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COMMISSION

AGENDA MEMORANDUM Item No. 10b

ACTION ITEM Date of Meeting June 27, 2023

DATE: June 20, 2023

TO: Stephen P. Metruck, Executive Director

FROM: Rick Duncan, Director, Aviation Business & Properties

Eileen Francisco, Director, Aviation Project Management Group

SUBJECT: Budget increase request – Concourse A Building Expansion for Lounges (C801205)

Amount of this request: \$21,507,000

Total estimated project cost: \$126,507,000

ACTION REQUESTED

Request Commission authorization for the Executive Director to (1) increase the authorized total project budget by \$21,507,000, and (2) increase the Tenant Reimbursement Agreement (TRA) budget from \$89,960,000 to \$111,508,000. This results in a total estimated project cost of \$126,507,000.

EXECUTIVE SUMMARY

Delta Airlines Inc., (Delta) has designed and is under construction of an approximate 52,000 square-foot (SF) building expansion at the east side of Concourse A, across from Gate A11 and directly south of the International Arrivals Facility (IAF), using a Tenant Reimbursement Agreement (TRA) with the Port. This project will incorporate a new passenger lounge for Delta and provide a new buildout space for the Port's common use lounge (Club at SEA). This project also supports the Century Agenda Goal #2 to advance this region as a leading tourism destination and business gateway.

Delta has notified the Port of additional project increases and escalations during their efforts to execute an agreement for the Final Guaranteed Maximum Price (FGMP) with their Contractor.

These cost increases are a direct result of 1) a delayed construction start and subsequent increases to the overall project duration, and 2) escalation in construction costs for materials and labor and the volatility in the construction market and global supply chains.

The delayed construction start was the direct outcome of an extended permitting review period resulting from multiple design packages, Port added scope changes, and outsourcing the Building

Template revised January 10, 2019.

COMMISSION AGENDA – Action Item No. 10b Page 2 of 9

Meeting Date: June 27, 2023

Department's code compliance review to a third party, due to limited capacity to conduct the review in-house.

JUSTIFICATION

Delta requested to construct a new lounge on Concourse A to accommodate passenger demand that shifted from the South Satellite to Concourse A, upon the opening of the IAF. The Port currently lacks sufficient space to meet this demand. Thus, to satisfy this request for additional leased space, the Port has allowed Delta to design and construct the lounge addition in undeveloped space, with the project delivered via a TRA.

On May 10, 2022, the Port Commission authorized both an overall project budget and TRA increase based off the 100% design / permit documents, for a total project value of approximately \$105 million, with a TRA value of \$89.96 million. Delta's original request to the Port was for the TRA value to increase to \$93 million; however, the Port was not able to validate the additional \$3 million, prior to the May 2022 Commission request. To advance the project, the Port held the \$3 million (still under negotiations) within a Port-controlled portion of the budget until the cost validations between the Port and Delta were finalized. On May 13, 2022, the Port issued Delta a revised reimbursement letter, reflecting the maximum reimbursement amount of \$89.96 million, which excluded the \$3 million while still under negotiations. Consequently, the Port and Delta eventually reached an impasse. Delta decided not to execute the full FGMP with their contractor and instead elected to enter a partial Guaranteed Maximum Price agreement with their contractor to begin the enabling work that relocated the PLB shop, reconfigured the concourse and Club at SEA restrooms and purchasing long lead materials.

Between May 2022 to November 2022, project costs continued to rise due to escalation and volatility within both the national and local construction markets, and global supply chains.

Without an executed FGMP, the Port was subject to additional project costs for reimbursable

scoped items.

In November 2022, Delta notified the Port of additional project increases since the May 2022 Commission authorization. By January 2023, Delta provided the revised bid packages for Port review. After which, the Port and Delta underwent numerous negotiations to validate the cost increases but were unable to reach an agreement until May 2023.

Today's request is to increase the overall project budget to incorporate additional costs based on the revised project estimates. Delta has informed the Port the Contractor's FGMP pricing will hold until the end of June 2023. It is the Port's understanding Delta will execute the FGMP with their Contractor upon Commission's approval of additional funds and before the Contractor's pricing expires at the end of June.

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COMMISSION AGENDA – Action Item No. 10b Page 3 of 9

Meeting Date: June 27, 2023

Diversity in Contracting

The Port collaborated with Delta and has included in the TRA a WMBE goal of 10%, an apprentice hiring goal of 15%, a women apprentice hiring sub-goal of 12%, a minority apprentice hiring subgoal of 21%, and a priority worker goal of 20% for the construction contractor. Delta has stated that they will strive to exceed these goals.

DETAILS

Existing national and local construction markets and global supply chain conditions have created significant cost increases. The value of this request incorporates all known cost increases, separated into three categories listed below. This additional authorization is necessary because construction costs were not locked in under an executed FGMP between Delta and their Contractor after the May 2022 authorization – and costs continued to escalate.

Item Value

Direct Construction Costs \$12.1 million

Schedule Delay Costs \$7.4 million

Additional Port Contingency \$2.0 million

TOTAL \$21.5 million

Direct construction costs include escalation and increased pricing associated with the six required addenda to the design package in order to receive a permit. These six addenda contributed significantly to the prolonged permitting process. Additionally, costs continued to increase as a result of multiple design packages, which the contractor was unable to accurately price until the final set was accepted, prior to permit issuance. These cost escalations have impacted the total cost not only for the Port portion of the project, but also Delta's costs for their Lounge buildout. As a result of the expanded permit review, construction was delayed, which is represented above in schedule delays.

Lastly, this request includes additional Port-controlled contingency to secure a reasonable level of cost certainty for the project moving forward.

If Commission approves this request to increase the total project budget by \$21.5 million, the value of the TRA will be increased from the previously authorized amount of \$89.96 million to \$111.5 million. Upon such approval, the Port will issue Delta a revised reimbursement letter that reflects an updated maximum reimbursement. It is then expected that Delta will execute the FGMP with their Contractor.

Under this TRA, Delta will be responsible for the cost and construction of the interior buildout of their lounge within the new building shell. The Port's common use lounge will be completed by the Concourse A Port Shared-Use Lounge (Club at SEA) project.

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COMMISSION AGENDA – Action Item No. 10b Page 4 of 9

Meeting Date: June 27, 2023

Scope of Work

- (1) Construct a building addition of approximately 52,000 SF that will provide shell space for two lounges (one for DL, one for the Port) and associated building systems.
- (2) Reconfigure approximately 13,500 SF of existing space to provide additional leasable office area, an entry foyer, a replacement restroom, and vertical circulation.
- (3) Demolish an existing airport building deemed unfit to renovate and construct a new 3,000 SF standalone building in its place to house the relocated Aviation Maintenance Department Passenger Loading Bridge shop that is being displaced by this project. The

expense cost to move the shop is included in the budget.

(4) Provide temporary restrooms for the Port common-use lounge to keep the lounge operational during construction of the building expansion.

Schedule

Activity

Commission design authorization 2021 Quarter 2

Design start 2021 Quarter 2

Commission construction authorization 2021 Quarter 4

Construction start 2022 Quarter 3

In-use date 2024 Quarter 4

Cost Breakdown This Request Total Project

Design \$0 \$6,300,000

Construction \$21,507,000 \$120,207,000

Total \$21,507,000 \$126,507,000

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Do not increase the total project budget or TRA value. Request Delta complete the underground utility work outside the existing Concourse A – which preps the area for the building expansion (already underway) and restore the ground to functional use. Under this alternative, the Port would not move forward with the Concourse A Expansion and neither lounge will be built.

Cost Implications: Estimated \$25,000,000 for costs incurred to date.

Pros:

(1) This is the lower cost alternative.

(2) The airport will have a newly constructed Aviation Maintenance PLB Shop that was completed in April 2023 and new restroom on concourse level. These components were part of the required enabling work for the Concourse A Expansion.

(3) Upon completion of the underground utility work and restoring the area to a functional condition, the area will be available for future use by the Port, should it be desirable to take over this project and self-perform the build-out (in whole or part).

Template revised June 27, 2019 (Diversity in Contracting).

COMMISSION AGENDA – Action Item No. 10b Page 5 of 9

Meeting Date: June 27, 2023

Cons:

(1) If Delta does not complete construction of the new building shell and core, the forthcoming Club at SEA could not expand into the new shell space further limiting nonaeronautical revenue opportunities.

(2) This will not support Delta's operations on Concourse A, nor provide Delta with a new lounge space.

(3) Passengers will not have an alternative to waiting for flights in crowded hold rooms at this area and the Club at SEA will not be able to expand to support international airlines that do not possess their own branded lounge.

This is not the recommended alternative.

Alternative 2 – Increase the budget by \$21,507,000 for the project. Increase the TRA value to \$111,508,000.

Cost Implications: \$21,507,000

Pros:

(1) Passenger lounge spaces will be expanded to accommodate return of demand.

(2) Location of the lounge on Concourse A will support Delta's operations on Concourse A.

(3) The expanded lounges (Delta's and the Port's common use) will provide passengers an alternative to waiting for flights in crowded hold rooms and the Club at SEA will support international airlines who do not possess their own branded lounge.

Cons:

(1) Funds are unavailable for other uses.

(2) This is the higher cost alternative.

This is the recommended alternative.

FINANCIAL IMPLICATIONS

Cost Estimate/Authorization Summary Capital Expense Total

COST ESTIMATE

Original estimate \$60,000,000 \$0 \$60,000,000

Previous changes – net \$44,950,000 \$50,000 \$45,000,000

Current change \$20,824,131 \$682,869 \$21,507,000

Revised estimate \$125,774,131 \$732,869 \$126,507,000
AUTHORIZATION
Previous authorizations \$104,950,000 50,000 \$105,000,000
Current request for authorization \$20,824,131* \$682,869 \$21,507,000*
Total authorizations, including this request \$125,774,131 \$732,869 \$126,507,000*
Remaining amount to be authorized \$0 \$0 \$0

Template revised June 27, 2019 (Diversity in Contracting).

COMMISSION AGENDA – Action Item No. 10b Page 6 of 9
Meeting Date: June 27, 2023

Annual Budget Status and Source of Funds

This project, CIP C801205, was included in the 2023-2027 capital budget and plan of finance with a budget of \$104,950,000. A budget increase of \$20,825,131 will be transferred from the Aeronautical Allowance¹ CIP (C800753) resulting in zero net change to the Aviation capital budget. The funding sources will include the Airport Development Fund and revenue bonds. This project was approved by Majority-In-Interest (MII) with the airlines on December 7, 2021. With the budget increase, Port management elected to utilize the MII Management Reserve² provision within the Signatory Lease Operating Agreement (SLOA) without requiring additional MII approval from the airlines.

Financial Analysis and Summary

This project is an investment in additional terminal space that is intended to be used for both aeronautical and non-aeronautical purposes. As a hybrid project, the financial analysis looks at the project as both a standalone non-aero investment and a terminal investment that flows through airline rates and charges.

Aeronautical Rate Base Impacts

Airlines rates and charges impact
2025

(\$000s) Aero Non-aero Total

Rentable sqft without Conc A sqft 76.55% 23.45% 100%

Rentable sqft WITH Conc A sqft 77.09% 22.91% 100%

Project cost \$ 97,519 \$ 28,981 \$ 126,500

Incremental Revenues WITHOUT Conc A SF \$ 7,994

Terminal distribution 57

Incremental Revenues WITH Conc A SF 8,052

Incremental Debt Service 8,052 2,393 10,443

Incremental Amortization 2.6 0.8 3.4

Incremental CPE 0.30

Incremental Terminal Rental Rate 5.70

1 The Aeronautical Allowance is included in the Capital Improvement Plan to ensure funding capacity for unspecified projects, cost increases for existing projects, new initiatives, and unforeseen needs. This ensures funding capacity for unanticipated spending within the dollar amount of the Allowance CIP.

2 The Signatory Lease and Operating Agreement (SLOA) requires airline's approval for New Projects meeting the Majority-In-Interest (MII) threshold. The Port may increase the budgets of New Projects up to an aggregate additional \$210,000 million dollars in Management Reserve without further MII review.

Template revised June 27, 2019 (Diversity in Contracting).

COMMISSION AGENDA – Action Item No. 10b Page 7 of 9
Meeting Date: June 27, 2023

With the Concourse A expansion, the net terminal square footage distribution has a minor impact on the analysis as the existing project space allocation is reasonably close to the existing allocations.

The table above shows that before Concourse A expansion, 76.55% of the terminal costs are allocated to the aeronautical rate base, which equates to incremental revenue of \$7,994,000. After adding the incremental square footage of this project, the percentage of terminal costs increases to 77.09%; this reflects an \$57,000 increase to Aeronautical revenue. Thus, in 2025 the net impact of the Concourse A expansion project is to contribute \$8,052,000 in incremental revenue to the aeronautical rate base.

Terminal rents are established based on the total cost center costs. The project would be

completed in Q4 2024. The full year of debt service and equity amortization begins in 2025. The incremental terminal rent would be \$5.70 and CPE of \$0.30 in 2025.

Non-aeronautical Investment Analysis

The purpose of this section is to demonstrate that the Port has a compelling business case as a non-aero investment. The non-aeronautical investment includes both the cost of new space included in this authorization request and cost of the interior build-out and furnishings (\$29.6 million) included in CIP C801207.

The table below shows the allocation of capital costs based on rentable square footage. For nonaero purposes, 18.17% of the rentable square footage, equating to \$231 million in capital cost, establishes the basis of the non-aero portion of the project. The lower part of the table identifies an incremental revenue increase of \$7.4 million in 2030. This new revenue, attributed to the airport lounge which generates the negative Net Present Value of \$7.5M. Given that the existing space is currently generating revenues, the NPV is netted against a base case (do nothing).

Template revised June 27, 2019 (Diversity in Contracting).

COMMISSION AGENDA – Action Item No. 10b Page 8 of 9

Meeting Date: June 27, 2023

Non-aero Investments

Non-aero Aero Total

Concourse A rentable sqft 6,499 29,264 35,763

Concourse A rentable sqft % 18.17% 81.83%

\$ in 000s

Base Building, C801205 \$ 22,988 \$ 103,512 \$ 126,500

Furnishings, C801207, assumed 20% cost increase \$ 29,671 \$ - \$ 29,671

Total Capital \$ 52,659 \$ 103,512 \$ 156,171

Non-Aero Analysis

Payback (years from opening) 9

NPV (through 2043) \$ 29,390

NPV Incremental to Base \$ (7,540)

2025 2030 2035

Incremental Non-aero Revenue \$ 692 \$ 7,452 \$ 11,567

Incremental Non-aero O&M \$ 535 (2,045) (3,786)

Debt service TERMB to Non-aero \$ (2,393) (2,393) (2,393)

Debt Service Furnishing 100% Non-aero \$ (2,451) (2,451) (2,451)

Non-aero Net Cashflow \$ (3,616) \$ 564 \$ 2,938

Future Revenues and Expenses (Total cost of ownership)

The tenants would pay operating and maintenance annual costs in their space since maintenance of exclusive premises is the responsibility of the lessee. Those costs are not included in the amount shown below. This project provides 29,264 SF of aeronautical rentable space, as well as 6,499 SF of rentable non-aeronautical space.

Facility elements outside of or supporting the exclusive premises, such as custodial services,

domestic water, power, and HVAC will generate some additional demand for Aviation

Maintenance services, and those annual operating and maintenance costs for the new space are estimated to be \$340,000, according to the cost breakdown below:

Custodial services \$275,000

Facilities services 30,000

Electrical systems 18,000

Mechanical systems 17,000

Template revised June 27, 2019 (Diversity in Contracting).

COMMISSION AGENDA – Action Item No. 10b Page 9 of 9

Meeting Date: June 27, 2023

ATTACHMENTS TO THIS REQUEST

(1) Presentation slides

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

May 10, 2022 – The Commission authorized a budget increase for the project and an increase to the reimbursement amount to Delta.

December 14, 2021 – The Commission authorized construction and reimbursement to Delta Air Lines and utilization of Port crews for construction and support.

April 27, 2021 – The Commission authorized design and execution of a TRA for this project.

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