Item 1 File 11-0396	Department: San Francisco International Airport

EXECUTIVE SUMMARY

Legislative Objective

- The proposed resolution would authorize a five-year lease renewal between the San Francisco International Airport (Airport) and Asiana Airlines, Inc. (Asiana Airlines), for 33,339 square feet of cargo space and 6,339 square feet of support office space, including non-exclusive ramp and parking space at the Airport, for a total of 39,678 square feet.

Key Points

- Asiana Airlines is in the final year of an existing ten-year and four-month lease with the Airport for space to conduct its cargo operations, which includes (a) 34,691 square feet of cargo warehouse space, providing 11 truck docking spaces, and (b) 4,987 square feet of office space, for a total of 39,678 square feet. The lease also provides for non-exclusive use of ramps and employee and aircraft parking. Under the existing lease, Asiana Airlines pays the Airport annual rent of $943,146 for a total of 39,678 square feet.

- During the existing lease, due to Asiana Airlines' need for additional office space, Asiana Airlines converted 1,352 square feet of warehouse space to support office space, reducing the square footage of warehouse space from 34,691 square feet to 33,339 square feet and increasing their office space by 1,352 square feet from 4,987 square feet to 6,339 square feet. The total square footage of leased space remained the same at 39,678 square feet. Under the proposed five-year lease with Asiana Airlines this allocation of space and the total square footage would remain the same. The proposed lease would also continue to provide for non-exclusive use of ramps and employee and aircraft parking.

Fiscal Impacts

- The proposed lease renewal, which would begin on May 5, 2011, would result in an annual rent reduction to Asiana Airlines of $94,037 or approximately ten percent to Asiana Airlines, from $943,146 currently being paid to the Airport to $849,109. This reduction in rent is due to the $2.37 reduced rate per square foot from the current rate of $23.77 per square foot per year to the proposed rate of $21.40 per square foot per year as negotiated by the Airport for the proposed lease.

- Because any budgetary shortfall resulting from the proposed lease modification would be eliminated through increased rental rates and related fees charged to all airlines located at the Airport, under the Airport's residual rate setting methodology, otherwise known as the breakeven policy, the proposed lease modification does not have a direct fiscal impact on the Airport.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

Section 2A.173 of the City's Administrative Code authorizes the Airport to negotiate and execute leases of Airport lands and space in Airport buildings without undergoing a competitive bid process, as long as the original term of the lease does not exceed 50 years.

City Charter Section 9.118 (a) requires the Board of Supervisors approve any lease which would result in revenues to the City in excess of $1,000,000.

Background

On July 26, 2000, the Board of Supervisors approved Resolution No. 690-00, authorizing the current lease between Asiana Airlines, Inc. (Asiana Airlines) and the San Francisco International Airport (Airport). The existing lease extends for a term of ten years and four months, from January 1, 2001 through May 4, 2011, and initially included a total of 39,874 square feet, including (a) 34,887 feet of cargo warehouse space, which provides for 11 truck docking spaces and (b) 4,987 square feet of office space in Building 648, located in the West Field Cargo Area of the Airport. The lease also provides for non-exclusive use of ramp areas and employee and aircraft parking. On August 1, 2001, the Airport approved reducing the amount of cargo space leased to Asiana Airlines by 196 square feet from 34,887 to 34,691 square feet for a total leased space of 39,678 square feet (39,874 less 196) because Airport equipment that was located in the Asiana Airlines cargo leased space was occupying a portion of the originally leased space. This reduction was retroactive to May 1, 2001. The rate per square foot for both the cargo and the office space for the first year of the lease was $19.75 per square foot, with an annual rent of $783,641 per year.

At some point during the ten year and four month-term of the existing lease, Asiana Airlines converted 1,352 square feet of warehouse space to support office space, reducing the square footage of warehouse space from 34,691 square feet to 33,339 square feet and increasing the support office space from 4,987 square feet to 6,339 square feet, based on Asiana Airlines' need for increased support office space. The total square footage of leased space remained the same at 39,678 square feet. According to Mr. Dan Ravina, Senior Property Manager for the Aviation Division of the Airport, the Airport is not certain as to the date that the conversion took place since the lease did not need to be amended because the rental rates for office and warehouse space under the existing lease are the same.

The existing lease also includes a provision which allows annual rent increases payable to the Airport based on changes in the Consumer Price Index[1] (CPI). Table 1 below summarizes the Asiana Airlines lease rates per square foot and the annual rents received by the Airport from 2001 through 2010. The annual increases in the rates per square foot are based on changes in the CPI. As shown in Table 1 below, over the past ten years the Airport has received a total of

[1] The Consumer Price Index is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

$8,611,688 of rental revenues from the existing cargo operations and related office space lease with Asiana Airlines.

Table 1: History of Annual Rent Per Square Foot and Total Annual Revenues Received by the Airport Under the Current Lease

	Annual Rent per Square Foot	Annual Lease Amount
2001	$19.75	$783,641
2002	20.11	797,820
2003	20.78	824,512
2004	20.82	826,180
2005	21.15	839,108
2006	21.77	863,715
2007	22.46	891,189
2008	23.08	915,896
2009	23.35	926,481
2010	23.77	943,146
Total		**$8,611,688**

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize Asiana Airlines to renew its existing lease with the Airport for a term of five years, from May 5, 2011 through May 4, 2016. Specifically, the proposed lease would authorize Asiana Airlines to lease a total of 39,678 square feet of space, including (a) 33,339 square feet of cargo warehouse space that provides 11 truck docking spaces, and (b) 6,339 square feet of office space in Building 648. The proposed lease would also provide Asiana Airlines with non-exclusive use of various ramp areas and employee and aircraft parking.

As noted above, Asiana Airlines currently leases a total of 39,678 square feet of space at the Airport, including 6,339 square feet of office space, which includes 1,352 square feet of space previously converted from warehouse to office space during the term of the existing lease. The proposed lease would codify that conversion of space by reducing the square footage of warehouse space included in the proposed lease from 34,691 square feet to 33,339 square feet, a reduction of 1,352 square feet and increasing the support office space included in the proposed lease by 1,352 square feet from 4,987 square feet to 6,339 square feet. Under the proposed lease renewal, the total square footage of leased space would remain the same at 39,678 square feet (33,339 plus 6,339).

The proposed lease is based on a rate of $21.40 per square foot per year for a total annual rent of $849,109. Like the existing lease, the proposed lease also provides annual rent increases based on changes in the CPI.

FISCAL IMPACT

As shown in Table 2 below, the proposed lease renewal would result in an annual rent reduction of $94,037 or approximately ten percent for Asiana Airlines, from $943,146 (see Table 1 above) currently being paid to the Airport to $849,109. This reduction in rent is due to the $2.37 reduced rental rate per square foot from the current rate of $23.77 per square foot (see Table 1 above) to the proposed rate of $21.40 per square foot. The new rental rate of $21.40 per square foot per year was negotiated by the Airport for the proposed lease, as shown in Table 2 below.

Table 2: Proposed Reduction In Leased Space

Type of Space	Square Feet Under Current Lease Terms	Square Feet Under Proposed Modified Lease Terms	Difference
Total Space (Square Feet)	**39,678**	**39,678**	**0**
x Annual Rental Rate	$23.77	$21.40	$2.37
Annual Rent	**$943,146**	**$849,109**	**$94,037**

According to Mr. Dan Ravina, the reason for the reduction in the rental rate per square foot is that “both the rental rate and the term of the lease were heavily negotiated and reflect the extremely challenging air cargo business environment, consisting of substantial market shrinkage over the recent years.” Mr. Ravina advises that the Airport currently has 96,779 square feet of vacant cargo space or 12.5 percent out of a total of 772,765 square feet of total cargo space at the Airport.

As a result of the Airport’s “residual rate setting methodology” (the breakeven policy) used by the Airport to determine rental rates, landing fees, and related fees for all Airlines, the proposed rent reduction for Asiana Airlines will not result in any budgetary shortfall for the Airport. The residual rate setting methodology is a formula which sets the schedule of all rental rates, landing fees, and related fees to a level which ensures that Airport revenues received from all of the airlines at the Airport, plus the non-airline revenues received by the Airport, is equal to the Airport’s total costs, including debt service and operating expenditures. According to the Airport’s breakeven policy, prior to the beginning of each fiscal year, the Airport determines the total airline revenues needed to balance the Airport’s budget in the upcoming year, after considering all other non-airline revenue sources (such as concession revenues and parking revenues) and carrying forward any projected budget shortfall or surplus from the current fiscal year.

The amount needed to balance the Airport's budget then becomes the basis for calculating, by a formula specified in the leases with all of the airlines operating at the Airport, the rental rates, landing fees, and related fees charged to the airlines each fiscal year, such that the total revenues paid to the Airport by all airlines and other tenants in the upcoming fiscal year is sufficient to balance the Airport's budget. At the end of the fiscal year, any budgetary shortfall or surplus is carried forward into the following fiscal year and is used in the calculation of the new rental rates, landing fees, and related fees charged to the airlines and other tenants. Therefore, the rental reduction under the proposed lease renewal would not have a direct fiscal impact on the Airport.

RECOMMENDATION

Approve the proposed resolution.