554)	(558)	(641)	(281)	(288)	Depreciation	0	0	0	0	0	NOI After Depreciation	(\$1,554)	(\$558)	(\$641)	(\$281)	(\$288)
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<p>IRR/NPV</p>	<p>NPV reflects the incremental impact of the new lease as compared to base case which assumes comparable vessel sizes, calls and passenger volumes as used in the 2015 Budget and continued use of Tariff Rates. NPV also reflects the impact to the Port of foregone lease revenues at Pier 66 and the estimated impact of the reduction in financial contribution from Bell Harbor International Conference Center due to reduced activity in 2016-2018, as well as the cost to mitigate the impact of reduced management fees to Columbia Hospitality.</p> <table border="1"> <thead> <tr> <th>NPV (in \$000's)</th> <th>IRR (%)</th> <th>Payback Years</th> </tr> </thead> <tbody> <tr> <td>(\$16,650)</td> <td>NM</td> <td>NA</td> </tr> </tbody> </table>	NPV (in \$000's)	IRR (%)	Payback Years	(\$16,650)	NM	NA																																																																														
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COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 9 of 10

TRIPLE BOTTOM LINE

Economic Development

The proposed business commitment that results in the expanded cruise facilities and passenger volume guarantees is estimated to generate in total over the 15-year term of the Bell Street Cruise Terminal Lease:

- \$2.3 billion in Total Revenue over 15 years
- 898 total jobs over 15 years (Direct, Indirect, Induced)
- \$66.9 million state and local taxes

Environmental Responsibility

- There are a variety of sustainability opportunities to promote Maritime environmental responsibility such as use of locally sourced, recycled, re-used /refurbished material and use of more energy efficient appliances, lighting and equipment.
- The improved utilization of existing space within the building envelope encourages efficient use of available space resources and infrastructure without loss of land.
- Newer cruise vessels have marine propulsion engines that are also more energy efficient and will produce less greenhouse gas emissions during voyages.

Community Benefits

- The improved design of the facility will facilitate efficient movement of people and traffic.
- Project will maintain Port and Port Tenant competitiveness keeping working waterfront and cruise ship provisioning jobs in the community.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Turn down the opportunity. The Pier 66 cruise facility would be unable to attract larger cruise ships. There is a risk of losing market share as ship sizes continue to increase. The prospect is minimal growth in passenger volume and limited growth in economic value the cruise business brings to Seattle and our region. This is not the recommended alternative.

Alternative 2) – Enter into a lease agreement with Norwegian Cruise Line Holdings Ltd. at the Bell Street Cruise Terminal at Pier 66 for a term of 15 years and execute related lease amendments as described in attached documents. This alternative secures a minimum passenger guarantee of 214,000 in the 2016 cruise season and 276,000 each cruise season for the remainder of the term of the agreement and an unprecedented commitment from a cruise line to invest in Port cruise terminal facilities. NCLH will undertake improvements to the terminal sufficient to accommodate their fleet of cruise ships and potential upsizing. The Port will provide a tenant improvement allowance equal to 50 percent of the cost undertaken by NCLH not to exceed \$15 million. The Port will provide additional funds of \$2 million to cover program costs of termination agreements, tenant relocation costs, mitigation for construction impacts, and

COMMISSION AGENDA

Ted Fick, Chief Executive Officer

August 7, 2015

Page 10 of 10

additional fit and finish interior work to accommodate event operations. Total Port investment for this program is estimated at \$17 million. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- Bell Street Cruise Terminal Lease Agreement between the Port and NCLH
- Bell Street Cruise Terminal Sublease Agreement between the Port and NCLH
- Amended and Restated Cruise Terminal Lease Agreement between the Port and CTA
- Second Amendment to Conference and Event Center Management Agreement between the Port and CHI
- Lease Agreement with CHI for office space in the World Trade Center Seattle

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- July 14, 2015 – Staff Briefing – Pier 66 Terminal Improvements
- June 23, 2015– Special Order of Business – Cruise Industry Trends