COMMISSION
AGENDA MEMORANDUM

ACTION ITEM

Item No.	6h
Date of Meeting	June 23, 2020

DATE: June 5, 2020

TO: Stephen P. Metruck, Executive Director

FROM: Melinda Miller, Director, Portfolio & Asset Management
Stephanie Jones Stebbins, Managing Director, Maritime Division

SUBJECT: Third Amendment to Ground Lease with Duke's Chowderhouse, LLC. at Shilshole Bay Marina

Amount of this request:	$
Total estimated project cost:	$

ACTION REQUESTED

Request Commission authorization for the Executive Director to execute the third amendment to the ground lease with Duke's Shilshole Bay Chowder House, LLC., substantially similar to the attached draft amendment and on the following terms, effective April 1, 2020: (1) reduce the square footage of the amended ground lease to 4500 square feet; (2) reduce the base monthly rent during the Construction Phase from $4188/month to $2,048/month and during the Post-Construction Phase from $14,753/month to $7,216/month; (3) to defer payment of the Construction Phase Rent from April 1, 2020 through March 31, 2023; and (4) Duke's to repay the Port for the deferred rent over ten years, beginning April 1, 2023 through March 31, 2033.

EXECUTIVE SUMMARY

Due to the economic impact of COVID-19 on the restaurant industry in general and Duke's specifically, staff is proposing to amend this ground lease. The adjustments being proposed for Duke's are consistent with relief offered across the Port during this public health crisis.

There are two significant elements that have affected the development of a highly desired restaurant at Shilshole – the ongoing economic impact of COVID-19 and skyrocketing construction costs that undermined its financial feasibility. This is a ground lease that lays the expense and risk of building the restaurant on Duke's alone.

In response to the increased costs and to the evolving market, Duke's approached staff with a proposal for a smaller, more flexible restaurant, three years deferred rent, and reimbursement by the Port for the difference in the rent they had already paid and the new rental amount.

Staff counter-proposed and ultimately Duke's agreed to no reimbursed rent and the terms mentioned below which make the Port whole during the initial lease term.

The intent of this amendment is to allow Duke's the time to redesign, permit, and build their revised project and provide them with the flexibility to respond to ongoing economic uncertainty due to COVID-19 and help them weather the crisis. To this end, construction rent would be deferred for three years or substantial completion of the restaurant, whichever is sooner. All deferred rents will be repaid over the subsequent ten years. The rent rate per square foot remains the same as in the current lease. The lease expires in April 2041.

JUSTIFICATION

Over the 2-1/2 years of design development, Duke's experienced unexpected escalation of construction costs, from $4.3 million at schematic design to $8.3 million during the final formal bid process. This resulted from both an increase in the scope and unprecedented escalation in the construction market due to a booming economy. In early March, Duke presented a revised plan for a scaled down and more flexible restaurant model that will meet both their budget requirements and the evolution of the restaurant industry away from large full-service restaurants. They have contracted with an international restaurant consultant and developer who will oversee the design and construction of the new concept in line with their restaurant model that has been successful in many international locations.

Parallel to this project evolution, the impact of COVID-19 hit Duke's hard. Many of Economic Development and Maritime Division landside tenants, including Duke's, have been affected in some manner by the ongoing Covid-19 pandemic, the broader economic crisis, and the mandates from various regulatory agencies including the Governor, Mayor, and most recently, the Seattle City Council. Some sectors, particularly the restaurant and hospitality sector, have been severely affected through direct closure, starting on March 23, 2020.

Following on the Commission's policy direction and the Executive Director's guidance, the Port offered a deferred payment plan to all tenants who were directly affected by the various mandates made by the Governor, Mayor, and Seattle City Council. For those tenants who apply, rent and other charges are being deferred for four months (April through July) without finance charges and re-payment plans begin on October 1, 2020, in most cases. Most agreements give the tenant twelve months to repay the deferred rent. This payment plan does not change the terms and conditions of the lease. Duke's is participating in this program and if this amendment is approved, we will terminate their Deferral Program agreement.

Out of 190+ tenants, 74 tenants were deemed to be directly affected and invited to apply. 59 tenants applied for the program and 45 agreements have been executed to date. During this period, the Commission also authorized lease adjustments to Aviation Dining and Retail tenants that included waiving the Minimum Annual Guarantee and providing lease extensions.

Duke's is a family-owned, local company that was established in 1976 and currently operates restaurants in seven locations in Seattle, Bellevue, Kent and Tacoma, Washington. All operations were shut-down by the Governor's first mandate in March. This week, King County now allows partial re-opening for restaurants with many operating constraints including occupancy limits between 25-50% of permitted occupancy.

Recent polls, as reported in the LA Times article of May 23, have stated that "much of the country remains unlikely to venture out to bars, restaurants, theaters, or gyms anytime soon, despite state and local officials…allowing businesses to reopen…" It is widely held that the recovery for the restaurant industry will be long and shallow.

Duke's has made significant investments ($250K+) in the design and permitting of the original restaurant concept at Shilshole. They are committed to this new smaller concept that they believe better suits the evolving post-COVID-19 restaurant market and the seasonal nature of the location.

Diversity in Contracting

Staff have contacted the Diversity in Contracting Department to discuss this request and found no opportunity for WMBE participation as it is an amendment to an existing lease.

DETAILS

Lease Term	Current Agreement	Amendment #3 eff. 4/1/20
Premises	9,200 SF	4500 SF
Construction Rent/month	$4,188	$2,048
Begin Post-Construct. Rent	May 1, 2021	April 1, 2023
Post-Construction Rent/month	$14,753	$7,216
Lease Expiration	April 30, 2041	April 30, 2041

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Duke's management approached the Port with a proposal to help them survive the effects of the first Governor's mandate that closed all their restaurants and the uncertain dining market and their recent conclusion that escalating construction costs had made their original restaurant plan too expensive to build. Staff discussed their proposal at length and proposed a revised structure which Duke's has accepted, contingent on Commission authorization.

Alternative 1 – Reject Duke's proposal for lease amendment

Cost Implications: Revenue loss if tenant abandons the lease. None if they continue the project.

Pros:

(1) If tenant continues with the project, continues monthly revenue.
(2) Maintains continuity of lease terms

Cons:
(1) Exposes tenant to significant financial risk from COVID-19 economic impact
(2) Tenant may abandon lease thus provoking legal action
(3) Exposes Port to costly legal action, lost revenue, and renovation expenses

This is not the recommended alternative.

Alternative 2 – Agree to terms as initially proposed by Duke's

Cost Implications: Reduced square footage, three years to redesign, permit, and build the new concept effective January 1, 2020, and as a credit to their Construction Rent the Port to reimburse Duke's for difference in rent between 9200 SF and 4500 SF restaurant concepts, retroactive to beginning of lease.

Pros:
(1) Accepts tenant's proposal thus strengthening relationship
(2) Supports the likely only viable option for a restaurant development at Shilshole
(3) Gives tenant flexibility to weather impact of Public health crisis and complete the new restaurant concept

Cons:
(1) Essentially no revenue until building completed
(2) Potential perception of gift of public funds
(3) Retroactive credit of rent difference not acceptable

This is not the recommended alternative.

Alternative 3 – Accept negotiated terms proposed by staff

Cost Implications: Effective 4/1/20, reduce square footage from 9200 SF to 4500 SF, defer construction rent for three years and pay back over ten years, post-construction rent will start no later than 4/1/23.

Lease expires in April 2041.

Pros:
(1) Provides reasonable terms to tenant and recovers deferred rent for Port
(2) Accepts tenant's proposal thus strengthening relationship
(3) Supports the likely only viable option for a restaurant development at Shilshole
(4) Gives tenant flexibility to weather impact of Public health crisis and complete new restaurant concept
(5) Little financial risk to Port since Duke's is financing the design, permitting, and construction

Cons:
(1) Postpones collection of deferred rent
(2) Delays opening of highly desired amenity for customers

This is the recommended alternative.

FINANCIAL IMPLICATIONS

This is a ground lease and the development and construction costs are borne by the tenant. There are no incremental costs to the Port for this request.

Financial Analysis and Summary

Project cost for analysis	No incremental costs to the Port for this request
Business Unit (BU)	Maritime Portfolio Management
Effect on business performance (NOI after depreciation)	This amended lease agreement will generate the Total Cash Flow of $2,035,593 for the remainder of the lease term until April 30, 2041. The first-year post-construction lease revenue for this amendment will be $64,945.
IRR/NPV (if relevant)	Total Effective Rent: $2,035,593 Discounted Effective Rent at 4.5%: $1,156,753
CPE Impact	N/A

Future Revenues and Expenses (Total cost of ownership)

Future revenues will be generated based on lease rates and terms stated above in the third amendment.

ATTACHMENTS TO THIS REQUEST

(1) Presentation
(2) Draft Ground Lease Amendment

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

September 24, 2019 - Commission authorized Second Amendment to the Ground Lease
January 9, 2018 – Commission authorized First Amendment to the Ground Lease
May 9, 2017 – Commission approved the Ground Lease with Duke's Chowder House, LLC.