



DATE: October 12, 2016
TO: Board of Commissioners
FROM: Kimberly Branam, Executive Director
SUBJECT: Report Number 16-53

Authorizing the Execution of a Lease Amendment with Spar-Tek Industries, Inc. for the Portland Development Commission Property Located at 2221 N. Argyle Street within the Interstate Corridor Urban Renewal Area

BOARD ACTION REQUESTED

Adopt Resolution No. 7213

ACTION DESCRIPTION

This action by the Portland Development Commission (PDC) Board of Commissioners (Board) will authorize the execution of the Fourth Amendment to Lease Agreement (Lease Amendment) between PDC and Spar-Tek Industries, Inc. (Spar-Tek), for the PDC-owned real property located within the Interstate Corridor Urban Renewal Area (URA) located at 2221 N. Argyle Street (Property) (see Attachment A for the Project Summary, and Site Map). The leased premises contains approximately 5,000 square feet of office space, 30,000 square feet of manufacturing area, and 25,000 square feet of exterior surface vehicle parking and storage areas. Spar-Tek, which employs approximately 40 individuals, engineers and fabricates high-quality machinery with the cutting edge technology for many industries including plywood, laminated veneer lumber, and rubber. Their continued presence in the Kenton neighborhood complements PDC's 2015-2020 Strategic Plan goal of ensuring business vitality and opportunities for employers that offer middle-wage jobs.

The original lease (Original Lease) term with Spar-Tek, as previously amended, will terminate on November 30, 2016 and this Lease Amendment will extend the aggregate term beyond five years and thus requires PDC Board approval. If approved, execution of the Lease Amendment will extend the term of the Original Lease for an additional seven years.

BACKGROUND AND CONTEXT

On May 30, 2011, the PDC Board through Resolution No. 6872 authorized the acquisition of four real properties referred to as the Nelson Sites for a total purchase price of \$3,657,000. This assemblage of real properties totals 3.5 acres, sits at a strategic location at the North Gateway of the Historic Kenton Commercial District, is across from a MAX Station, and in close proximity to Kenton Park. Following is a brief description of each property:

1. **2221 N. Argyle Street, Portland, OR 97217.** A 59,485 square foot parcel with a 35,000 square foot single tenant and occupied industrial/warehouse building referred to as the **Spar-Tek Building**.

2. **8411 N. Denver Avenue, Portland OR 97217.** A 43,000 square foot parcel with a 27,593 square foot multi-tenant and occupied industrial/warehouse building referred to as the **Nelson Industrial Building**. This building is occupied by two tenants, Figureplant, a full service design and fabrication studio and Salvage Works, a company who salvages reclaimed vintage lumber for sale to the public and the making of furniture products.
3. **8419 N. Denver Avenue, Portland, OR 97217.** A 9,955 square foot parcel referred to as the **Nelson Retail Site**. This site is now the home of the Nelson Plaza, a community open space which includes a food cart pod.
4. **2221 W/ N Argyle Street, Portland, OR 97217.** A 43,287 square foot unimproved lot referred to as the **Argyle Street Lot**.

The original acquisition plans called for PDC to work in close coordination with TriMet, which in 2005 acquired a 2.2-acre lot located east of the Spar-Tek Building/Argyle Street Lot and north of the Nelson Industrial Building/Nelson Retail Site, to jointly master plan a future transit oriented development.

In 2012 PDC decided to re-tenant the Nelson Industrial Building:

- Because market conditions in 2012 could not support a mixed-use redevelopment.
- To not create a demolished site with an unknown redevelopment time-line.
- To look at the property as an opportunity to retain an industrial/warehouse building for a business incubator site and for job creation purposes.
- To create a use that was supported by the neighborhood stakeholders.

As a result of this decision, PDC was required to perform many repairs and improvements to address fire/life/safety/code issues along with structural upgrades and interior space improvements at a total cost of approximately \$1,650,000. Those improvements were completed in 2015.

In 2016, PDC decided to demolish the former coffee shop, complete the required environmental remediation, and convert the Nelson Retail Site into a Public Plaza to include a Food Cart Pod at a total cost of approximately \$500,000.

The lease agreements with the existing tenant in the Spar-Tek Building and the multi-tenants in the Nelson Industrial Building were assigned to PDC upon its acquisition of these properties and PDC assumed the position of the Lessor.

The Original Lease with Spar-Tek for the Spar-Tek Building commenced on December 01, 2005 and will expire on November 30, 2016 with no remaining options to extend the Lease term. The Lease is an absolute triple-net wherein Spar-Tek is responsible for all operating costs associated with the structure and land including real and personal property taxes, property insurance, all building maintenance, repairs, alterations and improvements. Since PDC's assumption of this Lease, Spar-Tek has always made their base rent and operating expense reimbursement payments on time and in the correct amounts. Staff has met with Spar-Tek to discuss the Lease extension and recommends the following terms:

1. To have the Lease term extended for an additional seven years commencing December 01, 2016 and expiring November 30, 2023.

2. To receive a Lease Renewal Incentive in the amount of \$100,000 and to be applied as a \$5,000 monthly credit against their base rent for the first 20 months of the Lease renewal term (from 12/2016 through 07/2018).
3. To receive a \$50,000 Advance Tenant Improvement Reimbursement Allowance Payment to be reimbursed back to PDC by Spar-Tek through equal monthly payments amortized over the seven year Lease Renewal term at an eight-percent per-annum interest rate. This equates to 84 monthly payments in the amount of \$779 and will provide PDC with a total repayment amount of \$65,436 earning a return on investment of \$15,436.
4. To maintain the current base rent schedule for the first two years of the Lease renewal term and thereafter annual adjustments based on the Consumer Price Index with a minimum adjustment no less than 2.5 percent and a maximum adjustment not to exceed five percent.
5. To provide Spar-Tek with the right to an early Lease termination by providing no less than six months advance written notice at any point after the fifty-fourth month of the Lease renewal term. In the event this option is exercised, Spar-Tek agrees to repay to PDC any remaining balance owed on the \$50,000 Advance Tenant Improvement Reimbursement Allowance Payment.

Spar-Tek has advised PDC that the cost savings from the \$100,000 Lease Renewal Incentive and the \$50,000 Advance Tenant Improvement Reimbursement Allowance will be utilized to relocate two large fabrication machines and miscellaneous equipment from a space they will be vacating in the Nelson Industrial Building and to invest in the growth and modernization of their business operations.

See Attachment B for a financial pro-forma based on the above proposal and estimated total net operating income to PDC in the amount \$847,148 over the length of the extended lease term.

On December 30, 2015, PDC in coordination with TriMet, commissioned an “Argyle Properties Development Study” prepared by Otak, Inc. for the Nelson and TriMet Sites with the goal to formulate possible development scenarios that are appropriate for the location and based on what the current market can support. The Spar-Tek Building Site was identified as Phase 4 of this study with an estimated future redevelopment time-line of 8-12 years out. The proposed seven (7) year Lease renewal extension term with Spar-Tek will terminate prior to the redevelopment time-line stated within the Development Study.

COMMUNITY AND PUBLIC BENEFIT

If approved, this action by the PDC Board will allow Spar-Tek to continue to operate and provide employment opportunities in the Kenton neighborhood of North Portland. Spar-Tek has indicated that by continuing to lease and improve the Property, they will be able to grow from 40 to 60 jobs.

PUBLIC PARTICIPATION AND FEEDBACK

There was no community outreach regarding this action.

BUDGET AND FINANCIAL INFORMATION

PDC will be disbursing funds in the amount of \$50,000 for the Advance Tenant Improvement Reimbursement Allowance from the Interstate Corridor URA Budget which will be amended in

November 2016 to incorporate this expense. The amended budget will also include decreased rent revenue projections. The previously projected property management expenses and revenue are shown in Fiscal Year 2016-17 Adopted Budget (see Attachment C).

RISK ASSESSMENT

If PDC and Spar-Tek are not able to agree to Lease renewal terms and/or if Spar-Tek elects to terminate the Lease and vacate the property then PDC's risks include the following:

- Revenue loss due to vacancy and holding costs during the term the property remains vacant.
- Securing a new tenant who is willing to accept a seven year or less lease term.
- Payment of leasing commissions if a new tenant is secured.
- Rental concessions given to a new tenant as part of the lease negotiations.
- Tenant improvement costs to build-out the property for a new tenant. It should be noted the current construction of the building is suited for Spar-Tek's business operations and unless a similar user is secured and accepts the building in an as-is condition then the tenant improvement costs could become significant.

ALTERNATIVE ACTIONS

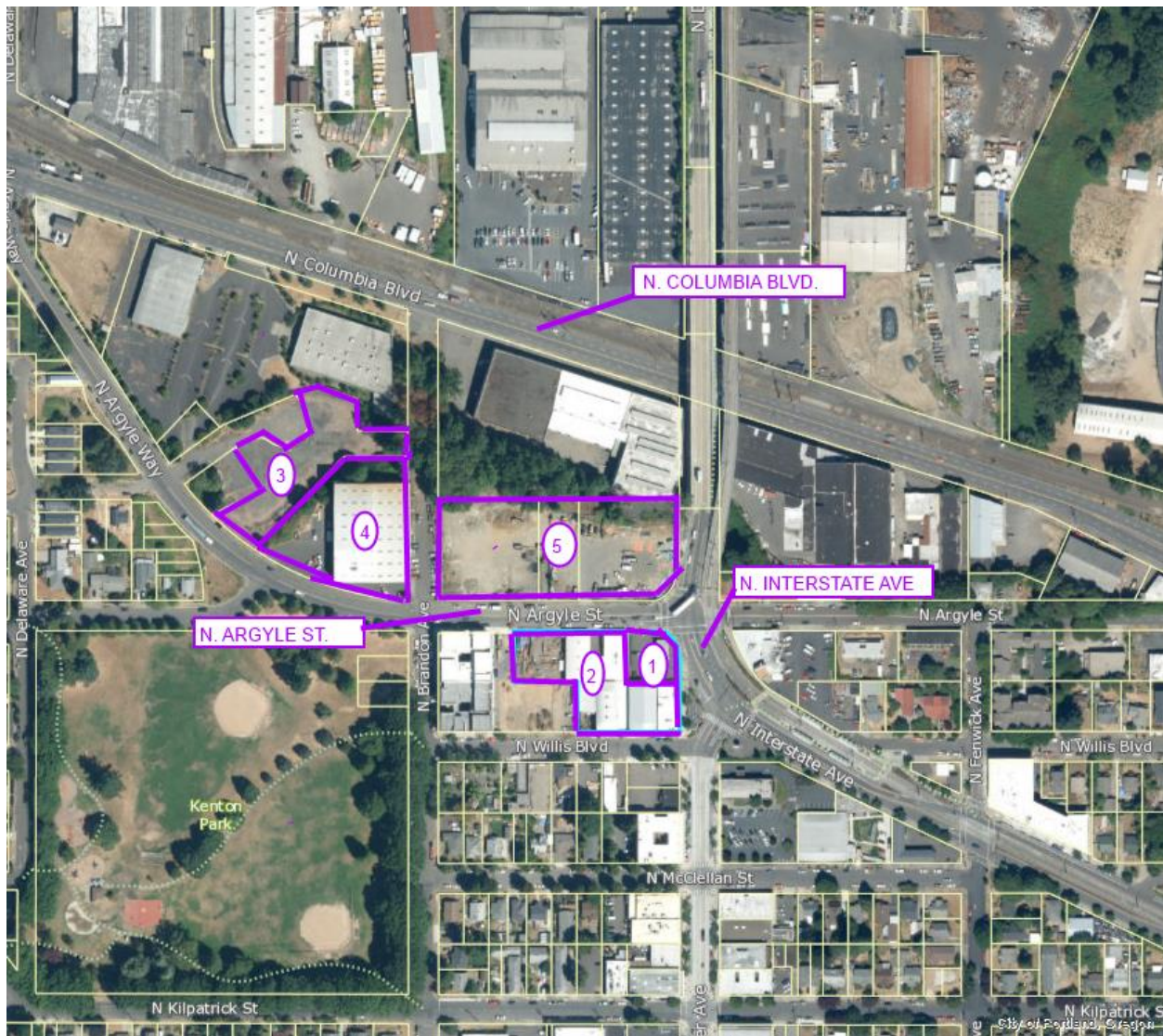
The PDC Board could elect to offer a Lease renewal incentive package to Spar-Tek of lower value or allow them to remain under a month-to-month tenancy under the current Lease terms and conditions and mutually agree to a Lease termination notice period.

ATTACHMENTS

- A. Project Summary and Aerial Map
- B. Financial Pro-Forma
- C. Interstate Corridor URA Financial Summary

PROJECT SUMMARY AND AERIAL MAP

Project Name: Spar-Tek Industries, Inc. Lease Amendment
Description & Location: 35,000 square foot building located on a 59,485 square foot parcel located at 2221 N. Argyle Street, Portland, OR 97217
URA: Interstate Corridor
Current Phase: Entering into Fourth Amendment to Lease Agreement with Spar-Tek Industries, Inc.
Next Milestone: Execution of Lease Amendment
Completion Target: November 2016
Outcome: To extend the Lease term for an additional seven years.



Site Legend: 1-Nelson Retail Site, 2-Nelson Industrial Building, 3-Argyle Street Lot, 4-Spar-Tek Building
5-TriMet Site

FINANCIAL PRO-FORMA

Lease Pro-Forma														
Property Name:	Spar-Tek Building													
Property Address:	2221 N. Argyle Street, Ptld, OR 97217													
Space to be Leased:	Entire Building consisting of approximately 5,000 square feet of office space and 30,000 square feet of warehouse/manufacturing space													
Date of Analysis:	09/2016													
	Lease Year	1	2	3	4	5	6	7						
Revenues														
Base Rent:	\$	124,800	\$	124,800	\$	128,500	\$	132,300	\$	136,300	\$	140,400	\$	144,612
TI Reimbursement Allowance:	\$	9,348	\$	9,348	\$	9,348	\$	9,348	\$	9,348	\$	9,348	\$	9,348
Total Revenues:	\$	134,148	\$	134,148	\$	137,848	\$	141,648	\$	145,648	\$	149,748	\$	153,960
Expenses														
PDC-Paid TI Reimbursement Allowance:	\$	50,000	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-
Abated Rent:	\$	60,000	\$	40,000	\$	-	\$	-	\$	-	\$	-	\$	-
Brokerage Fees:	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-
Property Management Costs:	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-
Utilities:	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-
Insurance:	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-
Assessments:	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-
Other Costs:														
Total Expenses:	\$	110,000	\$	40,000	\$	-	\$	-	\$	-	\$	-	\$	-
Annual Net Operating Income:	\$	24,148	\$	94,148	\$	137,848	\$	141,648	\$	145,648	\$	149,748	\$	153,960
Cumulative Cash Flows:	\$	24,148	\$	118,296	\$	256,144	\$	397,792	\$	543,440	\$	693,188	\$	847,148
Effective Annual Rent per SF for Initial Term:		.68		2.68		3.93		4.04		4.16		4.27		4.39
Assumptions:														
Lease type	Absolute Triple-Net wherein tenant pays for all operating costs including taxes, insurance, assessments, maintenance, alterations & repairs													
Square Feet	5,000 square feet of office space and 30,000 square feet of warehouse/manufacturing													
Annual Base Rent Escalator	CPI no less than 2.50% or greater than 5.00% commencing year 3 (3.00% used for above proforma)													
TI Reimbursement Allowance:	\$50,000.00. Disbursed in year 1. 84 monthly payments at \$779 per month													
Total Rent Credit	\$100,000 total rent concession to be applied as a rent credit of \$5,000 per month for lease months 1 to 20													
Year 1 Rent Credit	\$ 60,000													
Year 2 Rent credit	\$ 40,000													
Initial Term Broker Fee %	N/A													
Initial Term Broker Fee	N/A													
Extension Broker Fee %	N/A													
Extension Broker Fee	N/A													

INTERSTATE CORRIDOR URA FINANCIAL SUMMARY

**Financial Summary
 Five-Year Forecast**

<u>Interstate Corridor URA Fund</u>	<u>Revised FY 2015-16</u>	<u>Adopted FY 2016-17</u>	<u>Forecast FY 2017-18</u>	<u>Forecast FY 2018-19</u>	<u>Forecast FY 2019-20</u>	<u>Forecast FY 2020-21</u>
Resources						
Beginning Fund Balance	22,486,620	18,140,851	10,241,604	2,934,243	1,382,337	12,278,770
Revenue						
Fees and Charges	1,500	4,991	4,498	4,374	4,676	3,468
Interest on Investments	72,914	39,901	41,662	622	812	36,051
Loan Collections	664,611	167,137	309,606	284,737	345,199	103,557
TIF - Short Term Debt	18,981,000	18,981,000	18,958,972	18,665,851	18,981,000	18,981,000
TIF - Long Term Debt	0	-	9,000,000	2,200,000	-	28,954,146
Property Sales	415,000	502,160	-	-	-	-
Rent and Property Income	284,124	290,246	304,209	305,161	306,137	307,138
Reimbursements	63,529	71,526	84,644	85,277	85,930	86,602
Total Revenue	20,482,678	20,056,961	28,703,591	21,546,022	19,723,754	48,471,962
Total Resources	42,969,298	38,197,812	38,945,195	24,480,265	21,106,091	60,750,732
Requirements						
Administration						
A00030-Debt Management-ISC	34,133	22,532	22,532	22,532	22,532	22,532
Administration Total	34,133	22,532	22,532	22,532	22,532	22,532
Economic Development						
Traded Sector						
A00114-Business Development-ISC	5,000	5,000	5,000	5,000	5,000	5,000
A00381-Lean Manufacturing-ISC	50,000	50,000	50,000	50,000	50,000	50,000
Community Economic Development						
A00122-Community Development-ISC	51,000	25,000	25,000	25,000	25,000	25,000
A00106-NPI & Main St Network-ISC	65,000	50,000	50,000	50,000	50,000	50,000
Business Lending						
A00209-BL -General-ISC	8,652,000	650,200	650,200	650,200	650,200	200,200
Economic Development Total	8,823,000	780,200	780,200	780,200	780,200	330,200
Housing						
A00160-Home Repair Projects-ISC	500,000	-	-	-	-	-
A00162-Home Buyer Assistance-ISC	1,000,000	-	-	-	-	-
A00171-Affordable Housing-ISC	1,926,776	17,723,948	28,864,651	16,849,525	2,458,688	13,703,965
A00173-Beech St Apartments-ISC	182,893	-	-	-	-	-
A00181-PHB Staff & Admin-ISC	1,439,177	-	-	-	-	-
A00434-Grant Whse-ISC	510,000	-	-	-	-	-
Housing Total	5,558,846	17,723,948	28,864,651	16,849,525	2,458,688	13,703,965
Infrastructure						
Parks						
A00245-Bridgeton-ISC	0	1,500,000	-	-	-	-
A00247-Small Scale Improv-ISC	603,000	-	-	-	-	-
Transportation						
A00249-Killingsworth Stscape-ISC	2,450,000	500,000	-	-	-	-
A00250-Lombard Investment-ISC	500,000	759,830	1,000,000	-	-	-
Infrastructure Total	3,553,000	2,759,830	1,000,000	-	-	-
Property Redevelopment						
Real Estate						
A00335-Nelson Bldg-Indust-ISC	829,385	80,414	73,029	73,029	73,029	73,029
A00336-Spar-Tek Building-ISC	24,287	24,287	24,287	24,287	24,287	24,287
A00337-Argyle Lot-ISC	6,533	6,700	6,700	6,700	6,700	6,700
A00338-3620 NE MLK Prkng-ISC	15,240	10,066	10,066	10,066	10,066	10,066
A00339-C&M Motors Lot-ISC	12,224	-	-	-	-	-
A00340-Reiss House-ISC	7,392	7,692	-	-	-	-
A00342-Real Estate Mgmt-ISC	15,290	17,500	17,500	17,500	17,500	17,500
Commercial Property Lending						
A00366-CPRL-General-ISC	2,472,000	1,879,172	1,276,275	1,276,275	1,276,275	1,276,275
Redevelopment Strategy						
A00333-MLK Alberta-ISC	50,000	734,375	196,455	199,553	200,858	210,005
A00334-Kenton Redev Dtnw-ISC	88,592	-	-	-	-	-

**Financial Summary
 Five-Year Forecast**

<u>Interstate Corridor URA Fund</u>	<u>Revised FY 2015-16</u>	<u>Adopted FY 2016-17</u>	<u>Forecast FY 2017-18</u>	<u>Forecast FY 2018-19</u>	<u>Forecast FY 2019-20</u>	<u>Forecast FY 2020-21</u>
A00341-Project Development-ISC	5,000	20,000	20,000	20,000	20,000	20,000
Redevelopment Grants						
A00131-CLG-General-ISC	300,000	700,000	300,000	300,000	300,000	300,000
A00138-DOS-General-ISC	100,000	100,000	100,000	100,000	100,000	100,000
A00146-SIP-General-ISC	500,000	500,000	500,000	500,000	500,000	500,000
A00150-GFGP-General-ISC	100,000	100,000	100,000	100,000	100,000	100,000
Property Redevelopment Total	4,525,943	4,180,206	2,624,312	2,627,410	2,628,715	2,637,862
Total Program Expenditures	22,494,922	25,466,716	33,291,695	20,279,667	5,890,135	16,694,559
Personnel Services	491,371	413,544	435,236	444,821	460,877	470,556
Total Fund Expenditures	22,986,293	25,880,260	33,726,931	20,724,488	6,351,012	17,165,115
Interfund Transfers - Indirect Charges	1,842,154	2,075,948	2,284,021	2,373,440	2,476,309	2,547,970
Contingency	18,140,851	10,241,604	2,934,243	1,382,337	12,278,770	41,037,647
Total Fund Requirements	42,969,298	38,197,812	38,945,195	24,480,265	21,106,091	60,750,732