



MEMORANDUM

November 10, 2020

TO: AIRPORT COMMISSION
Hon. Larry Mazzola, President
Hon. Eleanor Johns, Vice President
Hon. Richard J. Guggenlime
Hon. Everett A. Hewlett, Jr.
Hon. Malcolm Yeung

20-0207

NOV 10 2020

FROM: Airport Director

SUBJECT: Approval of Amendment No. 2 to the Terminal 3 Common Use Club Lease No. 13-0006 with American Express Travel Related Services Company, Inc.

DIRECTOR’S RECOMMENDATION: (1) APPROVE AMENDMENT NO. 2 TO THE TERMINAL 3 COMMON USE CLUB LEASE NO. 13-0006 WITH AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC., AND (2) DIRECT THE COMMISSION SECRETARY TO REQUEST APPROVAL BY THE BOARD OF SUPERVISORS.

Executive Summary

American Express Travel Related Services Company, Inc. (Tenant) operates its Centurion Lounge (Lounge) in the post-security mezzanine level of Terminal 3 (T3 West). Since opening in November 2014, the Lounge has been very well received, but suffered from a severe shortage of space. Before the pandemic, guests were being turned away during normal operations because the Lounge was full.

To address this deficiency, improve the guest experience and increase revenue to the Airport, Staff recommends approval of Amendment No. 2 to the Lease (Amendment). The Amendment will (1) expand the premises into an adjacent, otherwise unmarketable space (Expansion Premises), (2) extend the term of the Lease by seven years, and (3) adjust the rent and promotional charge for the Expansion Premises. Upon Airport Commission approval, Staff will seek Board of Supervisors’ approval of Amendment No. 2 under Section 9.118 of the Charter of the City and County of San Francisco.

Background

On January 15, 2013, by Resolution No. 13-0006, the Commission awarded the Terminal 3 Common Use Club Lease (Lease) to Tenant, with a base operating term of 10 years that expires on November 5, 2024. Tenant operates the location branded as a “Centurion Lounge,” which is a premium line of lounges operated by Tenant at other large hub airports across the United States

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and in select international locations. The Lounge is located in T3 West (as depicted on Attachment 1 to this Memorandum), the site of a capital improvement project (T3 West Project) that is presently suspended but likely to proceed before the Lease expires.

On October 6, 2020, by Resolution No. 20-0180, the Commission adopted the COVID-19 Emergency Rent Relief Program for Airport Concession Tenants, which included the Lounge and will be memorialized in Amendment No. 1 to the Lease. With the rapid decline of enplanements as a result of a global pandemic, the COVID-19 Emergency Rent Relief Program for Airport Concession Tenants authorized the waiver of certain rent and fees to encourage business recovery, employee rehiring, and continued operation of concessions at SFO.

The Lounge has proven to be very successful and popular with travelers since commencing operations in 2014, and the Airport is satisfied with Tenant as an operator. Although it is a membership lounge for premium American Express cardholders, the Lounge has had to turn away members and their guests when it is at maximum capacity, which occurs with frequency during peak travel times. Airport staff and Tenant have studied the operation of the Lounge in the last year and have determined that there is a severe shortage of space. In order to address this deficiency, improve the guest experience, and increase revenue to the Airport, Staff has been considering expansion options for the Lounge. The Lounge was closed from March 20 to October 11 of 2020 due to the COVID-19 pandemic and dramatically lower enplanement activity. However, the Lounge is now open, and both Airport and Tenant expect demand to return and there to be an increased sensitivity to crowding due to public health issues emphasized by the pandemic.

Staff has identified pre-security space adjacent to the Lounge currently used as offices for aviation support service providers and a couple of smaller concession operators under permits, all terminable upon 30 days' notice. Areas in and around this adjacent space will likely be impacted by the construction scheduled to take place in connection with the T3 West Project (although that project schedule is itself subject to change due to the impact of the COVID-19 pandemic on capital projects at SFO). Due to the current pre-security location of the ingress and egress of the adjacent space and the necessity to maintain adequate flexibility in accommodating construction in the areas around the space arising from the T3 West Project, the space is not currently marketable as a stand-alone concession space.

The adjacent space, however, is suitable for an expansion space for the Lounge. The Expansion Premises totals approximately 7,088 square feet. Adding the Expansion Premises to the Lounge will both remedy the guest experience problem caused by the acute shortage of space and allow the Airport to generate additional revenue from space that would otherwise lie dormant or generate minimal revenue given the T3 West Project construction activities. Tenant has indicated its willingness to expand into the Expansion Premises and assume all construction costs for such expansion, which are substantial. In order for Tenant to fully amortize such costs, Staff recommends extending the Lease through November 5, 2031.

This expansion will require an amendment to the Lease, which will provide for:

- (i) the addition of approximately 7,088 square feet;
- (ii) the extension of the current Lease term by seven years to allow for an appropriate capital investment amortization period; and

- (iii) an adjustment of the rent and promotional charge to reflect the Expansion Premises, all as further set forth below.

Given the significant time that the Expansion Premises would otherwise be unused or underused as a result of its pre-security location and the construction activities in and around the area contemplated by the T3 West Project, and the opportunity presented to have the space improved at no cost to the Airport and rented well in advance of the current expiration date of the Lease in November 2024, Staff believes entering into this transaction, including the extension of the Lease, is in the best interest of the City and the Airport. In addition, although the expansion of the Lounge was under discussion between the parties prior to the outbreak of the COVID-19 pandemic, Staff believes this transaction is even more beneficial to the City and the Airport at this time, given the anticipated lack of demand for concession space that is expected to persist for the next three to four years due to the pandemic, which is beyond the timeframe during which a replacement tenant for the lounge premises would otherwise need to be procured.

Proposal

Staff recommends entering into the Amendment, in accordance with the following terms and conditions:

1. **Premises** – The Lounge will increase from approximately 8,199 square feet (Existing Premises) to approximately 15,287 square feet (Revised Premises) by capturing the Expansion Premises.
2. **Base Rent and Annual Rent Adjustments**
 - a. Existing Premises – Until the Expansion Premises Rent Commencement Date (as defined below), the Base Rent for the Existing Premises will continue to be charged at \$255.21 per square foot per annum, as previously set according to Category II - VIP and Club Lounge Terminal Area Rental Rates of the current Lease and Use Agreement.
 - b. Expansion Premises – Base Rent for the Expansion Premises will be based upon a rate of \$160 per square foot per annum and will commence upon the earlier to occur of (i) 365 days from the delivery of the Expansion Premises to Tenant with all permits and approvals for construction in place for buildout; and (ii) the date upon which the Expansion Premises is open for business (Expansion Premises Rent Commencement Date). This lower per square foot rental rate was negotiated with the Tenant based upon the location of the Expansion Premises, the significant construction costs to be incurred by Tenant in reconfiguring and incorporating the Expansion Premises from a pre-security mezzanine level space into a natural extension of the post-security Existing Premises (which will not change), and the requisite build-out of lounge fixtures and improvements for the Expansion Premises.
 - c. The combined base rents for the Existing Premises and the Expansion Premises will be reflected in the Amendment as the Minimum Annual Guarantee (MAG) and, upon the Expansion Premises Rent Commencement Date, will initially be set in the aggregate amount of \$3,226,546 for the entire Revised Premises.
 - d. The MAG will be subject to annual increases based on a local Consumer Price Index. In no event will the adjustment be lower than the previous year's MAG.

3. Promotional Charge – The annual Promotional Charge will increase from \$8,199 to \$15,287 to reflect the increase in square footage.
4. Term – In order to allow for an appropriate capital investment amortization period by Tenant for its expansion and buildout costs, the Term will be extended by seven years, for a new expiration date of November 5, 2031.

Additionally, given the complexities of the buildout of the Expansion Premises and the potential impacts of the T3 West Project, Staff recommends that the Airport Director be given authority to enter into any further modifications to the Lease that the Airport Director determines are in the best interests of the City and County of San Francisco and that do not materially increase the obligations or liabilities of the City. Such modifications shall only be made when necessary or advisable to effectuate the purposes of the Lease and the Amendment, and are in compliance with all applicable laws, including the Charter of the City and County of San Francisco.

Recommendation

I recommend the Commission adopt the accompanying Resolution approving Amendment No. 2 to the Terminal 3 Common Use Club Lease No. 13-0006 with American Express Travel Related Services Company, Inc., which (1) increases the Lounge premises to approximately 15,287 square feet; (2) establishes a MAG of \$3,226,546 for the revised premises; (3) increases the annual Promotional Charge to \$15,287 in proportion to the net increase in square footage of the premises, and (4) extends the term of the Lease by seven years, through November 5, 2031. I also recommend forwarding Amendment No. 2 to the Board of Supervisors for approval pursuant to Section 9.118 of the Charter of the City and County of San Francisco.



Ivar C. Satero
Airport Director

Prepared by: Kevin Bumen
Chief Commercial Officer

Attachments

Attachment 1

Terminal 3 Common Use Club Lease

Terminal 3 Common Use Club Lease No. 13-0006 - American Express Centurion Lounge

