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- M E M O R A N D U M -

To: Ashley Mitchell, Deputy City Manager

From: Bill Dyer, Airport Real Estate Manager

CC: Joel Jenkinson, Airport Director

Date: June 19, 2020

Re: A Request for the Consideration and Consent of the Town of Addison for a Proposed Ground Lease with Mercury Air Center – Addison, Inc. d.b.a. Atlantic Aviation FBO at Addison Airport, Texas

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Requested Action:

Mercury Air Center – Addison, Inc., d.b.a. Atlantic Aviation, ("Mercury") is requesting the Town of Addison's consent to a proposed ground lease agreement (the "Ground Lease"), which includes 11.49 acres of airport land located in the vicinity of 4400 Glenn Curtiss Drive at Addison Airport. The premises subject to the lease are currently improved with seven building structures, totaling 108,509 building square feet (BSF) of aircraft hangar space and 32,514 BSF of office/shop space.

The proposed Ground Lease has a base term of seven years with three consecutive lease-term extension options (described in more detail below) providing an additional 23 years for a maximum lease term not to exceed the 40-year statutory limit.

Airport Management recommends the City Council give its consent to the proposed Ground Lease and authorize the City Manager to execute the Ground Lease and other related documents necessary to fully consummate the transaction as advised by the City Attorney. The City Attorney has reviewed the proposed Ground Lease and related documents and finds each acceptable to form for the City's purposes.

Background Information:

Mercury Air Center – Addison, Inc., d.b.a. Atlantic Aviation, is one of two operating fixed based operators (FBOs) currently licensed to sell fuel to the aviation public at Addison Airport.[1] Mercury's current leasehold consists of two ground leases and one commercial office/hangar lease agreement, each subject to a long-term term and are practically coterminous to one another (Mercury's "Primary Leasehold"). The three leases are due to expire between June 2021 and June 2022. Mercury's Primary Leasehold includes the land and buildings located at 4451, 4453, 4480, and 4400 Glenn Curtiss (within the red boundary drawn in the aerial below). The agreements originated between 1981 and 1996 by and between Town of Addison and Beech Holdings, Inc./Three River Gypsum, Inc and were assigned by Beech Holdings/Three River Gypsum to California-based Mercury Air Group, Inc. in 1996. In 2007, Macquarie FBO Holdings, a wholly owned subsidiary of Macquarie Infrastructure Company Trust (NYSE – MIC), acquired all the assets of Mercury Air Center Group (approximately 20 domestic FBOs) and merged the Mercury assets with Macquarie's existing FBO holdings that operate as Atlantic Aviation FBOs. Atlantic Aviation currently operates 70 FBO locations nationwide, including the Mercury Air Group facilities.

Figure 1 Mercury's Primary Leasehold outlined in red. The city-owned hangars, subject to short-term leases, are outlined in yellow.

In addition to the above-described Primary Leasehold, Mercury also commercially leases three city-owned aeronautical facilities located at 4540, 4352, and 4530 Glenn Curtiss subject to one-year lease terms at prevailing market rental rates ranging between $6.00 to $7.06 per building square foot.

[1] Million Air Dallas is the second operating FBO. Galaxy FBO is currently under construction and is expected to begin operations mid-calendar year 2021.

In total, Mercury currently leases 11.49 acres of airport land improved with 108,000 BSF of office and aircraft hangar improvements. Mercury currently pays $664,000 in annual rental to the Airport in 12 monthly installments of $55,300, subject to periodic adjustments tied to changes in the consumer price indices.

As of 6/1/2020

	Primary Leasehold			Short-term Leasehold			
Lease #/Ramp Address	**0440-Combo (A8-A9)**	**0400-21 (T-7)**	**0430-24 (A-7)**	**#0390-11 (T5)**	**#0410 (T1)**	**#0420-30 (T3)**	**Total**
Street Address	4451 & 4453 Glenn Curtiss Dr.	4480 Glenn Curtiss Dr.	4400 Glenn Curtiss Dr.	4540 Glenn Curtiss Dr.	4352 Glenn Curtiss Dr.	4530 Glenn Curtiss Dr.	
Land Area	279,519	28,358	124,873	25,244	28,937	13,573	500,504
Hangar Area	47,742	13,736	26,000	6,600	10,335	4,096	108,509
Office Shop	10,204	-	22,310	-	-	-	32,514
Total Building Area	57,946	13,736	48,310	6,600	10,335	4,096	141,023
Year Built	1964/1988	1980	1985	1979	1979	1979	
Dedicated Ramp (approx.)	123,720	8,748	52,200	4,500	12,132	4,600	205,900
Lease Type	Ground Lease	Ground Lease	Commercial	Commercial	Commercial	Commercial	
Lease Commenced	7/1/1982	6/30/1981	4/1/1996	9/19/2016	5/6/2019	9/9/2019	
Lease Expiration	6/30/2022	6/30/2021	9/30/2021	9/30/2020	2/28/2021	2/28/2021	
Years Remaining	2.08	1.08	1.33	0.33	0.74	0.74	
Currently Monthly Rent	$6,597	$1,045	$36,333	$3,885	$5,160	$2,314	$55,334
Current Annual Rent	$79,167	$12,543	$435,994	$46,620	$61,920	$27,767	$664,010
Annual Rent/BSF	$1.37	$0.91	$9.02	$7.06	$5.99	$6.78	$4.71
Annual Rent/SFL	$0.28	$0.44	$3.49	$1.85	$2.14	$2.05	$1.33

Note: all areas and dimensions are estimated and subject to verification by the user.

Summary of Proposed Ground Lease Terms:

Mercury approached airport management staff with its proposal to early terminate each of the above-described lease agreements in favor of a new single 40-year term ground lease. The initial lease term (or "Base Year Term") would be seven years. Mercury has the option to extend the lease term as follows:

Extension Term #1 – Provided Mercury completes,[2] within the first four years of the lease term, the demolition of the hangar located at 4451 Glenn Curtiss and constructs a new executive hangar in the same location to be larger and with a 28' hangar door clearance with a minimum capital investment of $6 million, the Based Lease Term would be extended an additional 13 years or until 2040[3].

Extension Term #2 – Provided Mercury also completes, within the first seven years of the lease term, the renovation of their main terminal building located at 4400 Glenn Curtiss and

[2] "Complete" is defined in the lease agreement as substantial completion or upon the issuance of a certificate of occupancy. Therefore, the improvements must be started and substantially completed prior to the stipulated deadline.

[3] The Base Term and the extension dates are assuming an 8/1/2020 lease commencement date.

reconstructs 203,000 square feet of aircraft apron with a minimum capital investment of $5.5 million, the already-modified Lease Term would be extended an additional 15-years or until 2055.

Extension Term #3 – Provided Mercury completes, within the first 13 years of the lease term, the renovation of the hangar at 4453 Glenn Curtiss and construct off-street parking improvements where the hangars at 4532 and 4530 now stand with a minimum capital investment of $2.5 million, the modified Lease Term would be extended an additional five years or until 2060.

In total, Mercury may extend their initial seven-year lease term an additional 33 years on the condition it expends $14 million in new capital investment in its existing facilities within the first 13 years of the lease term. Mercury may complete the phased improvements any time before the prescribed completion date. Should Mercury fail to complete the improvements as required, including the stipulated minimum capital investment, Mercury shall forego the extension and all subsequent extension options.

Other Terms and Conditions: The other terms and conditions of the Ground Lease are generally consistent with the Town's prevailing ground lease terms including Addendum #1: "*Tenant's Leasehold Minimum Maintenance and Repair Standards and Practices"* adopted by the Town in 2018.

Other salient terms and condition of the proposed ground lease include:

1. **Effective Date**: The date the ground lease agreement is executed by the Town.
2. **Commencement Date**: The first day of the calendar month following the Effective Date.
3. **Expiration Date**: Base Term is seven years from the Commencement Date or until 2027, subject to three extension options outlined above.
4. **Demised Premises**: 11.49 acres as described in Exhibit 3 – Property Survey prepared by Sparr Surveys dated March 19, 2020.
5. **Title to Building Improvements**: Mercury will hold title to all building improvements made to the Demised Premises throughout the Term.
6. **Base Rental**: The annual ground rental is $1.23 per square foot of gross land area within the Demised Premises or $615,620 (500,504 SFL x $1.23), due payable in 12 equal monthly installments of $51,302 with the first installment due on or before the Commencement Date and then the first day of each calendar month thereafter.
7. **Adjustment of Rent**: The Base Rent is subject to biennial adjustments (every two years) based upon the percentage change in the Consumers' Price Index as defined in the ground lease.
8. **Use of the Demised Premises**: for Fixed Base Operations ("FBO") including but not limited to the sale of aircraft goods and services to the public, including without limitation, providing storage of transient aircraft in aircraft hangars and on the adjacent ramp area, and the dispensing of aviation fuel in accordance with and subject to the ordinances and regulations issued by the Town of Addison from time to time and/or the

Airport Governing Documents.

9. **Capital Repairs & Improvements**: All capital repairs and improvements shall be approved in advance and in writing by the City and shall be performed in a first-class manner in accordance with all applicable local, state, and federal building codes, ordinances, and regulations.

10. **Termination of Existing Leases**: The proposed Ground Lease is subject to and on the condition the Parties each enter into and make effective simultaneously, and without interruption, the early termination of the Mercury Primary Leaseholds located at 4400, 4451, and 4453 Glenn Curtiss. A fully executed Memorandum of Lease Agreement will be publicly recorded for each evidencing the early terminations and the new Ground Lease taking effect in their place. Each of the short-term leases affecting the three city-owned properties will be early-terminated by written notice as provided for in each lease agreement.

The following matrix is a summary of the entire Mercury leasehold interests subject to the proposed Ground Lease.

Mercury Air Center – Addison, Inc. Proposed Consolidated Leasehold Subject to Ground Lease

Lease #/ Ramp Address	#0440-Combo (A8-	#0400-21 (T-7)	#0430-24 (A-7)	#0390-11 (T5)	#0410 (T1)	#0420-30 (T3)	Total
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Year Built	1964/1988	1980	1985	1979	1979	1979	
Dedicated Ramp (approx.)	123,720	8,748	52,200	4,500	12,132	4,600	205,900
Lease Type	G. Lease	G. Lease	G. Lease	G. Lease	G. Lease	G. Lease	
Lease Commenced	8/1/2020	8/1/2020	8/1/2020	8/1/2020	8/1/2020	8/1/2020	
Lease Expiration	7/31/2060	7/31/2060	7/31/2060	7/31/2060	7/31/2060	7/31/2060	
Years Remaining	40	40	40	40	40	40	
Base Monthly Rent ($1.230/SFL)	$28,651	$2,907	$12,799	$2,588	$2,966	$1,391	$51,302
Base Annual Rent	$343,808	$34,880	$153,594	$31,050	$35,593	$16,695	$615,620
Annual Base Rent/SFL	$1.23	$1.23	$1.23	$1.23	$1.23	$1.23	$1.230
Note: all areas and deminsions are estimated and subject to verification by the user.							

Economic Impact and Justification of Proposal:

The Mercury Ground Lease proposal meets or exceeds the targeted highest and best use for the subject properties as identified in the 2016 Airport Master Plan, which contemplates the redevelopment of the Taxiway Tango Neighborhood. The Airport Master Plan assumes the airport would continue to gain control of all properties within the "neighborhood" (as the existing ground leases expire) and commercially lease them subject to market rents until 2025-2026, at which time many of the hangars would be demolished and cleared from the airport to make room for a major redevelopment initiative. A major component of the Taxiway Tango redevelopment would be the reconstruction and realignment of Taxiway Tango to parallel more closely with the existing Addison Airport Tollway easement to the south and Glenn Curtiss Drive would be widened and improved to city standards. The airport land fronting Taxiway Tango would then be made available for third-party redevelopment subject to new long-term ground leases requiring legal off-street parking, dedicated aircraft apron constructed to airport standards, and fewer but larger office/hangar facilities suitable for aircraft maintenance, cargo, and aeronautical charter operations.

A cashflow model was developed for each of the six parcels included in the Mercury Ground Lease proposal based upon the Airport Master Plan's Taxiway Tango Neighborhood scenario. Various assumptions and conditions believed to be reasonable were used in developing these variable cashflow streams over a 40-year holding period, being the same duration as the proposed Mercury Ground Lease, should all extension options be exercised. These assumptions included but are not limited to (i) projected ground rental and commercial lease rates subject to periodic cost-of-living escalations; (ii) building size and use; (iii) remaining economic life; (iv) projected capital repair and improvement costs; (v) demolition costs, and (vi) the sale price of the certain city-owned building improvements subject to a new long-term ground lease. Once completed, each cashflow's net present value (NPV)[4] was calculated using a 9% discount rate[5]. The NPV for each parcel was added to the others for a combined NPV for the entire leasehold.

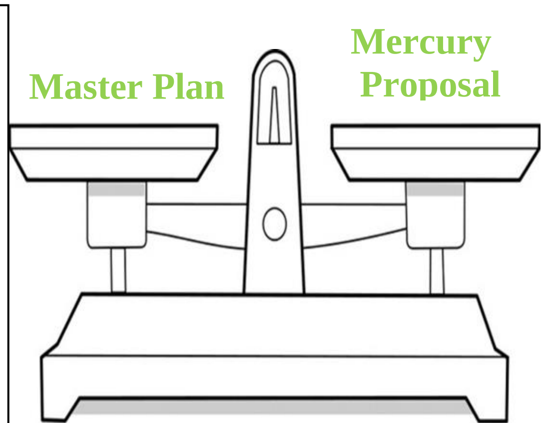
A second set of cashflow models were developed for each of the same parcels reflecting the Mercury proposal using the same market ground rental for the 11.49 acres as assumed in the Airport Master Plan scenarios. Additionally, it is recognized that if Mercury is taking title and ownership of the building improvements under the Ground Lease, then Mercury must compensate the City for its "reversion value" the City would otherwise be entitled to under the Airport Master Plan scenario. In rather simplistic terms, the reversion value would be that value or values needed to cause the Mercury Proposal cashflow NPV to equal the combined Airport Master Plan NPV in excess of market ground rent.

[4] Net Present Value (NPV) is a financial analytical technique used to discount all anticipated future (variable) cashflows back to their present value, or what they would be worth today given the time-value of money. This technique allows for the comparison of the outcome of multiple investment alternatives.

[5] A fixed interest rate used to calculate a future cashflow stream's present value. For the purpose here a 9% rate was assumed using the weighted average of debt to equity: 60% @ 4.5% cost of debt and 40% ROE of 16% (2.7%+6.3%=9.0%).

Mkt. Ground Rent
+ Commercial Rent
+ Remaining Economic Life
- Project Cash Outlays
+ Projected Sale Proceeds

Net Present Value



Mkt. Ground Rent
+ Reversion Value

Net Present Value

Figure 2: Solving so the two Alternatives Equal

The above analysis resulted in a beginning ground lease rate of $.725 plus a reversionary interest payable to the City in an amount equal to $3,758,197. So that the reversionary component does not take away from Mercury's available capital to put towards the building improvements, Mercury requested the reversionary component be amortized over the lease term at a 9% interest per annum payable in monthly installments as additional rent. This resulted in a blended annual ground lease rate of $1.23 per square foot, or $615,619 in annual rent beginning with YR-1, subject to biennial adjustments tied to the percentage of change in the Consumers Price Index as provided for in the Ground Lease.

For the 40-year lease term, the total projected cash flow is $32,404,420 resulting in an NPV of $7,512,687 in today's dollars. Including the value of the proposed capital improvements of $14 million, the total Mercury Proposal is valued at $21.5 million.

Another economic consideration and benefit for the City is the conversion of the city-owned hangars to private ownership that will allow the building improvements to be eligible for ad valorem taxes, thus contributing to the City's tax base.

As proposed, the Mercury Ground Lease proposal represents a significant and stable long-term source of revenue for the Airport for many years to come. Assuming Mercury completes the $14 million in capital repairs and improvements, it will have also contributed to the further enhancement and quality of aeronautical facilities at Addison Airport, a major objective of the 2013 Strategic Plan and 2016 Airport Master Plan.

Conclusion and Recommendation:

The proposed Mercury Ground Lease represents to the City and Airport a significant contribution to the long-term growth and success of Addison Airport. The Mercury Proposal:

- Is consistent with 2013 Strategic Plan and 2016 Airport Master Plan.
- Allows the Airport the opportunity to retain Atlantic Aviation, the largest FBO in country, as a major tenant at Addison Airport for many years to come.
- Shifts a significant amount of capital and market risk from the Airport to Mercury.

- Provides for the amortizing of the value of the City's reversion interests over the lease term, which provides a substantial increase in Airport revenue over the lease term.
- Significantly improves the quality of the aeronautical facilities at the Airport with private capital.
- Allows Mercury to remain competitive with the other FBOs at the Airport.
- Increases the City's tax base by converting exempted, city-owned assets to taxable assets.
- Represents exceptional value and opportunity for the Town and Addison Airport.

Based upon the foregoing, Airport Management and Town Staff strongly encourage the City Council to accept the Mercury Ground Lease as proposed and authorize the City Manager to execute the Ground Lease and other related documents necessary for the transaction. The City Attorney has reviewed the Ground Lease and other related agreements and finds them acceptable for the Town's purposes.