

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6b
Date of Meeting August 11, 2015

DATE: August 4, 2015
TO: Ted Fick, Chief Executive Officer
FROM: Wayne Grotheer, Director, Aviation Project Management Group
James Schone, Director, Aviation Business Development
SUBJECT: Building Expansion for New Delta *SkyClub* (CIP #C800690)

Amount of This Request:	\$13,655,000	Source of Funds:	Airport Development Fund and 2015 Revenue Bonds
Est. Total Project Cost:	\$13,725,000		
Est. State and Local Taxes:	\$981,000		

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to: 1) authorize \$11,791,755 of tenant reimbursement budget between the Port and Delta Air Lines (Delta) for the design and construction of an additional floor on an existing building located between Concourses A and B to house a new Delta *SkyClub* at Seattle-Tacoma International Airport; (2) execute a Tenant Reimbursement Agreement (TRA) with Delta for this purpose under the Airport's AV-2 Policy; and (3) authorize \$1,933,245 of non-tenant reimbursement budget for Port-completed utility work and other Port costs including overhead associated with this project. This request seeks a single Commission authorization to proceed with design, abatement, and construction. The total cost to the Port for this project shall not exceed \$13,725,000.

SYNOPSIS

To support its growing operations at the Airport, Delta has proposed to construct a new centrally located Delta *SkyClub* lounge located between Concourses A and B. Using a TRA, the Port would reimburse Delta the cost to construct the building shell and core utilities. Delta would also construct the interior of the new club using its own funding. The total cost to the Port would be \$13,725,000. Delta anticipates completing construction and occupying the club in July 2016. This project was not included in the 2015 – 2019 capital budget. The budget for this project will be transferred from the Aeronautical Allowance CIP resulting in no net change to the Aviation capital budget.

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BACKGROUND

To address the growing need for lounge space between Concourses A and B, the Port has chosen to expand the concourse level over an existing, one-story outbound baggage handling building to create additional leasable space. Delta has committed to lease this new space and has requested to design and construct the project. As this project makes material improvements to the terminal building, Delta has also requested to receive a reimbursement for the cost of designing and constructing the building shell through a TRA. Delta will be responsible for the entire cost of the *SkyClub* interior tenant improvement, including finishes, furniture and equipment. The Port will reimburse Delta for the construction of the building shell and basic infrastructure only, following Aviation Procedure on Tenant Improvements AV-2.

Delta has proposed an approximately 23,000 square foot second floor and mezzanine for its new *SkyClub*. Delta has been proceeding at risk with the project design since January 2015 in order to achieve its preferred construction schedule and occupancy date of July 2016. The design is currently 60% complete.

This project's TRA is similar to the ones that have been successfully used for the Delta *SkyClub* at the South Satellite and for the Delta Zone 3 Flow-Through Ticketing projects in the Main Terminal. As part of the Port's TRA requirements, Delta will be paying prevailing wage on the construction contract.

Both Delta and the Port have taken steps in order to address the risk of cost growth. Delta has hired a Construction Manager at Risk (CMR) to complete design and construction of the *SkyClub*. The CMR has presented a preliminary guaranteed maximum price as part of the selection process. The CMR will work with Delta's designers in order to fully understand the project and then prepare a final guaranteed maximum price to Delta as design is completed. Any cost growth past this point would be at the risk of the CMR.

To establish the amount of the TRA, Port staff reviewed the 60% design and preliminary cost from the CMR to determine an estimate of total cost to the Port. This estimate includes design and construction contingencies. Delta understands and agrees that the design contingency can only be used to fund changes in scope related to the design progressing from 60% to 100%, and the construction contingency can only be used to pay for Port approved non-discretionary change orders that arise during the course of construction. The TRA is subject to further increase only if a non-discretionary construction change order exceeds the amount of the Project Contingency.

The initial TRA amount of \$11,791,755 includes design and construction contingencies. The difference between the TRA and the total project cost of \$13,725,000 includes contingencies, Port soft costs and the cost to bring utilities to the tenant lease area.

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PROJECT JUSTIFICATION AND DETAILS

At present there is not adequate space in the terminal to accommodate Delta's need for a large lounge to support current and projected passenger loads at the Airport. This project presents a strategic opportunity to create new leasable space on the concourse level that will meet an important airline's operational needs, while generating increased aeronautical revenue for the Airport. This project expands the terminal footprint by building on top of an existing structure.

Early in design it became apparent that the initial design concept for the location of the project's Heating Ventilation and Air Condition (HVAC) system on the building roof would require structural upgrades to the existing building that would significantly impact existing airline baggage operations. A new site was chosen adjacent to the structure. This required an expansion of the building by nearly 1,600 square feet and increased the project budget by \$525,000.

The Port will use an existing Indefinite Delivery Indefinite Quantity (IDIQ) Architectural and Engineering contract to complete the design to bring the necessary utility infrastructure to the lease line of the new club. Port Construction Services (PCS) will manage the construction of the utility connections using their Port-wide on-call mechanical and electrical contractors. Delta is responsible for the entire cost of their interior tenant build-out which is in the \$8.5 to \$9.0 million range.

The Port forecasts an increase of approximately \$3.8 million per year in revenue from this lease with Delta.

Schedule

Commission Authorization of TRA and project	3 rd Quarter 2015
Early Structure Steel Package Issued	3 rd Quarter 2015
Building Permit Issued/Construction Begins	4 th Quarter 2015
Construction Complete/Grand Opening	3 rd Quarter 2016

Delta is pursuing an aggressive design, review and construction schedule to achieve their desired occupancy date of July 2016.

FINANCIAL IMPLICATIONS

Budget/Authorization Summary

	Capital	Expense	Total Project
Original Budget	\$13,725,000	\$0	\$13,725,000
Previous Authorizations	\$70,000	\$0	\$70,000
Current request for authorization	\$13,655,000	\$0	\$13,655,000
Total Authorizations, including this request	\$13,725,000	\$0	\$13,725,000
Remaining budget to be authorized	\$0	\$0	\$0
Total Estimated Project Cost	\$13,725,000	\$0	\$13,725,000

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Project Cost Breakdown

	This Request	Total Project
Design Phase	\$1,663,000	\$1,663,000
Construction Phase	\$11,081,000	\$11,081,000
Sales Tax	\$981,000	\$981,000
Total	\$13,725,000	\$13,725,000

Budget Status and Source of Funds

This project was not included in the 2015-2019 Capital Budget and Plan of Finance. The budget for this project will be transferred from the Aeronautical Allowance CIP (C800404) resulting in no net change to the Aviation capital budget. The Funding sources will include the Airport Development Fund and 2015 revenue bonds. While this is an aeronautical project, it is exempt from majority-in-interest (MII) review under article 6.5.1(c) of the Signatory Lease and Operating Agreement since the project is needed to accommodate the expansion of Delta and existing space was not available.

Financial Analysis and Summary

CIP Category	Revenue/Capacity Growth
Project Type	New Business Development
Risk adjusted discount rate	8%
Key risk factors	Risks that may affect performance and financial returns, as displayed below, include: -schedule delays may impact rent payments -risk due to SLOA expiration 12/31/17 -shifting lounge business dynamics at Sea-Tac Airport -gate allocation changes may result in airline moves -new lounge may reduce revenues at the Port's Club at SEA on concourse A which is used by Delta
Project cost for analysis	\$13,725,000
Business Unit (BU)	Terminal Building
Effect on business performance	Lease payments are assumed to begin 8/1/16. Annual lease payments will start at approximately \$3.8 million based on 23,000 square feet for the lounge. Within five years lease payments total approximately \$5 million per year.

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IRR/NPV	5-year analysis (assumes 5-year lease with Delta with SLOA renewals): NPV: \$2.7 million IRR: 14% Payback: 4 years 30-year analysis (based on probable asset life, independent of tenant): NPV: \$39.9 million IRR: 29% Assumptions: -lease rate of \$164.77 per square foot per year in 2016 increases to \$235.64 in 2024 and then is held flat thereafter -lease space of 23,000 square feet. -lease year of 8/1 through 7/31.
CPE Impact	.04 in 2017

Lifecycle Cost and Savings

The major assets this project will install are a 23,000 square foot second floor and mezzanine on top of an existing building and an adjacent HVAC mechanical tower. Aviation Maintenance anticipates there will be some incremental costs associated with the mechanical and electrical utilities added for this facility, as well as some building envelope maintenance costs (roof, electronic glazing units, and exterior wall maintenance). The impact can be better estimated at the completion of the design phase of the project. The Port will be responsible for maintaining the building shell/exterior and associated utilities. The building envelope will have a useful life span of 50 years. The roof and HVAC system will have a useful life span of 20-25 years.

STRATEGIES AND OBJECTIVES

This project supports the Port's goals of:

- Advancing the region as a tourism destination and business gateway by providing the improved facilities and amenities that are expected by international and business travelers
- Operating a world class airport by anticipating and meeting the needs of our tenants and passengers

Environmental Responsibility

This project will support the Port's commitment to environmental stewardship and the Century Agenda objective to be the greenest and most energy efficient port in North America by:

- Making use of the existing one-story building footprint

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- Encouraging the use of locally procured and/or renewable materials as well as the use of items containing both pre and post-consumer recycled content
- Specifying the use of energy efficient materials and equipment to include:
 - ✓ Low E, electronically dimming exterior glazing units to reduce the size of HVAC equipment thereby lowering energy consumption and cooling costs
 - ✓ Installation of EnergyStar compliant equipment

Even though the project is being completed by Delta, it is being designed and built to established Port of Seattle standards and specifications which stipulate the use of environmentally sustainable materials and construction practices.

Small Business Opportunities

In addition to having their own robust MWBE program, Delta has expressed their ongoing support of the Port's Small Contractor and Supplier (SCS) goals. Toward this end Delta has pledged to work closely with their consultants, contractors and their subcontractors to achieve the highest level of MWBE/SCS participation possible on this project.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Have Delta use the common use 'Club on A' instead of building a new club. At present nearly 50% of the patrons using this club are Delta passengers who do not have convenient access to a Delta branded club on Concourses A and B.

Additional Cost: \$0 for the Port/Unknown for Delta

Pros:

- The 'Club on A' is already built and functioning as a lounge.

Cons:

- The 'Club on A' is located at the south end of Concourse A and is not well situated for Delta's operations at the north end of Concourse A or on Concourse B.
- The space would require extensive remodeling and modification to bring to Delta's standards.
- It is less than 5,000 square feet and only expandable to approximately 6,200 square feet, which is not nearly large enough to accommodate either Delta's current or projected passenger growth.
- The common use 'Club on A' currently generates an average of \$60,000/month of non-aeronautical revenue, and is intended to serve passenger from other carriers who do not have their own clubs. Delta's exclusive lease of this facility would eliminate this current revenue stream and preclude the use of other international airlines if/when gates on Concourse A are connected via the new International Arrivals Facility.

This is not the recommended alternative.

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Alternative 2) – Have the Port take over the design and construct the basic building shell for a new lounge and provide core utilities on the second floor of the existing one-story building as a capital project after which Delta would lease the space and complete their tenant improvement work.

Additional cost: \$500,000 for the Port/Unknown for Delta

Pros:

- Delta would still be able to lease space at the junction of Concourses A and B for a Delta *SkyClub*.
- The Port would have primary control and actively manage the design, procurement and construction of the new space.

Cons:

- The project would take longer to design as the Port designer would need to review Delta's project design progress in order to take over the design. Also, current circumstances mean that a designer would not be available immediately as well. This would likely add 9 months to the design process.
- Delta would have to wait until the Port's project was complete prior to beginning interior construction and fit out. This would likely add at least an additional 6 months to the construction schedule.
- This is the costliest of the alternatives.

This is not the recommended alternative.

Alternative 3) – Not reimburse Delta for costs associated with the construction of the new lounge's base building terminal expansion

Additional Cost: \$0 for the Port/\$12,567,000 for Delta

Pros:

- This would be the least cost option, with Delta bearing 100% of the costs to expand the terminal and build out the space for their lease.

Cons:

- This would put financial burden on Delta, making them pay for the costs of both the landlord (Port) and tenant (Delta) improvements.
- Although the Port has made no formal commitment for reimbursement, pending Commission approval of this action, not reimbursing Delta for this work is not consistent with past practice and Port policy (AV-2).
- This is not consistent with industry norms, whereas the Landlord is responsible for costs associated with the development costs of building the base shell, and therefore charges rent to a tenant based on the recovery of those costs, plus the operation and maintenance

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of that facility. If reimbursement was not made, Delta would have to pay the high capital costs, but still be obligated to pay the high rental rates associated with leasing the space based on their current SLOA agreement.

This is not the recommended alternative.

Alternative 4) – Authorize a TRA with Delta to complete the design and construction of the new lounge space at the existing one-story building between Concourses A and B.

Cost: \$13,725,000

Pros:

- The design and construction schedule durations align with Delta's desired occupancy date of July 2016.
- The location will provide easier access to Delta's passengers throughout Concourses A and B vs. alternative 1, and also allow for access for passengers in route to the South Satellite.
- The 'Club on A' will continue to serve passengers from other airlines that do not have lounges, as well as future international flights associated with the future International Arrivals Facility.

Cons:

- This alternative would cost more than Alternatives 1 and 3.

This is the recommended alternative.

ATTACHMENTS TO THIS REQUEST

- Tenant Reimbursement Agreement and associated support documents
- Computer slide presentation

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- None