Form revised: December 12, 2012

FISCAL NOTE FOR NON-CAPITAL PROJECTS

Department:	Contact Person/Phone:	CBO Analyst/Phone:
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Legislation Title: AN ORDINANCE authorizing the Director of Finance and Administrative Services to execute an Amended and Restated Lease between the City of Seattle and EF Seattle Fifth Avenue LLC, a Washington limited liability company, for a portion of the property located at 700 5th Avenue, commonly known as the Seattle Municipal Tower.

Summary of the Legislation:
This legislation authorizes the Director of Finance and Administrative Services (FAS) to execute a lease with EF Seattle Fifth Avenue, LLC, doing business as Seattle Executive Fitness (SEF). This action replaces an existing five-year lease for approximately 24,721 rentable square feet of special use retail space in the Seattle Municipal Tower (SMT). The new lease provides for a term of fifteen (15) years, retroactively commencing on October 1, 2011. The lease provides the City with an option to terminate the lease early in the event that the City has a public use for the space. The lease also allows the City to utilize the space during emergencies, providing emergency staff and responders a place to rest and shower. The lease requires legislation because the term of the lease exceeds the FAS Director's statutory authority for leasing under Seattle Municipal Code (SMC) 3.127.010.

Background:
Ordinance 117739, adopted July 31, 1995 authorized the purchase of SMT by the City. The primary purpose of SMT is as a class A office building; however the design of the building also includes ancillary special use spaces including retail on the 3rd and 4th floor and purpose-built fitness center space on the 14th floor of the parking garage. The fitness center space is a unique space that includes special features such as high ceilings, showers, saunas, locker rooms and a swimming pool.

Between 1997 and 2011, the fitness center was operated by All Star Fitness under consecutive leases with the City. The last five-year lease expired on September 30, 2011 but, in August 2011, All Star Fitness sold the business to SEF. SEF initially sought a fifteen-year lease with the City however, due to the sale occurring immediately prior to Council's budget deliberations and the SMC requirement that a lease in excess of five years be approved by the Council, FAS was only able to execute a five-year lease running through September 30, 2016. FAS and SEF subsequently agreed to business terms for a new, long-term lease that would replace the initial short-term lease and would be retroactive to October 1, 2011, expiring on September 30, 2026.

The lease rate structure is provided under the Revenues section below. FAS has no direct expenditures associated with the proposed lease.

The fitness center business is traditionally a very difficult model due to the competitive nature of the marketplace. Because of this, the credit worthiness of a fitness center tenant is very important. The lease requires either a personal guaranty (or letter of credit) to be provided by business owners Merle Gregg, George Petrie and John Goodman. The two latter partners are local commercial property owners who are very credit worthy, with prior experience in operating a fitness facility. Their ownership of the club's "sister" facility at the Medical Dental Building provides a strong incentive to ensure that this operation succeeds.

Please check one of the following**:**

____ This legislation does not have any financial implications.

__X__ This legislation has financial implications.

Appropriations:

Fund Name and Number	Department	Budget Control Level*	2013 Appropriation	2014 Anticipated Appropriation
TOTAL				

See budget book to obtain the appropriate Budget Control Level for your department.

Appropriations Notes: No new appropriations in this legislation.

Anticipated Revenue/Reimbursement Resulting from this Legislation:

Fund Name and Number	Department	Revenue Source	2013 Revenue	2014 Revenue
50330 – FAS Facility Operations Subfund	FAS	Space Rent	$102,592.20	$102,592.20
TOTAL			$102,592.20	$102,592.20

Revenue/Reimbursement Notes:

Lease Years	Rent per Rentable Square Foot	Monthly Rent
10/1/11 - 9/30/16	$4.15	$8,549.35
10/1/16 – 9/30/17	$5.57	$11,464.36
10/1/17 – 9/30/18	$6.07	$12,494.41
10/1/18 – 9/30/19	$6.57	$13,524.45
10/1/19 – 9/30/20	$7.07	$14,554.49

10/1/20 – 9/30/21	$7.57	$15,584.53
10/1/21 – 9/30/22	$8.07	$16,614.57
10/1/22 – 9/30/23	$8.57	$17,644.61
10/1/23 – 9/30/24	$9.07	$18,674.66
10/1/24 – 9/30/25	$9.57	$19,704.70
10/1/25 – 9/30/26	$10.07	$20,734.74

- The apparently low face rate of the rent is due to the fact that the City is not required to provide a tenant improvement allowance otherwise common in such deals. Further, this is a triple net lease in which the tenant is responsible for the cost of utilities, janitorial, and other services related to the space.
- In addition to the base rent above, the new lease provides that the tenant will pay percentage rent of 8% of annual gross revenue above $1,500,000 on top of the base rent.
- The revenues through 2012 have already been received and future revenues are anticipated in the 2013 Adopted Budget.

Total Regular Positions Created, Modified, or Abrogated through this Legislation, Including FTE Impact:

Position Title and Department	Position # for Existing Positions	Fund Name & #	PT/FT	2013 Positions	2013 FTE	2014 Positions*	2014 FTE*
TOTAL							

** 2014 positions and FTE are <u>total</u> 2014 position changes resulting from this legislation, not incremental changes. Therefore, under 2014, please be sure to include any continuing positions from 2013.*

<u>Position Notes</u>: None.

Do positions sunset in the future? Not applicable.

Spending/Cash Flow:

Fund Name & #	Department	Budget Control Level*	2013 Expenditures	2014 Anticipated Expenditures
TOTAL				

** See budget book to obtain the appropriate Budget Control Level for your department.*

<u>Spending/Cash Flow Notes</u>: The City has no direct expenditures over the life of the lease.

Other Implications:

a) **Does the legislation have indirect financial implications, or long-term implications?**
The term of the proposed lease would run through September of 2026. However, the lease provides the City with an option to terminate the lease at any time in the event the City requires the space for a public purpose. In the event that the City chooses to exercise its termination option, the City would be obligated to reimburse SEF for the unamortized cost of certain improvements made by SEF. The total cost of improvements subject to reimbursement is capped at $650,000, and would be amortized on a flat-line basis over a maximum period not to exceed the term of the lease. As an example, if the City were to exercise its termination option in early 2016, the approximate reimbursement would be $485,000. The longer the City waits to exercise its option, the lower the cost to the City.

b) **What is the financial cost of not implementing the legislation?**
If the legislation is not implemented, the existing lease will expire on September 30, 2016. At that time, SEF and the City may mutually decide to enter into a new lease, however neither party would be obligated to do so. If SEF chooses not to renew the lease, it is anticipated that the space would remain vacant for as little as three months, however economic conditions at the time could cause an extended vacancy of more than a year as the City seeks a new fitness center operator. In addition, entering into a new lease will likely require a tenant improvement allowance to be paid by the City, and may require offering several months of free rent to attract a new operator in what has been for several years a difficult business model. While it is possible to convert the space to another type of use other than a fitness center, this is not advised due to the high estimated cost (upwards of $150/sq. ft., or approximately $4 million in today's dollars), the potentially undesirable location, and the fact that any conversion for use by a private tenant would likely need to be done speculatively due to the length of time necessary to complete the work. Conversion would result in minimum vacancy period of twelve months to complete the renovations and seek a new tenant.

c) **Does this legislation affect any departments besides the originating department?**
No.

d) **What are the possible alternatives to the legislation that could achieve the same or similar objectives?**
An analysis of potential scenarios shows that the Net Present Value (NPV) of the proposed SEF lease exceeds the NPV for either a new fitness center operator or a new office tenant. This is due to the costs associated with vacancy, marketing and capital expenditures. As noted above, while repurposing the fitness center to an office use would increase revenues, the substantial upfront investment required would offset those revenues. The estimated payback period would be approximately thirteen years.

The early termination option provides the City with flexibility to utilize the space for its own purposes at any time during the life of the lease.

e) **Is a public hearing required for this legislation?**

No.

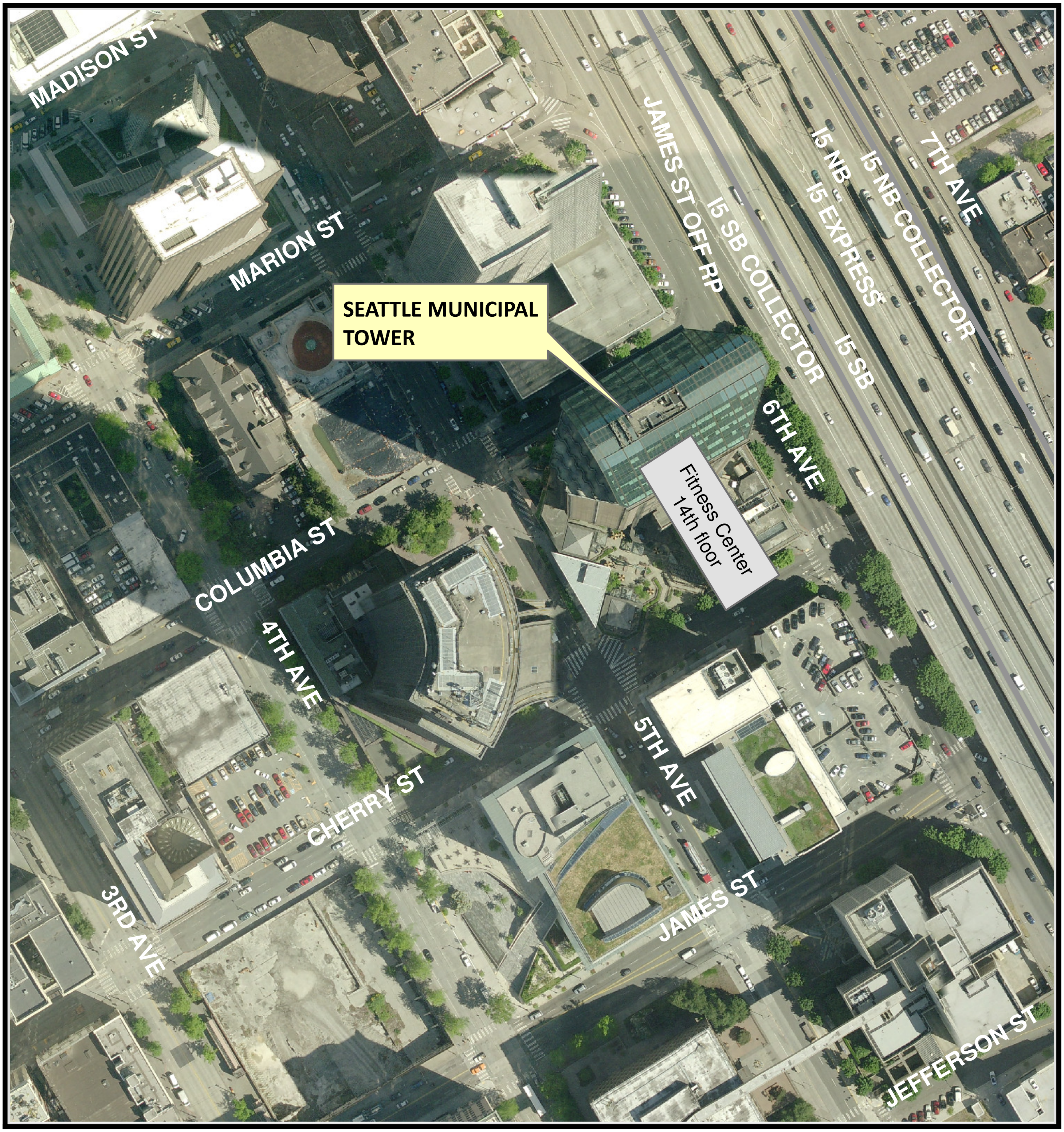
f) Is publication of notice with *The Daily Journal of Commerce* and/or *The Seattle Times* required for this legislation?
No.

g) Does this legislation affect a piece of property?
Yes. See Attachment A.

h) Other Issues: None.

List attachments to the fiscal note below:

Attachment A – Map.



City of Seattle

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Dept. of Finance and Administrative Services
February 8, 2013

Seattle Municipal Tower Fitness Center Lease

Attachment A to the FAS Seattle Executive Fitness Lease Fiscal Note