COMMISSION
AGENDA MEMORANDUM | Item No. 8c
ACTION ITEM | Date of Meeting September 25, 2018

DATE: September 17, 2018

TO: Stephen P. Metruck, Executive Director

FROM: James Schone, Director Aviation Commercial Management
Wayne Grotheer, Director Aviation Project Management
James Jennings, Senior Manager, Aviation Properties

SUBJECT: Federal Express Corporation (FedEx) Lease and Tenant Reimbursement Agreement (CIP #C800950)

Amount of this request: $4,612,000
Total estimated project cost: $4,612,000

ACTION REQUESTED

Request Commission authorization for the Executive Director to (1) enter into a lease with Federal Express Corporation, (2) execute a Tenant Reimbursement Agreement in the amount of $3,054,000 with Federal Express Corporation to make necessary base building repairs and infrastructure upgrades to a Port-owned cargo facility, and (3) authorize $1,558,000 of Port costs associated with this project. The total request for authorization is $4,612,000.

EXECUTIVE SUMMARY

The Port intends to enter into a 10-year lease and execute a tenant reimbursement agreement (TRA) with FedEx to make essential improvements to a vacant cargo handling facility. This lease will co-terminate with their existing building lease on December 31, 2028. The proposed rent is at a market rate of $16.00 per square foot, with five-year rent evaluations.

The vacant cargo handling facility, commonly referred to as the Bolanos Building, is 31 years old and reverted to Port ownership in 2017 upon the expiration of the former tenant's long-term ground lease. Most of its base building systems and infrastructure have reached the end of their useful lives. This building does not currently have direct airfield access. However, with FedEx's lease and improvements, the building will be converted to an on-airfield building with direct airfield access.

FedEx is by far the largest cargo carrier at SeaTac. FedEx has a large handling facility just to the north of the Bolanos Building. Because of the adjacency of the facilities, it creates a unique opportunity to repurpose the Bolanos Building to on-airfield use. This will be accomplished by agreements reached with Airport Security, the Transportation Security Administration, and the Federal Aviation Administration.

In order for this building to be leasable, the Port, as building owner, must make improvements to the mechanical, roofing, fire suppression, electrical, exterior lighting, paving, site drainage, and other systems in order to bring this facility up to leasable, code-compliant condition. In addition, FedEx has agreed to be solely responsible for the maintenance of the building, including the landlord-related infrastructure, during the term of the lease.

JUSTIFICATION

Detailed inspections of this facility reveal that significant upgrades to the base building infrastructure are needed to extend its usefulness as a viable property to lease. These improvements are also required to bring the building into compliance with current code requirements. The location of this building will not be impacted by phase 1 of the Sustainable Airport Master Plan (SAMP). This site may be impacted by the later stages of the second phase of SAMP, suggesting the building would have a useful life of approximately 20 years. Consequently, the financial analysis is based on twenty years. While the proposed lease is for ten years, assuming the building is leased under similar terms for 20 years, the project would have a positive Net Present Value ($1.2 million). The breakeven point (zero NPV) would be approximately 15 years.

If these improvements are delayed, the existing systems and infrastructure are subject to random failure, resulting in potential safety concerns, revenue loss, and further damage to the facility and even more costly emergency repairs. Converting this building into an on-airfield cargo building with direct airfield access and investing in the ongoing viability of the asset will help the Port achieve the Century Agenda goals to triple air cargo volume to 750,000 metric tons and triple the value of our outbound cargo to over $50 billion by 2036.

DETAILS

FedEx urgently needs additional lease space to meet their goal of efficiencies in air cargo handling requirements and there are currently no suitable alternative facilities that have the unique ability to provide on-airfield access.

The lease of this building to and improvements by FedEx will allow it to become on-airfield cargo space with direct airfield access and will allow FedEx to accommodate their heavy cargo handling capability prior to the end of Q1 2019. This is important because it aligns with the annual export of substantial tonnage of Alaskan crab to foreign customers. In an effort to meet this challenging schedule, FedEx has been negotiating in good faith with the Port and proceeding at risk with the design for this project. Port staff has made it abundantly clear that the Port cannot commit to a lease or improvements until after Commission authorization.

Since FedEx plans to construct its own tenant improvements in the building, having FedEx also construct the needed base building improvements via a TRA is an efficient, cost-effective approach. A TRA is a proven project delivery method that will allow these improvements to be made along with FedEx's tenant improvements, translating into an accelerated schedule and more efficient construction project than if the Port were to complete them under a separate contract of its own.

Building Lease Summary:

(1) Tenant	FedEx
(2) Building size	35,100 square feet
(3) Term	10 years plus (expires concurrently with existing lease)
(4) Rent	$16.00/square foot
(5) Escalations	Associated with Sea-Tac's 5-year appraisal process

Scope of Work

FedEx will be reimbursed for the cost of replacing and upgrading base building infrastructure that would otherwise be the Port's responsibility. FedEx will be responsible for the cost of the interior office and workspace modifications, cargo handling and storage equipment, bonded storage warehouse area, and a small ground floor retail space.

The proposed reimbursable scope of work includes:

(1) Heating, venting, and air conditioning equipment replacement
(2) Electrical service panel replacement
(3) Repairs to damaged interior structural columns
(4) Fire suppression system upgrade
(5) Loading dock overhead door replacement
(6) Roof replacement and associated seismic upgrades
(7) Exterior glazing replacement
(8) Exterior paving and site drainage upgrades and replacement
(9) Exterior lighting upgrade and replacement
(10) General landscaping clean-up
(11) Airport security fence modifications and additions

Schedule

FedEx intends to break the construction work into two phases. Phase 1 will concentrate on upgrading the infrastructure components necessary to make the cargo handling area ready for use before the end of Q1 2019. Phase 2 will focus on interior office and work space modifications that are not considered as urgent. Roofing and paving work may possibly be scheduled to begin in Q2 2019 to avoid winter weather.

Activity

Construction start	2018 Q4
In-use date, Phase 1	Q2 2019
In-use date, Phase 2	Q1 2020

Cost Breakdown	This Request	Total Project
Design	$389,000	$389,000
Construction	$4,223,000	$4,223,000
Total	$4,612,000	$4,612,000

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Status Quo - Leasehold remains in current unsatisfactory condition and the Port continues to make repairs on an as-needed basis as individual systems fail.

Cost Implications: Cost Estimate: Unknown

Pros:

(1) The Port could continue allowing existing systems, components, and equipment to ‘run to failure’ for an indefinite period of time, foregoing a significant investment up front.
(2) Failures could be addressed on an as-needed basis instead of all at once.

Cons:

(1) The tenant would have to curtail or cease operation while repairs are made, which would not be acceptable to FedEx with their commitment to a term lease.
(2) The Port could potentially lose the tenant and associated revenue because they are not comfortable putting their operation at risk and there are no available alternative facilities to which the tenant could relocate.
(3) The ‘run to failure’ method inevitably leads to unplanned and more costly capital and expense costs.
(4) The cost to repair or replace individual items as they fail is collectively greater over time than addressing them in one project.
(5) Failures and outages increase the risk of personal injury and further property damage.
(6) Not making these modifications results in a less energy-efficient facility that will be more costly to operate.

This is not the recommended alternative.

Alternative 2 – Make the capital investment required to improve known building deficiencies.

Cost Implications: $4,612,000

Pros:

(1) Proactively replaces or upgrades systems and equipment in a more cost-effective manner.
(2) Extends the useful life of this facility (aligning with the Sustainable Airport Master Plan, which will not impact the areas where this facility is located for another 15-20 years).
(3) Leaves the Port with a safer, more energy-efficient and code-compliant lease space.
(4) Mitigates the potential loss of a tenant and the potential negative impact to cargo handling operations.
(5) Avoids unplanned expense and capital funding requests.
(6) The tenant will make these base building upgrades/replacements on their schedule and be reimbursed by the Port for them under the TRA.

Cons:

(1) Requires $4,612,000 of capital funding in the short term in a capital constrained budget environment.

This is the recommended alternative.

FINANCIAL IMPLICATIONS

Cost Estimate/Authorization Summary	Capital	Expense	Total
COST ESTIMATE			
Original CIP estimate	$6,610,000	$0	$6,610,000
AUTHORIZATION			
Previous authorizations	$75,000	$0	$75,000
Current request for authorization	$4,537,000	$0	$4,537,000
Total authorizations, including this request	$4,612,000	$0	$4,612,000
Remaining CIP amount to be authorized for future cargo building improvements	$1,998,000	$0	$1,998,000

Annual Budget Status and Source of Funds

This CIP #C800950 was included in the 2018 – 2022 capital budget and plan of finance with a budget of $6,610,000. The funding source for this project will be future revenue bonds to be issued in 2019.

Financial Analysis and Summary

Project cost for analysis	$4,612,000
Business Unit (BU)	Aviation Commercial
IRR/NPV (if relevant)	$1,200,000 (analysis based on 20 years)
CPE Impact	N/A

Future Revenues and Expenses (Total cost of ownership)

Over the course of asset life, the building is expected to generate over $12 million in lease revenue. It will take seven years for the revenue to recover costs to improve the building.

ATTACHMENTS TO THIS REQUEST

(1) Slide presentation
(2) Lease Agreement
(3) Tenant Reimbursement Agreement

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

None