## STAFF REPORT

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| **Agenda Item:** | 7 | **Name:** | Nick Bowman  |
| **Proposed No**.: | 2018-0283 | **Date:** | July 25, 2018 |

**SUBJECT**

An ordinance authorizing the King County executive to enter into a long-term lease agreement with Kenmore Aero Services, LLC for county-owned land at the King County International Airport.

**SUMMARY**

Proposed Ordinance 2018-0283 would approve a 35-year lease with Kenmore Aero Services, LLC. The lease approves the demolition of existing facilities on the property and the construction of approximately 44,000 square feet of Forward Base Operator (FBO) terminal space and hangars on a 9.54-acre parcel at the King County International Airport (KCIA).

**BACKGROUND**

Kenmore Air has been a family-owned local airline since 1946. Kenmore Aero Services (KAS), a separate limited liability company, was initially established by Kenmore Air at the KCIA to guarantee fueling service for the Kenmore Air airline. KAS has been operating on Boeing Field since May of 2016, conducting retail sale of aeronautical products, providing maintenance and repair services, aircraft parking, fueling and flight instruction among others, under two agreements: KAS purchased the remaining term of the BFI Holdings LLC lease, which expired in June 2017, but has since been extended to accommodate the review of the proposed long-term lease agreement, and a month-to-month rental agreement with the County covering the property adjacent to the BFI leasehold. Both leases would terminate upon execution of the proposed lease. Through the lease of additional space under the proposed lease agreement, KAS is seeking to expand into a full service FBO.

The property lease for approximately 9.54 acres would combine three contiguous parcels at KCIA, including the creation of a new parcel which was previously unused space. KAS plans to demolish three existing hangar buildings on the property and build approximately 44,000 square feet of FBO terminal and hangar space. Additional improvements to the leased space include upgrades to existing ramps which will provide flexibility in storing aircraft of various types and an expansion of boundaries increasing Light General Aviation (LGA) aircraft parking.

The King County Code (KCC) provides the conditions under which county-owned property may be leased. The relevant code provisions are provided below.

KCC 4.56.010 and KCC 4.56.160 require that “fair market rental value,” determined by an appraisal, be the basis for all leases of county-owned real property.

KCC 4.56.160 also requires that in general, properties available for lease be competitively bid. However, that same section of code does allow for a negotiated lease when it is in the County’s interest. The relevant section of code is quoted below with the reference to the negotiated lease provision underlined (emphasis added).

"…the manager of the facilities management division shall determine whether the new lease, or renewal of an existing lease, is to be awarded by competitive bidding or by negotiation with interested parties without bidding. New leases shall be awarded by competitive bidding unless the manager of the facilities management division determines it is advantageous to the county to negotiate without bidding. In the event the county negotiates the award of lease contracts, the facilities management division shall submit to the executive the reasons for recommending award through negotiation rather than competitive bidding. At the option of the executive, competitive bidding may be required. The county shall give notice of its intention to execute a lease by publishing a notice in a legal newspaper at least once a week for the term of two weeks."

When a lease of county-owned property is awarded through direct negotiation, KCC 4.56.160 requires consideration be given to financial accountability, compliance to previous and current leases of county-owned property, environmental and worker safety records and adherence to human trafficking laws. This criteria is commonly referred to as the “Responsibility Ordinance.”

Finally, KCC 4.56.160 requires the county to give notice of its intention to execute a lease by publishing a notice in a legal newspaper at least once a week for the term of two weeks.

KCC 4.56.170 requires the lessee to make an appropriate deposit.

KCC 4.56.180 allows the county to lease property for a term of 35 years if the leasehold is to be improved or has been improved at a value at least equal to the value of the property.

**ANALYSIS**

The analysis will first identify the relevant provisions of King County code for long-term lease agreements and compare them to the key provisions of the proposed lease agreement. Secondly, the analysis will evaluate whether or not it is in the county’s interest to negotiate the lease rather than having a public bidding process.

KCC 4.56.010 and KCC 4.56.160

*Fair Market Rental Value*: An independent appraisal conducted on March 8, 2017 determined the fair market rental value for the combined leasehold at $2.05 per square foot per year. The proposed lease rental rate of $3.00 per square foot for the Northern and Central Portion of the property and $0.75 per square foot for the Southern Portion is in-line or exceeds the rental value assigned to the property by the independent appraisal. Table 1 below provides a breakdown of the appraiser’s valuation of the three contiguous parcels under the proposed lease agreement.

**Table 1 – Property Appraisal Summary Report**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Conclusion – Base Value | $/sf | sf applied to | Land Value | 7.50% | $/sf |
| $45.00 | Market Rent |
| Northern Portion | $40.00 | 170,499 | $6,819,960 | $511,497 | $3.00 |
| Central Portion | $27.00 | 139,481 | $3,765,987 | $282,449 | $2.03 |
| Southern Triangle\*  | $10.00 | 122,460 | $1,224,600 | $91,845 | $0.75 |
| Combined Leasehold |  | **432,400** | **$11,810,547** | **$885,791** | **$2.05** |

\*This portion of the property was previously unused space. The relatively low value of this portion of the land reflects the height restrictions and relatively low utility of the parcel.

*Negotiated Lease*: On April 7, 2017 the Director of the Facilities Management Division (FMD) sent a letter[[1]](#footnote-1) informing the Executive that direct negotiation with KAS was in the best interest of the county. The Executive agreed with this recommendation based on rationale that will be described in the Analysis section of this staff report.

*Public Notice*: A public notice of intent to negotiate a lease was published in the Seattle Times on July 18, 2018 (Attachment 6 is the Affidavit of Publication).

*Responsibility Ordinance*: FMD, in its evaluation of KAS’s proposal, assessed the company on several responsibility criteria including financial accountability, environmental compliance and worker safety.

According to executive staff, KAS answered several financial questions as part of the King County Responsibility Lease Detail and Attestation Form, regarding the last three years of operation. KAS stated that they have not been a debtor in a bankruptcy in the last three years; they are not in the process of being sold; they have not received a notice of default within the past three years; they have not been a defendant in a unlawful detainer action; they have not been subject to a judgement attachment or lien; and they have not received any notice of default from King County regarding leases or subleases. Furthermore, the principals of Kenmore Air, Inc. are the principals of Kenmore Aero Services, plus an FBO owner/operator from Texas[[2]](#footnote-2).

As for environmental compliance and worker safety, executive staff reports that KAS completed a Responsibility Ordinance and had no negative worker safety violations. However, Kenmore Air, KAS’ joint venture partner, did, and this was reported[[3]](#footnote-3). In June 2015, the U. S. Environmental Protection Agency expedited settlement agreement and final order was executed with Kenmore Air regarding storage of waste pursuant to Section 3008 of the Resource Conservation and Recovery Act (RCRA) and 40 CFR 22.13(b). On July 26, 2017, the Washington State Department of Ecology (DOE) issued a violation to Kenmore Air for failing to determine whether its wastes should be designated as dangerous waste, properly labeling and closing all its dangerous waste containers, and keeping required records of dangerous waste shipments at an aircraft maintenance facility on Lake Washington[[4]](#footnote-4). The most recent DOE inspection of the facility on April 25, 2018 identified several additional violations related to storage, handling and reporting of dangerous wastes[[5]](#footnote-5).

KCC 4.56.170

Deposit: The proposed lease requires a deposit equal to two months of regular lease payments and excise tax.

KCC 4.56.180

Long-Term Lease Capital Investment: The proposed leased property is approximately 9.54 acres. The most recent appraisal values the property at $11.8 million. The improvements in the proposed lease agreement have an estimated value of $14.8 million. This investment would represent one hundred twenty-five percent of what is required by the lessee in order to qualify for a 35-year lease.

Code Provisions

From the evaluation above, it appears the proposed lease meets all relevant code provisions including fair market rental value, level of investment, term of lease, rental deposit and public notice published in a newspaper for two consecutive weeks.

Bid versus Negotiation of Lease

The following paragraphs describe and analyze the rationale behind the Director of the Facilities Management Division and the Executive’s recommendation for a negotiated lease.

Benefits: KAS, while having only been in operation since 2016, is part of a group of King County companies that has been operating continuously in the Pacific Northwest since 1946. KAS assumed the former Aeroflight FBO and offers a business platform which includes service to the diverse constituents of KCIA including Light General Aviation, Corporate and Business Aviation, and the Cargo/Freight Forwarding sectors of the airport marketplace. Table 2 provides a summary of the benefits to the County under the proposed lease.

**Table 2 - Total County Benefits**

|  |  |
| --- | --- |
| **Action** | **Benefit** |
| 19 Employees | Payroll |
| Significant expansion of FBO services provided since 2016 (44,000 sq/f FBO terminal & hangar space) | Services to tenants and transient aircraft |
| Commitment to support for LGA community | Dedicated LGA services and parking |
| Acceptance of sight “as-is,” including unknown environmental contamination | KAS responsible for remediation associated with clean-up during development |
| Total Facility Investment | $14.8 million |
| Excess site improvement value | $3 million |
| Annual Lease Payment & Leasehold Tax | $1,116,696 |

In his direct negotiation letter[[6]](#footnote-6), the FMD Director describes the operating revenue generated by KAS’ expansion into a full service FBO as comparing favorably against that which would be produced by a private corporate hangar tenant. According to executive staff, the operating revenue from KAS includes the same ground rent as a corporate hangar user, generates more fuel flowage fees and more landing fees. Corporate hangar tenants typically pay the same ground rent, generate much less fuel flowage fees and do not pay landing fees as aircraft based at KCIA do not pay landing fees[[7]](#footnote-7).

The Director’s letter also makes several references to KAS’ commitment to serving and growing the LGA community at KCIA as advantageous and a contributing factor in pursuing a negotiated lease with KAS. This commitment is represented in the proposed lease which defines the Southern Triangle portion of the property as the, “Light General Aviation Area[[8]](#footnote-8),” and requires that area to be dedicated in support of LGA. Support for LGA is defined as including, LGA ramp and tie down parking, the construction and maintenance of a self-fueling island for avgas, and flight training support. According to Executive staff, the inclusion of these LGA provisions in the proposed lease would be a significant benefit to the County that would not likely have been achieved through the public bidding process.

Whether or not the Council agrees with the determination that the inclusion of these LGA provisions in the proposed lease are a benefit to the County is a policy choice.

**Fiscal Analysis**

The proposed lease stipulates that the first rental adjustment, based on a fair market rental value appraisal, would occur no earlier than the anniversary of the commencement date in 2020. Subsequent fair market value rental adjustments would occur every fifth year. Additionally, the transmitted Fiscal Note[[9]](#footnote-9) assumes the base rent would adjust upwards by 2.5 percent during non-appraisal years, also on the anniversary of the commencement date. In total, the Fiscal Note projects the County would receive $49.9 million in revenue, including operating expenditures and capital investments, over the life of the proposed lease.

**Legal Analysis**

Legal analysis is still ongoing.

**ATTACHMENTS**

1. Proposed Ordinance 2018-0283 (with attachment)
2. Transmittal Letter
3. Direct Negotiation Letter – KCIA Kenmore Aero Lease
4. Fiscal Note
5. Property Summary – KCIA Kenmore Aero Services
6. Affidavit of Publication
7. Exhibit A – Legal Description of Premises Leased
8. Exhibit A-1 – Diagram of Premises Under Lease
9. Exhibit B – Conceptual Plan

**INVITED**

1. Anthony Wright, Director, Facilities Management Division
2. Brian Hague, Real Estate Services Manager, Department of Executive Services
1. Attachment 3 [↑](#footnote-ref-1)
2. Executive staff response to council staff inquiries July 10th 2018 [↑](#footnote-ref-2)
3. Attachment 5 and Executive staff response to council staff inquiries July 10th, 2018 [↑](#footnote-ref-3)
4. <https://ecology.wa.gov/About-us/Get-to-know-us/News/2017/Aug-01-Facility-in-Kenmore-fined-for-dangerous-was> [↑](#footnote-ref-4)
5. Dept. of Ecology staff response to council staff inquiries July 16th, 2018 [↑](#footnote-ref-5)
6. Attachment 3 [↑](#footnote-ref-6)
7. Executive staff response to council staff inquiries July 12th 2018 [↑](#footnote-ref-7)
8. Attachment 8 [↑](#footnote-ref-8)
9. Attachment 4 [↑](#footnote-ref-9)