Items 1 and 2 Files 11-0536 and 11-0540	Department: San Francisco International Airport (Airport)

EXECUTIVE SUMMARY

Legislative Objectives

- File 11-0536: The proposed resolution would retroactively approve (a) Amendment No. 1 to an existing Spa Lease with XpresSpa SF International, LLC and the City of San Francisco, acting by and through its Airport Commission (Airport) and (b) Amendment No. 2 to an existing Technology Stores and Accessories Lease with ILJ San Francisco, LLC, and the Airport.

- File 11-0540: The proposed resolution would retroactively approve Amendment No. 1 to four existing Food and Beverage Leases between (a) Baysubway Airport (Subway), (b) Luna Azul Corporation (Jalapeno Grill), (c) Guava & Java, Inc. (Guava & Java), and (d) Burger Joint, Inc. (Mission Bar & Grill) and the Airport.

Key Points

- On April 14, 2011, the Airport began renovating Boarding Area E in Terminal 3, which is anticipated to extend approximately 14 to 16 months or through mid-August of 2012. The Airport has projected that the renovation and resulting closure of Boarding Area E in Terminal 3 will significantly reduce passenger traffic that support Airport concessions in this area.
- As a result, the proposed two resolutions would amend six existing leases with Airport concessions to partially waive the Minimum Annual Guarantee (MAG) and fees, otherwise payable by the lessees to the Airport, for the time that the renovations will occur.

Fiscal Impacts

- The Airport estimates foregoing a total of approximately $469,548 in annual lease payments and fees, if the two proposed resolutions are approved.
- In FY 2009-2010, these six lessees paid a total of $1,858,142 of lease revenues and $220,174 of fees, for a total of $2,078,316 in revenues to the Airport. If the proposed two resolutions are approved, based on the reduced rental and fee revenue of $469,548, the Airport's annual revenue would be approximately $1,608,768 from the subject six leases.
- Although under the proposed two resolutions, rent payments and fees will be waived while the Airport's space in Terminal 3 is renovated, any revenue reduction would not directly impact the Airport's budget due to the Airport's residual rate setting methodology (break-even policy).

Recommendations

- Approve the two proposed resolutions.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

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

Background

On April 14, 2011, the Airport began renovating Boarding Area E in Terminal 3 to (a) provide upgraded facilities due to the recent relocation of American Airlines from Terminal 3 into the Airport's recently completed new Terminal 2, (b) relocate Air Canada from two locations in the International Terminal into Terminal 3, and (c) seismically renovate, increase concession space and upgrade all systems in Boarding Area E. Ms. Cheryl Nashir, Associate Deputy Airport Director advises that the current renovation of Terminal 3 is anticipated to extend approximately 14 to 16 months or through mid-August of 2012. The Airport has projected that the renovation and resulting closure of Boarding Area E in Terminal 3 will significantly reduce passenger traffic that support Airport concessions in this area.

The Attachment to this report shows both a smaller overall Airport map with Boarding Area E identified and an enlarged picture of Boarding Area E in Terminal 3 that identifies the specific locations of the six concession tenants that would be directly impacted by the Airport's current renovations. Table 1 below identifies the major terms of the six Airport tenants that have existing leases, and the portion of each lease in square feet, that will be directly impacted by the current renovations of Boarding Area E in Terminal 3.

Table 1: Terms of Six Existing Leases Located in Terminal 3, Boarding Area E

Existing Airport Tenants	BOS Approval No. and Date	Lease Commence Date	Lease Expiration Date	Total Sq Ft Lease	Total Sq Ft in Boarding Area E	Minimum Annual Guarantee (MAG)	Percent Rent
ILJ San Francisco, LLC (Airport Wireless/Techshowcase)	Res. No. 432-07 07/31/07	8/1/2008	7/31/2013 + (2) 1 Year Options	4,199	542	$504,190	8% on licensed products, plus, on all other products: 12% up to $5M; + 14% up to $6M; + 16% over $6M
XpresSpa SF International, LLC (XpresSpa)	Not Applicable (Less than 10 yrs, $1M)[1]	4/15/2008	4/14/2013 + (2) 1 Year Options	2,471	805	$168,888	12% up to $1.5M; + 14% over $1.5M
Luna Azul Corporation (Jalapeno Grill)	Res. No. 0775-03 12/09/03	3/15/2005	3/14/2017	506	506	$24,126	6% up to $600K; + 8% up to $1M; + 10% over $1M
Baysubway Airport (Subway)	Res. No. 0775-03 12/09/03	9/1/2004	3/14/2017	1,307	601	$63,481	6% up to $600K; + 8% up to $1M; + 10% over $1M
Guava & Java, Inc. (Guava & Java)	Res. No. 0775-03 12/09/03	9/1/2004	3/14/2017	1,200	400	$58,284	6% up to $600K; + 8% up to $1M; + 10% over $1M
Burger Joint, Inc. (Mission Bar & Grill)	Res. No. 0775-03 12/09/03	12/30/2004	12/29/2016	1,967	1,967	$94,416	8% up to $600k; + 10% up to $1M; + 12% over $1M

DETAILS OF PROPOSED LEGISLATION

File 11-0536: The proposed resolution would retroactively approve as of April 14, 2011 (a) Amendment No. 1 to an existing Spa Lease with XpresSpa SF International, LLC and the Airport, (b) Amendment No. 2 to an existing Technology Stores and Accessories Lease with ILJ San Francisco, LLC, and the City of San Francisco, acting by and through its Airport Commission (Airport).

File 11-0540: The proposed resolution would retroactively approve as of April l4, 2011 Amendment No. 1 to four existing Food and Beverage Leases between (a) Baysubway Airport (Subway), (b) Luna Azul Corporation (Jalapeno Grill), (c) Guava & Java, Inc. (Guava & Java), and (d) Burger Joint, Inc. (Mission Bar & Grill) and the Airport.

[1] The XpresSpa lease is not over ten years and the Airport did not initially anticipate this lease to result in over $1,000,000 of revenues to the Airport over the term of the lease. However, based on actual revenues paid by XpresSpa to the Airport to date, the XpresSpa lease will likely result in over $1,000,000 of revenues to the Airport over the term of this lease, such that the subject lease amendment is subject to the Board of Supervisors approval.

Under each of the existing leases, each lessee pays the Airport the greater of a Minimum Annual Guarantee (MAG), or a specified percentage of gross revenues as shown in Table 1 above. The two proposed resolutions would retroactively approve amendments effective as of April 14, 2011 to six existing leases in order to waive the Minimum Annual Guarantee (MAG) rent payments for the portion of the leases that are located within Boarding Area E in Terminal 3 during the time that these Airport renovations are being completed. As a result, during the construction period from April 14, 2011 through approximately mid-August of 2012, each of the lessees under the proposed amendments would no longer be subject to the MAG based on the square footage located within Boarding Area E in Terminal 3. Instead, each of the lessees that continue to operate during the renovation period would be subject to the percentage rents for the area within Boarding Area E in Terminal 3.

In addition, the proposed resolution would waive the following specific Airport fees, as appropriate, based on the square footage located within Boarding Area E in Terminal 3.

- Tenant infrastructure fees, which are paid by each Food and Beverage lessee at a rate of $15 per square foot per year, and which are used to amortize the Airport's costs to initially construct individual lessee's concession facilities in the Airport.

- Food court infrastructure fees, which are paid by those Food and Beverage lessees that are located within food courts at a rate of $15 per square foot per year, and which are used to amortize the Airport's costs to initially construct the food courts, including the shared open spaces and seating areas.

- Food court cleaning fees, which are paid by those Food and Beverage lessees that are located within food courts, change annually based on the actual cost to pay for cleaning the food courts, and which are allocated according to the number of square feet and the annual gross sales of those Food and Beverage lessees located within the food courts.

- Promotional fees, which are paid by all concession leases at a rate of $1 per square foot per year, and which allow the Airport to recover a portion of the costs to advertise and promote the retail stores in the Airport.

According to Ms. Nanette Hendrickson of the Airport, with the exception of Mission Bar and Grill, which cannot opt to continue operations during the renovation period because their location is barricaded and no passengers are allowed in this section of the Boarding Area, the other five concessionaires have continued to operate during the renovations. However, Ms. Hendrickson advises that because passenger traffic is significantly reduced during this renovation period, once the summer is over, each of the lessees could potentially reduce their hours of operation or close their operations in Boarding Area E in Terminal 3 if sales decrease further. Ms. Hendrickson advises that either of these events would be done with Airport consultation and concurrence, would not affect the terms of the proposed lease amendments and would lead to less percentage rent paid to the Airport by those tenants. According to Ms. Hendrickson, it is likely, however, that lost sales in the Boarding Area E area would result in increased sales in other locations in the Airport.

FISCAL IMPACTS

Table 2 below summarizes the major provisions in the proposed lease amendments by Resolution numbers and highlights the projected annual revenue losses to the Airport that would occur based on reductions in the MAG and each of the Airport fees, as appropriate.

Table 2: Major Provisions of the Proposed Six Lease Amendments

Resolution File Nos.	11-0536	11-0536	11-0540	11-0540	11-0540	11-0540	Total
Tenants	ILJ San Francisco, LLC (Airport Wireless/Techshowcase)	XpresSpa SF International, LLC (XpresSpa)	Luna Azul Corporation (Jalapeno Grill)	Baysubway Airport (Subway)	Guava & Java (SFO), Inc. (Guava & Java)	Burger Joint, Inc. (Mission Bar & Grill)	
Total Square Feet in Lease	4,199	2,471	506	1,307	1,200	1,967	11,650
Square Feet in Boarding Area E	542	805	506	601	400	1,967	4,821
Open During Renovation?	Yes	Yes	Yes	Yes	Yes	No	
Current MAG Rent	$504,190	$168,888	$24,126	$63,481	$58,284	$94,416	$913,385
Adjusted MAG Rent	$439,149	$113,155	$0	$34,290	$38,856	$0	625,450
Annual MAG Reduced Revenues to Airport	$65,041	$55,733	$24,126	$29,191	$19,428	$94,416	287,935
Percentage Rent	8% on licensed products, plus, on all other products: 12% up to $5M; + 14% up to $6M; + 16% over $6M	12% up to $1.5M; + 14% over $1.5M	6% up to $600K; + 8% up to $1M; + 10% over $1M	6% up to $600K; + 8% up to $1M; + 10% over $1M	6% up to $600K; + 8% up to $1M; + 10% over $1M	8% up to $600k; + 10% up to $1M; + 12% over $1M	
Annual Waived Tenant Infrastructure Fees	N/A	N/A	$7,590	$9,015	$6,000	29,505	52,110
Annual Waived Food Court Infrastructure Fee	N/A	N/A	$7,590	$9,015	$6,000	N/A	22,605
Annual Waived Food Court Cleaning Fees	N/A	N/A	$25,958	$36,213	$39,906	N/A	102,077
Annual Waived Promo Fee	$542	$805	$506	$601	$400	$1,967	4,821
Estimated Annual Reduced Revenues to Airport	$65,583	$56,538	$65,770	$84,035	$71,734	$125,888	$469,548

As shown above in Table 2, the Airport estimates foregoing approximately $469,548 in annual rents and fees, if the two proposed resolutions are approved.

However, as noted above, under the existing leases, each lessee pays the Airport rent consisting of either the greater of a Minimum Annual Guarantee (MAG), or a specified percentage of gross revenues as shown in Table 1 above. Based on actual revenues received by the Airport in FY 2009-10, with the exception of ILJ San Francisco, LLC, which was subject to the MAG, the remaining five of the six lessees made payments to the Airport based on percentage rents rather than the MAG, because the percentage rents were higher. In FY 2009-2010, these six lessees paid a total of $1,858,142 of lease revenues and $220,174 of fees, for a total of $2,078,316 in revenues to the Airport. If the proposed two resolutions are approved, based on the estimated annual reduced rental and fee revenue of $469,548 shown in Table 2 above, the Airport's annual revenue would be approximately $1,608,768.

Although under the proposed two resolutions, rent payments and fees will be suspended while the Airport's Terminal 3 space is renovated, any revenue reduction would not directly impact the Airport's budget due to the Airport's residual rate setting methodology (break-even policy). Under the Airport's residual rate setting methodology, any decreases in non-airline revenues (including concession lease revenues and parking revenues) are automatically offset by increasing the total rent payable by the airlines operating at the Airport, through the Airport's formula specified in each airline's lease that recalculates the rental rates, landing fees, and related fees charged to airlines. This break-even policy of the Airport requires that the total revenues paid to the Airport by all airlines in the upcoming year are sufficient to balance the Airport's budget.

RECOMMENDATIONS

Approve both of the proposed resolutions.

Terminal 3
Boarding Area "E"
Affected Tenants