

AIRPORT COMMISSION

CITY AND COUNTY OF SAN FRANCISCO

RESOLUTION NO. 24-0222

**AUTHORIZATION OF AIRPORT DIRECTOR TO IMPLEMENT THE SPECIALTY
RETAIL MINIMUM ANNUAL GUARANTEE RENT REDUCTION PROGRAM**

WHEREAS, there are 17 Specialty Retail leases at the Airport and Base Rent on an annual basis is the greater of a tiered percentage of gross sales or a Minimum Annual Guarantee (MAG); and

WHEREAS, the MAG is adjusted annually based on a Consumer Price Index (CPI) resulting in continual increase in rent; and

WHEREAS, as a category of concessions leases, the Specialty Retail leases currently have an abnormally high rent as a percentage of sales brought about by a significant drop in per passenger spending, 17% when compared to pre-pandemic activity, and annual MAG growth of approximately 2%; and

WHEREAS, 12 of 16 Specialty Retail leases feature MAGs that are substantially higher than what is considered market rent; and

WHEREAS, one Specialty Retail lease, Lease No. 23-0250 with Chalo, LLC doing business as Chalo, is still under construction; and

WHEREAS, it is the best interest for the Airport to preserve these business deals, maintain service for the traveling public, and support local employment by taking measures to ensure the lease are financially viable; and

WHEREAS, Staff recommends enacting the Specialty Retail Minimum Annual Guarantee Rent Reduction Program to normalize the MAG payments due under these leases; and

WHEREAS, the Specialty Retail Minimum Annual Guarantee Rent Reduction Program consists of: (1) for those Specialty Retail leases with a Rent Commencement Date prior to January 1, 2023, a one-time reset of the Minimum Annual Guarantee commencing with calendar year 2025 to the lesser of the existing MAG or 16% of gross sales during calendar year 2023; (2) for the Specialty Retail Lease, Lease No. 23-0250 with Chalo, LLC, a one-time reset of the MAG for calendar year 2026 equal to the lesser of MAG for calendar year 2025 or 16% of gross sales during calendar year 2025, and (3) beginning with the next MAG adjustment date for each such lease in the program, change the method for adjusting the MAG from an annual CPI adjustment to the more common practice in the industry of MAG being adjusted to the greater of existing MAG or 85% of prior year's Base Rent; now, therefore, be it

MEMORANDUM

October 15, 2024

TO: AIRPORT COMMISSION
Hon. Malcolm Yeung, President
Hon. Everett A. Hewlett, Jr., Vice President
Hon. Jane Natoli
Hon. Jose F. Almanza
Hon. Mark Buell

24-0222

OCT 15 2024

FROM: Airport Director

SUBJECT: Specialty Retail Minimum Annual Guarantee Rent Reduction Program

DIRECTOR'S RECOMMENDATION: AUTHORIZE THE AIRPORT DIRECTOR TO IMPLEMENT THE SPECIALTY RETAIL MINIMUM ANNUAL GUARANTEE RENT REDUCTION PROGRAM AND ENTER INTO AMENDMENTS OF CONCESSION AGREEMENTS LOWERING THE MINIMUM ANNUAL GUARANTEES FOR 17 SPECIALTY RETAIL LEASES, AND DIRECT THE COMMISSION SECRETARY TO OBTAIN APPROVAL FROM THE BOARD OF SUPERVISORS FOR ANY LEASE AMENDMENTS AS REQUIRED UNDER SECTION 9.118 OF THE CHARTER OF THE CITY AND COUNTY OF SAN FRANCISCO.

Executive Summary

Staff recommends that the Airport Commission (Commission) authorize the Airport Director to implement the Specialty Retail Minimum Annual Guarantee Rent Reduction Program which will adjust the Minimum Annual Guarantees and the Minimum Annual Guarantee (MAG) adjustment methodology for Specialty Retail tenants, commencing with calendar year 2025. This program will ensure market rent is in place, helping to ensure the financial viability of the leases with the goal of preserving this vital category of tenants which are more vulnerable to passenger spending fluctuations than other categories of tenants at the Airport.

Background

The Airport currently has 17 leases in its Specialty Retail Program. Sixteen of those leases commenced operations between 2015 and 2022. One Specialty Retail lease, Lease No. 23-0250 with Chalo, LLC as tenant, doing business as Chalo, is still in its construction period and is therefore recommended to be treated differently than the others, as described below.

The Specialty Retail category covers single category locations such as confections and electronics, as well as gift merchandise. Newsstands and Duty Free are the backbone of the Airport's overall retail program. When food and beverage is considered, the

THIS PRINT COVERS CALENDAR ITEM NO. 3

Specialty Retail Program earns just 4% of concessions sales. Passenger surveys and sales data indicate food and beverage is the most sought after product at the Airport, followed by merchandise at newsstands. Duty Free merchandise is purchased by approximately 10% of the Airport's guests departing to international destinations. While dwarfed by other concessions categories, the Specialty Retail Program adds zest to the Airport's commercial offering. Confections and electronics merchandise are expected by our guests. Gift stores and single category specialty locations can feature merchandise that showcase the region, add authenticity and interest, and include opportunities for artisans and small and local businesses. A great concessions program also necessarily includes national and international non-luxury brands, which we classify as Specialty Retail.

Passenger spending growth, long an ordinary occurrence, has stalled at SFO and is similarly reported at other domestic airports. Specialty Retail spending is 17% less this year compared to pre-pandemic spending and is 9% less for fiscal year 2024 compared to fiscal year 2023. Base Rent under these concession leases on an annual basis is the greater of a tiered percentage of gross sales or a MAG. Among the Specialty Retail tenants operating during the 12 months of fiscal year 2024, 12 of the 16 leases had MAGs in excess of 23% of gross sales. These business deals were planned with rent being in the range of 13.5% to 14.6% of gross sales. Six of the Specialty Retail tenants are behind on rent, are on a payment plan, have requested a rent reduction, or have inquired about an early termination. Re-leasing these locations could be challenging and would likely produce less rent. It is of benefit to the Airport, our business partners and guests, and local employment to maintain these retail locations.

Staff desires to offer all Specialty Retail tenants a one-time MAG reset and, going forward, a new methodology for annual MAG adjustments. Currently, MAG grows by a Consumer Price Index (CPI). This longstanding practice for rent adjustments is resulting in MAG growth of approximately 2% per year. Coupled with a declining market, the tenant's profit and loss position is adversely affected. Tenants in difficult financial positions sometimes lessen staffing, let product dwindle, and fall behind on rent, or seek to leave before lease expiration. The Airport wants to preserve a robust and interesting product offering for its guests and a viable business landscape for its tenants, a significant number of which are locally owned or owned by Airport Concession Disadvantaged Business Enterprises (ACDBE) or both.

For Specialty Retail Program Concessions, Staff is recommending the following as the components of the Specialty Retail Minimum Annual Guarantee Rent Reduction Program: (1) for leases with rent commencement dates prior to January 1, 2023, establish the MAG for calendar year 2025 as the lesser of existing MAG or 16% of gross sales for calendar year 2023, (2) for the Specialty Retail Lease, Lease No. 23-0250 with Chalo, LLC only, the one-time MAG adjustment will be based upon the tenant's gross sales for calendar year 2025 and will be effective January 1, 2026, and (3) beginning with the next MAG adjustment date for each lease, change the method for adjusting the MAG from an annual CPI adjustment to the more common practice in the industry of MAG being adjusted each new lease year to the greater of existing MAG or 85% of prior year's Base Rent.

Attachment A lists the 17 Specialty Retail leases for which inclusion in the Specialty Retail Minimum Annual Guarantee Rent Reduction Program is sought. Attachment A also indicates those tenants which are locally owned or are certified ACDBE.

In some cases, lease amendments will require Board of Supervisors approval under Section 9.118 of the Charter of the City and County of San Francisco.

Proposal

Staff is recommending approval of the Specialty Retail Minimum Annual Guarantee Rent Reduction Program as outlined above and summarized in the Financial Relief Chart. The value of this relief program for calendar year 2024 is estimated at \$721,000.

Recommendation

I recommend the Commission adopt the accompanying Resolution (1) authorizing the Airport Director to implement the Specialty Retail Minimum Annual Guarantee Rent Reduction Program as outlined in this memorandum, which will include entering into appropriate amendments with concessionaires consistent with such provisions, and (2) directing the Commission Secretary to request the approval from the San Francisco Board of Supervisors only for lease amendments for which approval is required under Section 9.118 of the Charter of the City and County of San Francisco.



Ivar C. Satero
Airport Director

Prepared by: Kevin Bumen
Chief Financial and Commercial Officer

Attachments

Attachment A

Specialty Retail Concessions

	BOS	Tenant Entity and Lease Number	Concept	Local Ownership	ACDBE
1	Y	Air Sun JV Lease No. 18-0233	Sunglass Hut (T3 BA/E)		X
2	N	Air Sun JV Lease No. 18-0345	Sunglass Hut (T2)		X
3	Y	Apparel Sourcing and Production, LLC Lease No. 19-0053	We Are SF (T2)	X	
4	Y	Brookstone SFO T-2, LLC Lease No. 18-0071	Brookstone (T2)		
5	Y	Canonica New York, LLC Lease No. 17-0210	The Chocolate Market (IT BA/G)		
6	Y	Canonica New York, LLC Lease No. 18-0073	The Chocolate Market (T2)		
7	N	Canonica New York, LLC Lease No. 18-0284	The Chocolate Market (T3 BA/E)		
8	N	Chalo, LLC Lease No. 23-0250	Chalo (T3 BA/F)		
9	Y	DFS Group, L.P. Lease No. 17-0209	Sunglasses & Watches (IT BA/A)		X
10	Y	Emporio Rulli, Inc. Lease No. 18-0395	G.R. Chocolates (HMT1)	X	
11	Y	Genesco Partners Joint Venture #11 Lease No. 20-0046	Johnston & Murphy (HMT1)		
12	Y	InMotion Entertainment Group, LLC Lease No. 18-0203	iStore (HMT1)	X	X
13	Y	InMotion SFO-IT, LLC Lease No. 18-0231	InMotion Entertainment (IT BA/A)		
14	Y	InMotion SFO-T3, LLC Lease No. 18-0232	InMotion Entertainment (T3 BA/E), Sound Balance (IT BA/G)		
15	Y	L'Occitane Airport Venture, LLC., Lease No. 18-0205	L'Occitane (HMT1)		X
16	Y	RAKH, Inc. Lease No. 18-0207	NYS Collection Eyewear (HMT1)	X	
17	Y	World Duty Free Group North America, LLC Lease No. 15-0039	Jo Malone, Tom Ford, Aveda (T3 East)		X