



**COMMISSION
AGENDA MEMORANDUM**

Item No. 10b

ACTION ITEM

Date of Meeting July 12, 2022

DATE: July 12, 2022

TO: Steve Metruck, Executive Director

FROM: David McFadden, Managing Director, Economic Development Division
Kyra Lise, Director Real Estate Development

SUBJECT: Approval of Ground Lease for Port Property in Des Moines, WA: Des Moines Creek West

ACTION REQUESTED

Request Commission authorization for the Executive Director to execute a ground lease with PDC Seattle LPIV BB/TH, LLC (Panattoni) to allow them to develop approx. 399,337 sf of Class A, environmentally sustainable state of the art logistics & distribution facilities which are aviation-supportive, light-industrial logistics facilities in the City of Des Moines, WA, west of the Des Moines Creek Business Park (DMCBP).

EXECUTIVE SUMMARY

Port staff recently completed an RFP to select a developer for its Des Moines Creek West development project. Located just west of the Des Moines Creek Business Park (“DMCBP”) in the City of Des Moines, this 19.8-acre undeveloped property is zoned Business Park (“B-P”) and will expand upon the success of the industrial development at the DMCBP.

The DMCW site offered for ground lease includes land associated which were originally purchased to support the third runway development and has remained undeveloped for thirty years. An additional, adjacent parcel was acquired by the Port from WA Department of Transportation in 2021 (surplus SR509 ROW) to enhance the overall site’s development potential.

The Request for Proposals solicitation process took place in late 2021 in a process managed with the support of Heartland, LLC, the Port’s real estate advisors who, in consultation and coordination with the Port’s Real Estate Development team reached over 100+ qualified real estate developers with records of accomplishment in industrial and air cargo related development. The RFP invited each developer to present offers based on a variety of related building types – distribution, manufacturing, and business park/incubator.

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Seven developers submitted qualified proposals to the RFP which described their approach and included a Letter of Intent (“LOI”) spelling out their preferred terms for a long-term ground lease with the Port.

Project proposals were evaluated by a cross disciplinary Port team. The review team used the following criteria to evaluate each proposal received:

- **80 points** (or 40%) available for overall developer and team members bona fides of and experience with projects of the same type and scale along with the details of their proposed use and building type.
- **60 points** (or 30%) available on the initial review of the LOI/term sheet offered which roughly corresponds to the overall financial return on investment to the Port including long term financial yield, and net present value of cash flows due to the Port over the life of the project.
- **20 points** (or 10%) available for how the project may support aviation and logistics operations.
- **20 points** (or 10%) available for how the project intends to support fair and inclusive labor and labor harmony practices.
- **20 points** (or 10%) available for how the project approaches sustainability objectives in the projects design and development approach.

Financial components of the proposal were also reviewed by our finance team and Heartland LLC, our real estate advisors.

After evaluating all proposals received the Port evaluation team selected Panattoni Development Company (PDC) as their preferred respondent to the RFP. Panattoni is one of Puget Sound’s leading industrial developers and investors in commercial real estate with extensive Port experience on aviation-oriented product including other very successful projects at the Des Moines Creek business park. PDC has developed or acquired more than 525 million square feet of light industrial space, has been in business for 35 years and currently has 61 projects under construction globally.

(Note that PDC, like most developers, create a specific development entity to be the direct owner of the resulting building asset – in this case the specially created JV is incorporated as PDC Seattle LPIV BB/TH, LLC.)

Locally, Panattoni Seattle has developed more than 26 million square feet of industrial, office and build-to-suit projects in the Pacific Northwest, with 24 active projects totaling 14.1 million square feet currently under development. Another 9.0 million square feet across 33 potential projects are in the feasibility and due diligence phase. Panattoni was named NAIOP Washington’s Developer of the Year in 2017, and is proud to be the most active industrial developer in the Pacific Northwest, covering Washington, Oregon, and Idaho.

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Recent Port of Seattle Development projects with PDC include:

- Des Moines Creek Business Park Phase 1 – 3 = 1,332,000 SF
- Northeast Redevelopment Area 2 & 3 (NERA) = 460,000 SF

Panattoni has also developed several other properties within the region over the past five years:

- Frederickson.....PDC is currently developing our Fred310 project on 310 acres acquired from Boeing with 7 buildings for a total of approximately 4M SF. The first building is a build-to-suit for a national company of just over 1M SF
- Pacific Gateway.....PDC has recently completed a 42.6-acre development on land acquired from Boeing in Kent with 6 buildings totaling 823,606 SF
- Port of Olympia.....PDC is developing a 200-acre project on land ground leased from the Port of Olympia in Tumwater adjacent to the Port of Olympia Airport. The first building of 477,000 SF is being permitted for construction to begin early 2023
- PDC recently completed a 120,000 SF distribution center for Amazon on land partially ground leased from the Port of Bremerton adjoining the Port of Bremerton Airport
- PDC will complete a 5 story, 2.8M SF distribution center for Amazon in Arlington near the Arlington Airport

JUSTIFICATION

The Des Moines Creek West development has been planned and connected to specific transportation developments to enhance the utility of the site. The City of Des Moines and the Port of Seattle have collaborated on improving this area for almost a decade, as indicated and documented in the Port's Real Estate Strategic Plan of 2016. Initial work included a two year negotiation between WSDOT on the surplus of the SR 509 right of way, the eastern and adjacent parcel in 2021. The partnership with the City of Des Moines is critical to the success of the project to maximize benefits to the Port and the City and its residents.

Benefits and goals of a successful project connect to the Port of Seattle's Century Agenda by:

- Providing approximately 100+ prevailing wage construction jobs under a Project Labor Agreement with Panattoni's contractor partner (Abbot Construction) which preserves competitive living wage rates, labor harmony and a strong apprenticeship, small business and WMBE component to the project.
- At full occupancy, the development will be home to approximately 600+ full-time employees with an estimated payroll of more than \$16 million annually.
- The development will complement the adjacent Des Moines Creek Business Park by adding industrial space that attracts growing firms, supports City of Des Moines' retailers and keeps jobs within the city and nearby communities.

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- The development when complete will improve access to the regional trail system and effectively reduce blight and crime problems currently impacting the property and neighborhood.
- The development will support sustainability through the documented use of LEED or better standards for building performance as well as enhanced protections of existing ecology on the site in coordination with Port environmental staff.

This ground lease, along with the Port's adjacent ground leases, represents another milestone in the area's land development. The proposed development by Panattoni will create approximately 400,000 square feet of high quality, light industrial space with supporting warehouse functions within one or two industrial buildings. Tenants may include manufacturers, distributors and logistics providers that support the aviation and air cargo industries.

History of site ownership/use

The property's contemporary post-indigenous history shows it was originally platted in the early 1900's out of US land-grant property to individual property owners. Since the late 1800's the land was primarily used for agricultural purposes with orchards, farmland and some limited housing sites. The Port purchased the bulk of the site in the early 1990's with FAA funds for noise mitigation, and the lots, names of owners and years they were purchased (1991 – 1993) with a combination of takings (eminent domain) and direct purchase from individuals. As noted above, a single additional adjacent property was recently acquired by the Port from WSDOT in 2021.

Ecological Conditions, Sustainability Plans and Partnership with City of Des Moines

The property has the following attributes:

- 4.5 acres of the site contains wetlands that will be mitigated and preserved. Multiple large wetlands are located outside of the developable area to the east of the site. Securing approvals for required wetland mitigation is currently underway. The wetland critical area buffer and the securing of these approvals is regulated through the City of Des Moines.
- Tree canopy on the DMC – West Parcel covers about 70% of the site. Tree species composition is predominately red alder and other hardwoods, which is indicative of the disturbed site history. Small- to medium-sized conifers make up a small fraction of the trees on the site, and few if any large conifers are present. The remaining 30% of the site that lacks tree canopy is predominately invasive blackberry and English ivy, and much of the ground cover underlying the tree canopy is also invasive blackberry. Ivy growth is threatening the health and viability of a number of trees, which presents a public hazard when adjacent to public access, roads and structures.

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- Panattoni will work with the City of Des Moines in relocating, re-establishing, and improving the existing trail on site as both an amenity to the new industrial campus and as a recreational amenity for the greater community. This trail will enhance public access for commuters and recreational users through new linkages to the Des Moines Creek Trail to the north and the Barnes Creek Trail to the south.

As part of the property's development several steps are being taken to promote sustainability and mitigate project impacts.

Working with principals and planning priorities of the City of Des Moines, Panattoni plans to preserve the over 10 acre buffer zone for wetland mitigation in the Eastern portion of the site.

Panattoni has voluntarily agreed to an enhanced tree-replacement scheme at a 4:1. which is not a requirement on this site and exceeds the City of the Des Moines tree-replacement regulations. The city will use its recently adopted urban forest plan (done in partnership with Forterra and the Port of Seattle) to identify where new trees will be planted under the guidance of the Urban Forest Plan.

DETAILS

The basic terms of the ground lease are as follows:

Des Moines Creek-West

1. **Term** - Initial term of fifty-five (55) years with two (2) ten-year options to extend. (Longest lease term allowable by law.)
2. **Base Rent from the day after expiration of the Due Diligence period and during project construction:**
 - **\$.39** per square foot during the direct construction period for a roughly 12-16 month period.
3. **Base Rent from Substantial Completion** or day 1 of the 15th month of the term, whichever occurs first:
 - **\$3.96** per square foot or **\$3,415,452/year**.
4. **Base Rent Adjustments:** The applicable Base Rent will increase by 15% percent annually during the Term and any Extension Term beginning at the sixth (6th) Agreement Year and then every five (5) years thereafter.
5. **Base rent Adjustments reflecting Fair Market Value Re-appraisals** and after the Base Rent Adjustments:
 - For the twenty-first (21st), thirty-first (31st), forty-first (41st), and fifty-first (51st) Agreement years,
 - the sixty-first (61st) and seventy-first (71st) Agreement years if the options are exercised.

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6. In no event will the **Fair Market Rent** adjustments be:
- less than one hundred percent (100%) of the then current Base Rent or
 - more than one hundred and ten percent (110%) of the then current Base Rent.

The lease furnished at the date of the Commission presentation includes some elements that will need to be finalized through additional negotiation, but the parties agree in principle on the material terms.

Schedule

Subject to various approvals by permitting agencies and permissions therein granted by these agencies the Panattoni team intends a permitting schedule running through the balance of 2022 with building and land use permits issued in 2023 Followed by construction commencement. Building will be substantially complete in mid-2023 and taking tenants. (Property will be built to accommodate one or more tenants and developed currently as a spec property. Lease up will commence during construction and full occupancy by the end of 2024 depending on various market factors and tenant opportunities.)

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Do not sign the lease.

Implications: The loss of over \$3,415,452 in initial annual revenue.

Pros:

- (1) The property could remain available for an unknown airport operational purpose.
- (2) There could be some other use identified some-time in the future that could more closely align with some as yet unknown Port critical operational or strategic goals.

Cons:

- (1) The loss of \$3,415,452 in annual revenue that is equal to more than \$60,000,000 over the life of the lease with baseline escalations.
- (2) The loss of leasehold excise tax of \$438,544 per year (not including lease revenue escalations) to the State.
- (3) The loss of 100+ prevailing wage construction living wage jobs.
- (4) The loss of up to 600+ permanent jobs living wage, benefits jobs.

This is not the recommended alternative.

Alternative 2 – Sign the lease.

Revenue Implications: \$3,415,452 in annual revenue.

Pros:

- (1) \$3,415,452 in annual revenue equal to more than \$60,000,000 over the life of the lease with only Base Rent escalations.

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- (2) Leasehold excise tax of \$438,544 per year (not including lease revenue escalations) to the State.
- (3) The creation of 100+ prevailing wage construction jobs.
- (4) The creation of up to 600+ permanent jobs.

Cons:

- (1) The property would not be available for some yet unknown airport operational purpose.
- (2) There could be some other unidentified use that could more align with the Port's long term goals.

This is the recommended alternative.

FINANCIAL IMPLICATIONS

The purpose of developing Des Moines Creek-West is to put the property back into productive use with an aviation supportive and compatible development. To ensure a Fair Market Rent for the land, the Port appraised the property in its current condition and then competitively offered the property to the development community. This ensured the Port had a strong basis to evaluate proposals for financial implications and aspirational goals.

The proposal being presented exceeds the financial expectations and addresses the aspirational goals set by Commission.

Future Revenues and Expenses (Total cost of ownership)

The total estimated revenue is equal to more than \$60,000,000 over the life of the lease (75 years.) There are no financial requests being made as part of this ground lease approval.

The Port is making no capital investment as part of this ground lease. All capital costs will be carried by Panattoni Development Company.

ATTACHMENTS TO THIS REQUEST

- (1) Draft Ground Lease
- (2) Presentation

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- 2016 - 2017 DMC BP Lease Agreement Phase 1, 2 and 3
- 2017 DMC North Ground Lease Agreement
- 2018 ILA 216th Street Improvement Project between the Port / City of DM
- 2021 purchase of the SR509 ROW from WSDOT