

**CITY COUNCIL
COMMUNICATION:**

ITEM _____

**OFFICE OF THE CITY MANAGER
CITY OF DES MOINES, IOWA**

99-470

SYNOPSIS -

AGENDA:

OCTOBER 18, 1999

On February 16, 1998, by Roll Call No. 98-471, the City Council approved a Letter of Understanding between United Parcel Service, Inc. (UPS), the Airport and the City concerning the proposed construction by UPS of a new sort and distribution center at the Airport. During the past year, the Airport and UPS have negotiated a lease, which, in most respects, meets the conditions as set out in the referenced Letter of Understanding.

SUBJECT:

APPROVAL OF
LEASE AGREEMENT
WITH UNITED
PARCEL SERVICE,
INC.

The proposed lease has a term of thirty (30) years beginning on January 1, 2000, and expiring on December 31, 2029, with two additional option periods if exercised by UPS. The first option period is for a term of twelve (12) years and six (6) months. The second option period is for a term of ten (10) years.

TYPE:

RESOLUTION
ORDINANCE
RECEIVE/FILE

Ownership of all buildings and improvements constructed on the leased premises will remain with UPS during the lease term and be subject to ad valorem taxes. Ownership of the improvements will revert to the City (Airport) at the expiration or termination of the lease.

SUBMITTED BY:

WILLIAM F.
FLANNERY
AVIATION
DIRECTOR

By letter dated September 3, 1999, the Federal Aviation Administration (FAA) was asked to review the proposed Lease Agreement. By letter dated September 28, 1999 (attached), the FAA has given partial approval of the Lease Agreement

On September 14, 1999, by Resolution No. A99-317, the Airport Board approved recommending to the City Council approval of the proposed land lease agreement with UPS.

Approval of this proposed lease with UPS is most important to both the City and the Des Moines International Airport. It should insure that UPS's 2nd Day Air Hub is retained at the Airport. (The presence of this hub at the Airport currently accounts for 180 jobs with an annual payroll of \$4,370,000 and fees to the Airport of over \$1,000,000 per year.) It will retain in the City the 1350 jobs (i.e. 650 full time equivalents) currently

provided by UPS and will position UPS to substantially increase their local employment. Lastly, it positions the City and the Airport to experience growth from existing companies and to attract new companies because of the availability and convenience of quality transportation services.

FISCAL IMPACT -

Rent during the initial term of the lease is based on the actual annual debt service cost for principal, interest, and invoice expenses for that portion of the Aviation System Revenue Bonds, Series 1998C, issued by the City to finance the costs associated with the acquisition, demolition and improvement of the leased premises (currently estimated to be between \$17,000 and \$21,000 per month).

Additionally, UPS will pay an amount equal to the debt service associated with Aviation System Revenue Bonds issued for capitalized interest and debt service reserve fund requirements for the portion of bonds used for the project (currently estimated to be approximately \$5,000 per month). Although a maximum and minimum rent is also specified, based on the known and estimated costs so far incurred by the Airport to provide the initial leased premises, the annual rental should be within the specified range at approximately \$250,000 per year.

Rental for any future option land is to be at Fair Market Value as established by appraisal. Rental on the initial leased premises during the option periods is to be 33 percent of Fair Market Value if UPS remains operating at the Airport as a Signatory Carrier. (During FY1998-99, as a Signatory Carrier, UPS paid \$1,166,000 in fees to the Airport for their use of existing Airport facilities.) During the option periods, if UPS gives up its Signatory Carrier status, they become obligated to pay 100 percent of Fair Market Value rental.

RECOMMENDATION -

Airport Board and City staff recommend approval of the proposed Lease Agreement and that existing Declaration of Covenants given in favor of the City be released to that property included within the proposed leased premises to clear up inconsistencies regarding tax abatement.

BACKGROUND -

On February 3, 1998, by Resolution No. A98-31, the Airport Board approved a Letter of Understanding (LOU) with UPS concerning a proposal for them to construct, on Airport property, a new package sort and distribution center and authorized the Aviation Director to proceed with the negotiation of a land lease consistent with the provisions of the LOU. On February 16, 1998, by Roll Call No. 98-471, the Des Moines City Council also approved the LOU.

The main features of the LOU included:

- The proposed development of a new UPS sort facility to allow consolidation of their Des Moines' Package Car Operation, Package Sorting Facilities, and Air Cargo Hub at the Airport site.
- The Airport was to assemble a site totaling 46 acres in size and located just south of the Airport's South Air Cargo Building and aircraft parking area currently used by UPS, for the proposed new development. (Traffic was to be rerouted to relocated Army Post Road in the summer of 1998 thereby permitting a portion of the existing Army Post Road right-of-way to become a part of the 46 acres.) The LOU provided for three phases with minimum total acreage in each phase. The estimated cost of acquiring the 16 additional parcels needed for Phase 1 and Phase 2 was \$2,650,000. Approximately 16 acres of land was already owned by the Airport in the area at the time the LOU was executed.
- The Airport was to provide associated infrastructure and utilities for the site including relocated Army Post Road, SW 28th Court connection to relocated Army Post Road, a traffic signal at SW 28th Court and relocated Army Post Road, water, telephone, and sanitary sewer.
- The Airport was to utilize Airport Revenue Bonds to pay for the cost of land acquisition and demolition, and agreed to utility installations associated with Phase 1 & 2 development.
- The City was to provide 10 year declining tax abatement.
- UPS was to lease the site for a 30 year base term with the right for two-10 year options. Rent was to equal the debt

service costs for the land acquisition and demolition for Phase 1&2, but in no event less than an estimated Fair Market Value of \$205,000 annually. (Phase 3 land was to be added to the leasehold at a later date under terms and conditions to be determined at that time.)

- UPS was to construct a 290,000 square foot facility, with ability for future expansion, at an estimated cost of \$33.6 million for the building and site improvements and \$7.8 million for machinery and equipment.

- Construction on the new facility, pending negotiation of an acceptable land lease, was to start in 1998 and be completed in 1999.

Unfortunately it has taken longer than anticipated to acquire all the land needed for Phase 1&2 of the project. Additionally, during the latter part of 1998, UPS was involved in a labor disagreement with their employees who are represented by the Teamsters Union. These factors altered the proposed timetable for the project as well as the size of the initial building and the amount of initial investment that UPS is now willing to commit to.

The following is a summary of some of the main provisions of the proposed lease. Provisions related to FAA and Airport regulations, maintenance and operations, insurance and indemnification, and general provisions are consistent with the provisions included in similar land lease agreements that have been previously approved by the Airport Board and City Council.

- The proposed lease has a term of thirty (30) years beginning on January 1, 2000, and expiring on December 31, 2029, with two additional option periods if exercised by UPS. The first option period is for a term of twelve (12) years and six (6) months. The second option period is for a term of ten (10) years.

- The initial leased premises is to be made up of 30.74 acres of land, including a portion of old Army Post Road, as shown in Exhibit A. (All the land needed for the initial leased premises, including the State's transfer of old Army Post Road, has now been acquired and the houses have been removed.) On or before July 1, 2005, the Airport is to offer for lease to UPS an additional fifteen (15) acres of land adjacent and contiguous

with the initial leased premises. The 15 acres will be in the area south of old Army Post Road, north of new Army Post Road, west of the runway protection zone for Runway 31R, and east of SW 30th Court.

- In addition to completing the necessary property acquisitions and associated demolitions for the initial leased premises, relocating Army Post Road, and adding a new connecting street at SW 28th Court, the City/Airport remain responsible for a traffic signal at SW 28th Court and relocated Army Post Road, and installation of water, telephone, and sanitary sewer to the site. (These additional improvements are estimated to cost \$335,600 and are to be paid from remaining airport revenue bond proceeds.) The City, at Airport expense, is currently providing and placing fill dirt on the leased premises. Within 60 days of approval of the lease and receipt of an invoice, UPS is obligated to reimburse the Airport \$515,000 for the placement of the fill dirt. The Airport remains obligated, through May 1, 2001, to provide UPS up to an additional 423,200 cubic yards of fill dirt, if necessary, to develop the leased premises.

- The lease calls for the construction of a parcel distribution center of at least 250,000 square feet with a construction cost of not less than \$12,000,000. The initial cost of equipment is estimated to be \$21,600,000. The new facility and all associated improvements, which are to be finished by January 1, 2003, will remain under the ownership of UPS throughout the lease term thereby requiring the payment of ad valorem taxes by UPS. The City is to provide a 10-year partial declining exemption from taxation on the facility and improvements.

- Construction of the project is to be in accordance with all federal, state, and local laws, regulations, ordinances, and codes. Ownership of all buildings and improvements constructed on the leased premises revert to the Airport at the expiration or termination of the lease. The lease contains provisions to protect the Airport for environmental matters with the provisions surviving the expiration or termination of the lease for a specified period.

- The Lease Agreement is subordinate to any requirements of our existing or future bond resolutions and is contingent upon the written approval of lease by FAA prior to approval and execution by the City.

· In the event of a Catastrophic Loss during the term of the lease, including the Option Periods, UPS will have the right to repair and replace the improvements, or to terminate the lease. In the event that UPS chooses to terminate the lease because of a Catastrophic Loss, they will be required to reimburse the City/Airport for any remaining outstanding Project Bonds (1998 Revenue Bonds used for project).

· In addition to the right to construct and expand the initial facility, UPS or any affiliated company is to be permitted, without written consent of the City/Airport, to sublease and/or develop up to 25 percent of the total square footage of the initial leased premises for any business which can be demonstrated to provide products for transport by UPS or any affiliated company or which pass through UPS's or any affiliated company's facilities on the Airport.

· The lease can be terminated by the City if UPS defaults on any of its Material Obligations, which include: (1) non payment of rent; (2) not constructing a new parcel distribution center of at least 250,000 square feet by January 1, 2003; (3) development, use of, or subleasing of the leasehold, or any portion thereof, in ways not permitted by the lease; and, (4) for not complying with the environmental provisions of the lease.