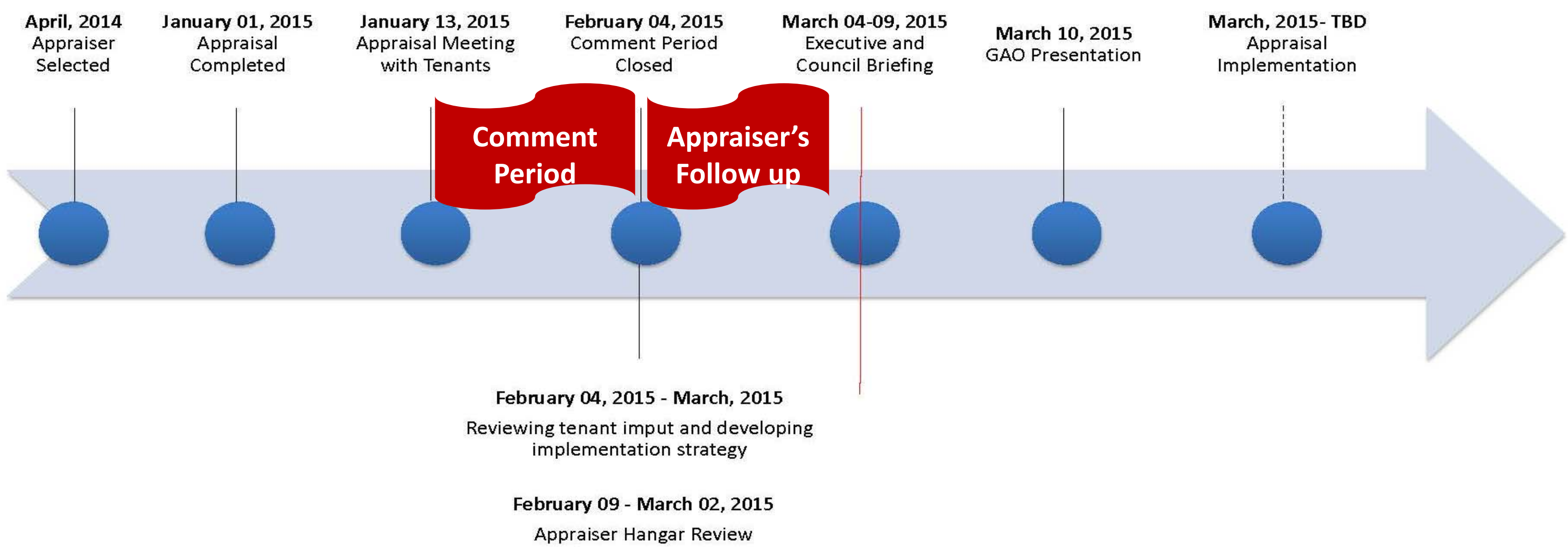
2015 KCIA Triennial Appraisal

Rental Adjustments for Non-Boeing Leaseholds

OVERVIEW

- King County International Airport is required under the King County Code (4.56.010) to perform periodic appraisals on 3 and 5 years cycles

- The triennial appraisal for non-Boeing leases and Monthly Rental Agreements has been completed



AIRPORT LEASE RATE IMPACTS

Application of appraisal conclusions would have a significant impact on 2015 property rents for the non-Boeing properties:

- Long-term leases would increase 29% on average (pending potential arbitration)
- Monthly Rental Agreements (MRAs) and agreements without arbitration rights would increase 26% on average
- Executive Hangar and T-Hangar rental rates would increase from 3% to 93% depending on type, condition and location
- Due to the significant change in the rental rates, <u>the process was extended to allow for a tenant comment period</u> prior to finalizing the rental rate adjustments

OUTREACH PROCESSS

TENANT INPUT SUMMARY

KING COUNTY INTERNATIONAL AIRPORT							
TENANT COMMENTS SUMMARY							
Common Comments	Aviation Advocate Groups (AOPA, NBAA)	Tie Downs	MRAS and Long Term Leases	Executive Hangars	T-Hangars	Totals
1 Facility conditions do not support increase	0	1	5	1	9	16
2 Rates tied to KCIA O&M costs	0	1	1	0	1	3
3 What will tenants get for their money?	0	0	2	0	0	2
4 Vacancy rate does not support an increase	0	7	1	0	0	8
5 Rates are pushing small GA away	0	6	1	1	6	14
6 Comparables not valid	1	5	3	1	4	14
7 Methodology not valid	0	4	1	0	9	14
8 Fair market value is not acceptable for aviation	0	1	2	0	5	8
9 Step increase is too large	0	1	2	1	8	12
10 Will vacate/relocate if apprasial is approved	0	1	1	1	9	12
11 Consider phasing the increase	0	0	0	0	2	2
12 Extend Initial Comment Period beyond 01/21	0	0	0	1	2	3
13 Extend Comment Period beyond 02/04	2	0	2	0	2	6
Totals	3	27	21	6	57	114

TENANT COMMENTS

79% of tenant responses received were from airport Tiedowns and Hangar Tenants

- Majority were from the Tiedowns and SW T-Hangar tenants
  - Primary comment focus was:
    - Facility condition
    - Comparables not valid
    - Methodology not valid
    - Increases to large
- The KCIA Management and FMD reviewed the comments and ***directed the appraiser to go back and specifically revisit facility condition for selected properties*** to ensure these were appropriately incorporated into the valuation

STRATEGIC BUSINESS PLAN

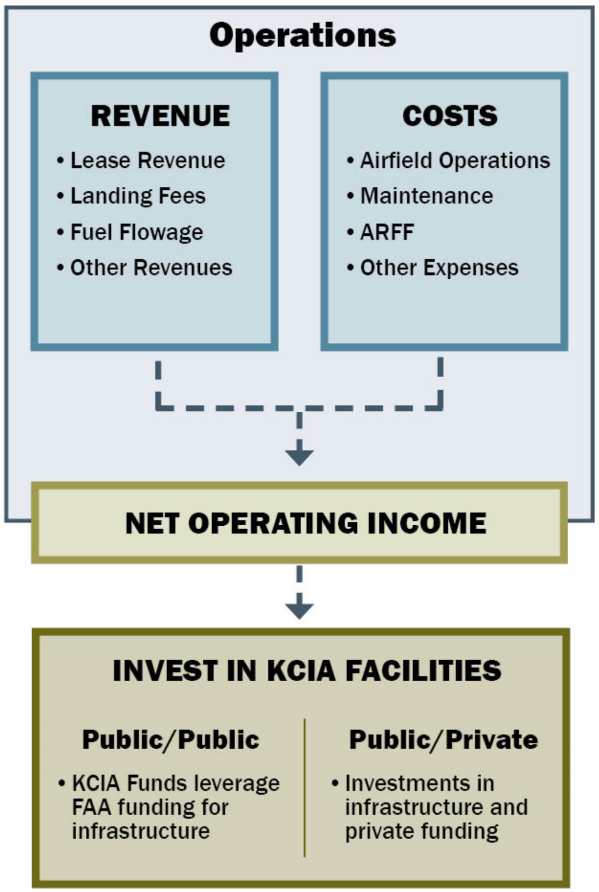
STRATEGIC CONTEXT FOR LEASE RATE DISCUSSION

- In 2011, County Council directed the KCIA to develop a Strategic Plan for the Airport (2012-2013 Budget Ordinance (17232 Sec. 128)
- Airport Division staff presented the completed Strategic Plan to the GAO Committee on September 9, 2014
- The Strategic Business Plan identified a series of action items that were developed to focus on two key performance metrics:
    1. Maximize **economic contribution** in terms of jobs support, high wages and economic activity
    2. Improve **operating margins** and **maximize financial** return on current assets and future investments
- As a result, the KCIA Management has a fiduciary responsibility to County taxpayers to maximize the value of the airport by ensuring that airport customers and tenants are paying fair market rents and fees

AIRPORT BUSINESS MODEL

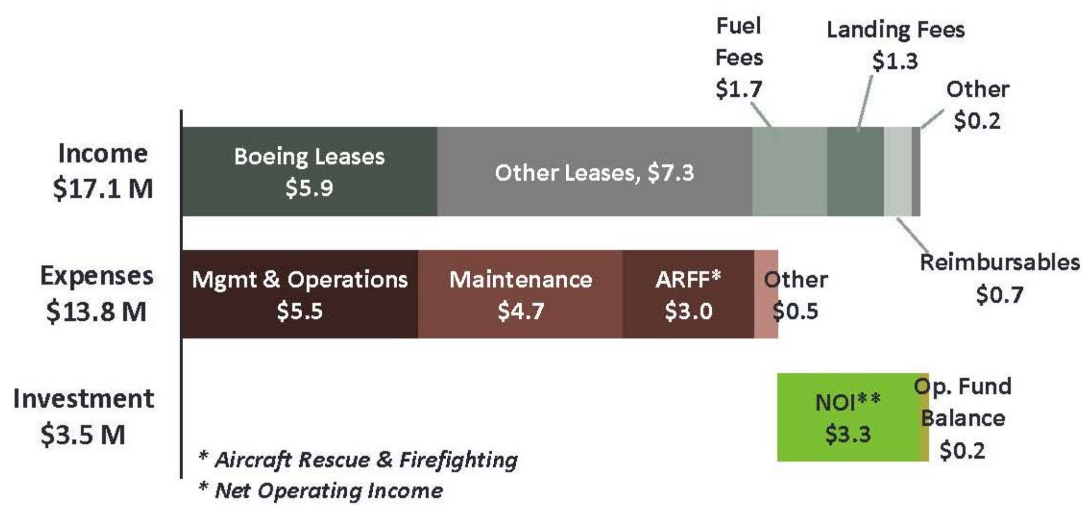
NET OPERATING INCOME IS FUNDAMENTAL TO KCIA MISSION

The Airport business model is based on the generation of net operating income to build up capital funds for critical facilities investments and updates.



In 2013, KCIA generated \$3.3M in new net operating income for the capital program.

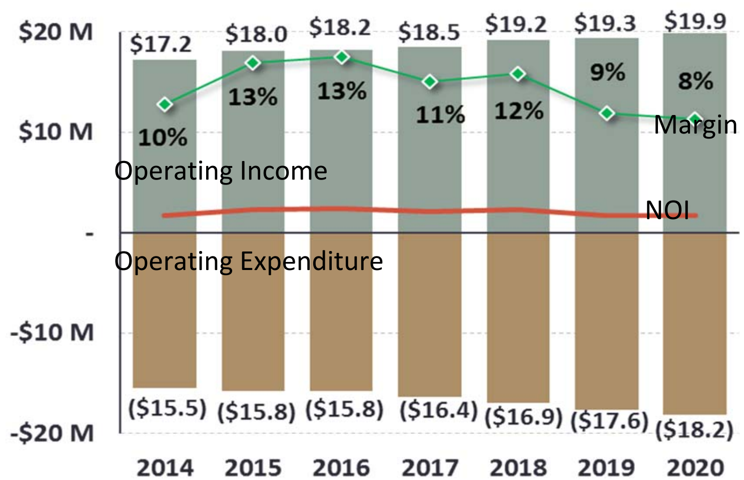
Leases generate the lion's share of income.



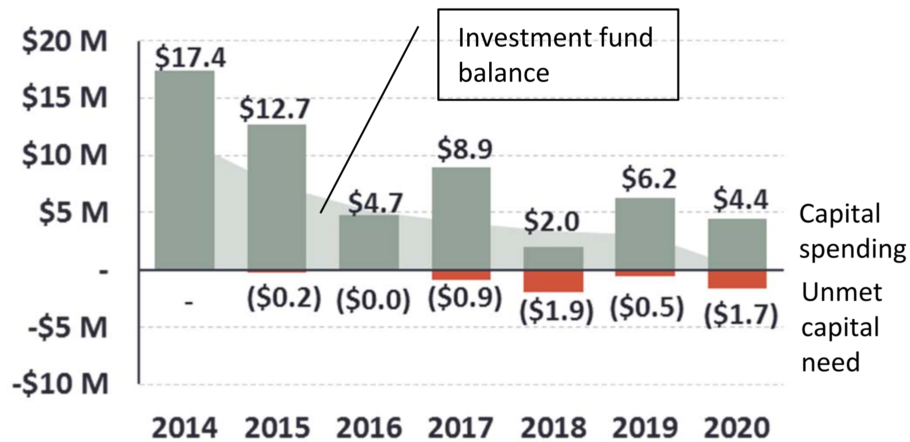
AIRPORT BUSINESS MODEL

FINANCIAL OUTLOOK IDENTIFIED CRITICAL CAPITAL FUNDING GAP

Strategic Plan identified declining operating margins and net operating income based on expected revenue outlook at the time

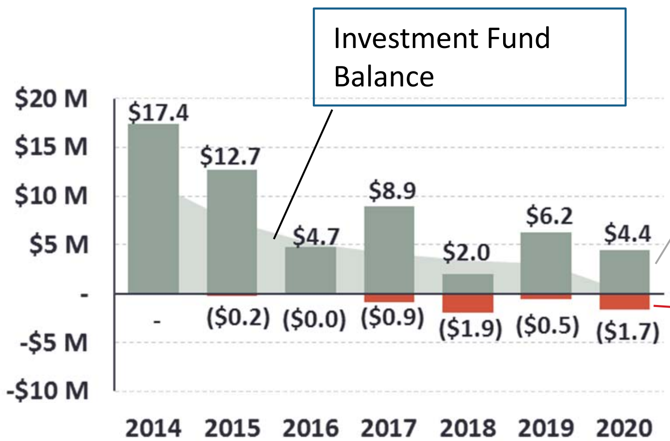


The lower operating margins would lead to reduced capital funding resulting in a depletion of KCIA's investment fund balance by 2020 and unfunded investment needs.



AIRPORT BUSINESS MODEL

CAPITAL FUNDING GAP LEADS TO DEFERRED INVESTMENT



Currently Funded Major Capital Investments (2015-2020)	
New ARFF Station	$7.1M
Environmental Cleanup	$3.6M
Fuel Farm Cleanup	$2.3M

Deferred Capital Investments (2015-2020)	
Arrivals Building Rehabilitation	$3.0M
Hangar Upgrades	$1.2M
Equipment	$0.6M
General Facility Investments	$0.4M

Uncertain Needs Which Might Require Funding (2015-2020) (not currently funded)

Duwamish Mitigation

Airport Security

Investments Beyond 2020 (not currently funded)		
Variable begin 2021	Common Use Aprons	$13.0M
Variable begin 2021	Perimeter Road	$10.0M
Variable begin 2022	Vehicle Parking Lots	$5.0M
2021	Runway 13L.31R System	$17.0M
2026	Runway 13R/31L System	$33.0M
2027	Taxiway "B" System	$26.0M
2035	Taxiway "A" System	$33.0M

Summary of Appraisal Findings

RESULTS OF APPRAISAL

COMPARABLE AIRPORT FACILITIES

Comparable airports were selected based on:

1. **Peer airports.** Other urban-oriented airports in close proximity to Central Business Districts in the region and elsewhere in the U.S. with similar business operations
2. **Competitive airports.** Regional airports that compete directly with KCIA for tenants and customers

			PEER AIRPORTS			COMPETITIVE AIRPORTS	
	KCIA Current	KCIA Proposed	Mineta San Jose	Oakland North Field	Van Nuys	Renton Municipal	Paine Field
Runway Length	10,000	10,000	11,000	6,213	8,001	5,382	9,010
Operations	180,000	180,000	142,211	203,718	232,931	100,215	113,460
Land Leases (ft^2)	$1.12 - $1.60	$1.90	$1.72-$2.15	$1.80-$3.14	$2.03	$0.63	$0.44
Hangars (ft^2)	$5.40-$10.27	$6.80 - $15.77	$13.08 - $18.48	$13.08 - $18.48	$8.45 - $14.57	$5.54 - $15	$5.12 - $5.84
Tie Downs (monthly)	$105	$105	$140 - $169	$140 - $169	$175.00	$120	$60

RESULTS OF APPRAISAL
RAW AND IMPROVED LAND

The appraiser concluded that the current market conditions justified a market ground lease rate for property at KCIA **$1.90/sf/yr**. for raw land. This was based on:

- Review of ground lease rates for peer airports in the region and elsewhere on the west coast, which range from $0.63/sf/yr to $3.14/sf/yr
- A review of recent relevant sales activity in the area, which concluded:
  - Based on certain airport-related factors, the raw land value of KCIA property was determined to be **$25/sf** (within the range of $21/sf and $31/sf from the observed sales)
  - A review of return rates for similar property in leased as raw land determined a current market rate of 7.5%, which when applied to the land value yields a land rental rate of **$1.88/sf/yr**
- In addition, the appraiser considered the incremental value that KCIA apron improvements provide for some properties and concluded a premium of:
  - $0.15/sf/yr for light duty aprons
  - $0.50/sf/yr for medium and heavy duty aprons

RESULTS OF APPRAISAL

OFFICE, RETAIL AND INDUSTRIAL SPACES

Office space. The office spaces and locations of office properties at KCIA vary, however, for the most part, the appraiser concluded that **existing office rents are in line with current market rates in the area**, considering location and condition of properties, with one exception:

- Comparing total rent to comparable properties at KCIA, building plus land rents (which UPS pays for separately) suggest that the building portion was too low
- A rate adjustment of **$0.50/sf/yr** was determined to be appropriate

Retail. KCIA leases one retail space, the CAVU Cafe. The appraiser concluded due to low sales volumes, the current rate was consistent with the market.

Industrial. KCIA currently rents out three industrial spaces. The appraiser concluded that based on the condition and location of these spaces, the current $6.00/sf/yr rent should be increased to **$7.00/sf/yr** to reflect current market conditions.

RESULTS OF APPRAISAL

AIRCRAFT HANGARS

KCIA Owned Executive and T-Hangars. The appraiser concluded that based on market conditions, KCIA's hangars were priced below market. Specifically, based on location and condition:

- Market rate rents for T-Hangar's were determined to be valued in a range of rent, $780-1,300/month
- Market rents for Executive Hangar's were valued in a range of $3,100-$4,300/month
- A key factor that supports these valuation is the extremely low vacancy rates and long wait lists which, to the appraiser, suggested rents that are currently less than fair market value
- Reclassify SW T-hangars from small to large based on review of unit sizes
- Reclassification accounts for 40% of the SW T-hangar rate increase

KCIA T-Hangars:	Unit Size
Southwest – Large end T-hangars	2,162 to 2,014
Southwest – Large middle T-hangars	1,730 ±
Midfield C – Large T-hangars	1,710 to 1,780
Midfield D – Small T-hangars	1,312 ±
Northeast Buildings A and B – Small T-hangars	1,303 to 1,335
Northeast Building C – Small T-hangars	1,038

RESULTS OF APPRAISAL

TIEDOWN SPACES

While the fees charged for tiedown spaces are not based on a fair market appraisal, KCIA requested that the appraiser look at these as well to provide a broader understanding of the value of the airports assets.

The appraiser concluded that, if tiedown fees were based on the value of the land and a comparison to other local competitors, then market rate would be set to $125/month

Current situation for tiedown spaces.

- Rate set at $105/month for 2015 and $110/month for 2016 by King County Council, resulting in an adopted 10% increase to be phased in over two years
- Current policy brings rate to $110 per month by 2016
- Airport staff will consider the appraiser's view as it reviews its overall property strategy over the next two years (per the Strategic Plan)

APPRAISAL FOLLOW-UP

REVIEW OF TENANT COMMENTS

The appraiser was asked to specifically review tenant comments that were material to the valuation of individual properties, which focused on three key issues:

- Selection of comparables and evaluation of building conditions for the hangar analysis
- Review of methodology for T-hangar analysis, particularly in comparison to a return on cost approach suggested by one of the commenters
- The overall land value determination

The appraiser concluded that, <u>with one exception</u>, there was no new information brought forward that warranted a change in the value conclusions presented. In the case of the SW T-hangars, the appraiser concluded:

- **Due to a more thorough review of the current conditions of these units, the fair market value was reduced by $100 per unit per month**

Monthly unit price	Current	Original	Revised
Southwest – Large end T-hangars	**$733**	**$1,250**	**$1,150**
Southwest – Large middle T-hangars	**$733**	**$1,200**	**$1,100**

Recommendations

RECOMMENDATIONS

FMD and KCIA **recommend implementing the rates as determined by the appraisal** and moving forward by applying the appraisal results to the affected leases and rental rates as per King County Code (4.56.010) on the following schedule:

- **Long-term leases.** Notification to tenants to begin after March 10, 2015. Tenants with arbitration rights have 30 – days to accept the new rate or arbitrate.
- **MRA's and Preferential Use Agreements.** Notification to begin after March 10, 2015 with new rates effective on July 1, 2015
- **Interdepartmental Use Agreements.** Notification to begin after March 10, 2015 with new rates effective on April 1, 2015
- **KCIA Owned Hangars.** Notification to begin after March 10, 2015 with new rates effective on July 1, 2015. Adjust SW T-Hangars per follow-up appraisal

BENEFITS OF THIS APPROACH

Recommendation and implementation schedule have a number of benefits:

- Aligns leases with current fair market value
- Delays the impact of the increase for tenants without arbitration rights to mid-year, effectively spreading the impact of the increase over 2015 and 2016.
- Addresses specific tenant comments related to conditions of SW T-hangars
- Additional lease revenues supports KCIA's capital investment program
  - The capacity to fund projects in the next 6 years that would otherwise be deferred, including accelerating the T-hangar modernization program
  - Improves KCIA's financial position in anticipation of major capital investment needs that are coming due just beyond 2020

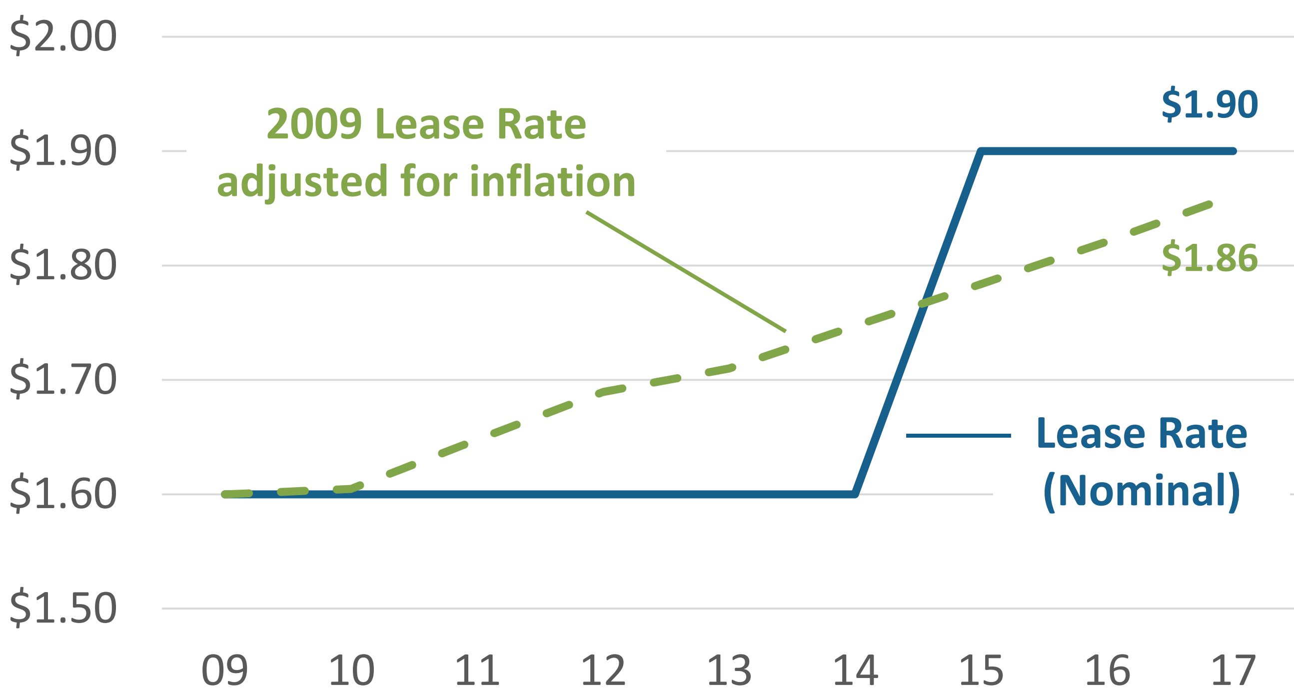
QUESTIONS

Appendix

HISTORICAL CONTEXT FOR LEASE RATES

Implementation of new lease rates, would bring land rents in 2017 back in line with the 2009 rates if rates had kept up with inflation

- No change in lease rates in 2011
- Periodic cycle results in bigger changes
- Rates were too low for several years and now they catch back up



TENANT OUTREACH RESPONSE

RESPONDERS BY PROPERTY TYPE AND LOCATION