

AIRPORT COMMISSION

CITY AND COUNTY OF SAN FRANCISCO

RESOLUTION NO. 24-0110

APPROVAL OF AMENDMENT NO. 5 TO THE INTERNATIONAL TERMINAL DUTY FREE AND LUXURY STORES LEASE NO. 17-0303 WITH DFS GROUP, L.P.

WHEREAS, on December 5, 2017, by Resolution No. 17-0303, the Commission awarded the International Terminal Duty Free and Luxury Stores Lease No. 17-0303 (Lease) to DFS Group, L.P. (Tenant) to operate duty free and luxury stores in the International Terminal and Harvey Milk Terminal 1 for a term of 14 years expiring March 31, 2034; and

WHEREAS, Tenant consists of a joint venture partnership between DFS Group, L.P., with 75% ownership, and the following five small business partners, each with 5% ownership: Bay Cities Concessions, J.R. Lester & Associates, Marilla Chocolate Co., Skyline Concessions, Inc., and Skyview Concessions, Inc.; and

WHEREAS, on March 17, 2020, by Resolution No. 20-0051, the Commission approved Amendment No. 1 to the Lease to temporarily reduce the Base Rent to a Percentage Rent Structure equal to 33% of gross revenues for Lease Year 1, which ended December 31, 2020; and

WHEREAS, on October 6, 2020, by Resolution No. 20-0180, the Commission approved amending the Lease as part of the overall COVID-19 Emergency Rent Relief Program which provided minimum annual guarantee (MAG) rent relief for most concession tenants for April and May 2020, which after being ultimately approved by the Board of Supervisors, was memorialized in Amendment No. 3 to the Lease after the Commission approved Amendment No. 2 to the Lease (as set forth below); and

WHEREAS, on October 6, 2020, by Resolution No. 20-0180, the Commission authorized the COVID-19 Emergency Rent Relief Program, which was memorialized in Amendment No. 3 to the Lease. On January 5, 2021, by Ordinance 5-21, the San Francisco Board of Supervisors approved the COVID-19 Emergency Rent Relief Program, which was memorialized in Amendment No. 3 to the Lease (after the final approval of Amendment No. 2 to the Lease, as set forth below); and

WHEREAS, on December 1, 2020, by Resolution No. 20-0222, the Commission approved Amendment No. 2 to the Lease, which continued the temporary modification of the Percentage Rent structure through the earlier to occur of Lease Year 4 (Calendar Year 2023), or the reinstatement of the MAG upon a stabilization of enplanements; and

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- WHEREAS, on October 17, 2023, by Resolution No. 23-0256, the Commission approved Amendment No. 4 to the Lease, providing for the temporary reduction in Percentage Rent and the MAG for Lease Years 5, 6 and 7, which also calendar years 2024, 2025 and 2026, contingent upon the construction of two stores in Harvey Milk Terminal 1 by December 31, 2024; and
- WHEREAS, pursuant to Amendment No. 2, the MAG was reinstated on May 1, 2023, which also had the unintended effect of reinstating the original Percentage Rent structure, which resulted in the Tenant's rent as a percentage of sales being 41% for calendar year 2023; and
- WHEREAS, when Amendment No. 2 was originally entered into in 2020, Airport staff anticipated that when enplanements reached the level of recovery that enabled the MAG to be reinstated, duty free sales would have recovered proportionately and rent relief of any form would no longer be appropriate. Duty free sales have not recovered proportionately to enplanements primarily due to the changing demographic of the international passenger. Prior to the pandemic, the Chinese passenger was 15% of total international passengers, yet accounted for nearly 50% of all duty free sales activity. In 2023, the Chinese traveler represented less than 5% of total international passenger enplanements; and
- WHEREAS, Staff did not intend that the approved rent relief (Percentage Rent of 33% for 2020, 2021 and 2022) and further rent relief in Lease Amendment No. 4 (Percentage Rent of 36% for 2024, 2025 and 2026) would be interrupted by a year (Calendar Year 2023) in which effective Percentage Rent grew to 41% because four months of the year fell under a relief program and eight months did not, and further Staff did not anticipate this result when it drafted and brought Amendment No. 4 to the Commission in October of 2023; and
- WHEREAS, the Lease originally provided for Tenant to develop 3,714 square feet in Harvey Milk Terminal 1; and
- WHEREAS, as part of a Premises Change initiated by Staff pursuant to the Lease, in exchange for Tenant relinquishing part of its space in Harvey Milk Terminal 1, Tenant will develop a second 1,009 square foot location in Terminal 2 to serve international traffic departing from that terminal; and
- WHEREAS, the rent relief in Amendment No. 5 will be contingent upon Tenant's construction of its location in Harvey Milk Terminal 1 no later than December 31, 2024 and its other location in Terminal 2 no later than March 31, 2025; now, therefore, be it

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- RESOLVED, that this Commission hereby approves Amendment No. 5 to the Lease, which provides for a Percentage Rent of 33% for the entirety of calendar year 2023, notwithstanding any reinstatement of MAG, and making such rent relief contingent upon Tenant's construction of its location in Harvey Milk Terminal 1 no later than December 31, 2024 and its other location in Terminal 2 no later than March 31, 2025; and
- RESOLVED, that this Commission hereby directs the Commission Secretary to request approval of Amendment No. 5 from the Board of Supervisors pursuant to Section 9.118 of the Charter of the City and County of San Francisco.

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I hereby certify that the foregoing resolution was adopted by the Airport Commission
MAY 21 2024
at its meeting of _____



Secretary



San Francisco International Airport

MEMORANDUM

May 21, 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

24-0110

MAY 21 2024

FROM: Airport Director

SUBJECT: Approval of Amendment No. 5 to the International Terminal Duty Free and
Luxury Stores Lease No. 17-0303 with DFS Group, L.P.

DIRECTOR'S RECOMMENDATION: (1) APPROVE AMENDMENT NO. 5 TO THE INTERNATIONAL TERMINAL DUTY FREE AND LUXURY STORES LEASE NO. 17-0303 WITH DFS GROUP, L.P., MODIFYING THE REDUCED RENT STRUCTURE FROM MAY 1, 2023 TO DECEMBER 31, 2023, CONTINGENT UPON TENANT'S CONSTRUCTION OF ITS ONE LOCATION IN HARVEY MILK TERMINAL 1 BY DECEMBER 31, 2024 AND ANOTHER LOCATION IN TERMINAL 2 TO BE CONSTRUCTED BY MARCH 31, 2025, AND (2) DIRECT THE COMMISSION SECRETARY TO REQUEST APPROVAL OF THE AMENDMENT FROM THE BOARD OF SUPERVISORS PURSUANT TO SECTION 9.118 OF THE CHARTER OF THE CITY AND COUNTY OF SAN FRANCISCO.

Executive Summary

On October 17, 2023, the Airport Commission (Commission) adopted Resolution No. 23-0256 approving Amendment No. 4 to Duty Free and Luxury Stores Lease No. 17-0303 (Lease) with DFS Group, L.P. (Tenant). The Amendment approved a reduced Percentage Rent of 36% for calendar years 2024 through 2026 due to significantly depressed sales and mounting financial losses.

The Lease was previously amended in Amendment No. 2 to lower the Percentage Rent to 33% for calendar years 2020 through 2023 with the stipulation that the reinstatement of the Minimum Annual Guarantee (MAG) that occurs upon the recovery in enplanements ended the reduced Percentage Rent relief. The MAG was reinstated in May 2023, also reinstating the original Percentage Rent structure of 45.8% of gross revenue to \$100,000,000.00, plus 41.8% of gross revenue between \$100,000,000.01 and \$160,000,000.00, plus 30% of gross revenue of \$160,000,000.01 and above. While the reinstatement of the MAG signals international enplanements are well into recovery, duty free sales have not realized a proportionate recovery. Travelers from the Peoples Republic of China have historically accounted for more than 50% of duty free sales, and just 20 of 53 daily flights have recommenced. Duty free sales for 2023 are approximately 50% of what was forecast at commencement of the Lease.

THIS PRINT COVERS CALENDAR ITEM NO. 13

AIRPORT COMMISSION CITY AND COUNTY OF SAN FRANCISCO

LONDON N. BREED
MAYOR

MALCOLM YEUNG
PRESIDENT

EVERETT A. HEWLETT, JR.
VICE PRESIDENT

JANE NATOLI

JOSE F. ALMANZA

MARK BUELL

IVAR C. SATERO
AIRPORT DIRECTOR

Staff requests approval of Amendment No. 5 which provides that the Percentage Rent relief given for 2023 remain in effect for the entire 2023 calendar year notwithstanding any reinstatements of the MAG during that period. Amendment No. 4 will also provide that Tenant will construct one additional location in Harvey Milk Terminal 1 and one additional location in Terminal 2. Amendment No. 4, as presented to the Commission on October 17, 2023, identified the stores as both being located in Harvey Milk Terminal 1. Staff has since executed a Required Relocation of one location in Harvey Milk Terminal 1 to Terminal 2, to serve international passengers traveling to Canada from that terminal.

Background

Rent Adjustment for Calendar Year 2023

On December 5, 2017, by Resolution No. 17-0303, the Commission awarded the Lease to Tenant with a Base Term of 14 years. Tenant operates the Lease through a joint venture partnership named SFO Duty Free & Luxury Store Joint Venture made up of itself with 75% ownership and the following five small business partners each with 5% ownership: Bay Cities Concessions, J.R. Lester & Associates, Marilla Chocolate Co., Skyline Concessions, Inc., and Skyview Concessions, Inc. Each of the small business partners is a certified Airport Concessions Disadvantaged Business Enterprise (ACDBE).

On March 17, 2020, by Resolution No. 20-0051, the Commission approved Amendment No. 1 to the Lease which provided for a temporary suspension of the MAG and a temporary reduction in the Percentage Rent structure to equal 33% of gross revenue through December 31, 2020 necessitated by the following unanticipated factors in the time period leading up to the commencement of the Lease on April 1, 2020: (i) the severe reduction in international flights related to the COVID-19 pandemic, (ii) global economic issues impacting the value of the Chinese currency, and (iii) dramatic decrease in the spending patterns of the average Chinese traveler.

On October 6, 2020, by Resolution No. 20-0180, the Commission authorized the COVID-19 Emergency Rent Relief Program which provided MAG rent relief to most Airport concession tenants for April and May 2020, which after approval by the Board of Supervisors, was memorialized in Amendment No. 3 to the Lease after the Commission approved Amendment No. 2 (as set forth below).

On December 1, 2020, by Resolution No. 20-0222, the Commission approved Amendment No. 2 to the Lease (Amendment No. 2), which continued the temporary modification of the Percentage Rent structure due to the prolonged recovery from the pandemic. This modification of the Percentage Rent was in effect from January 1, 2020, through the earlier to occur of December 31, 2023, or the reinstatement of the MAG.

On October 17, 2023, by Resolution No. 23-0256, the Commission approved Amendment No. 4 to the Lease, providing for the temporary reduction in Percentage Rent and the MAG for Lease Years 5, 6 and 7, which are also calendar years 2024, 2025 and 2026.

Under Amendment No. 2, the MAG was reinstated on May 1, 2023, which also reinstated the original Percentage Rent structure. This Percentage Rent reinstatement resulted in the Tenant's rent as a percentage of sales being 41% for calendar year 2023. When Amendment No. 2 was originally conceived in 2020, it was believed that when enplanements reached the level of recovery that restated the MAG, sales would have recovered proportionately and rent relief of any form would no longer be

appropriate. Sales have not recovered proportionately to enplanements primarily due to the changing demographic of the international passenger. Prior to the pandemic, the Chinese passenger was 15% of total international passengers, yet accounted for nearly 50% of all duty free sales activity. In 2023, the Chinese traveler represented less than 5% of total international passenger enplanements. It was not intended that the approved rent relief (Percentage Rent of 33% for 2020, 2021 and 2022) and further rent relief in Lease Amendment No. 4 (Percentage Rent of 36% for 2024, 2025 and 2026) would be interrupted by a year (Calendar Year 2023) in which effective Percentage Rent grew to 41% because four months of the year fell under a relief program and eight months did not. Airport staff did not anticipate this result when it drafted and brought Amendment No. 4 to the Commission in October of 2023.

Premises Change

Tenant was originally leased 3,714 square feet in Harvey Milk Terminal 1. As part of a Premises Change initiated by Staff pursuant to the Lease, in exchange for Tenant relinquishing part of its space in Harvey Milk Terminal 1, Tenant will develop a second 1,009 square foot location in Terminal 2 to serve international traffic departing from that terminal. The rent relief in Amendment No. 5 will be contingent upon Tenant's construction of its location in Harvey Milk Terminal 1 no later than December 31, 2024 and its other location in Terminal 2 no later than March 31, 2025.

Proposal

Staff recommends approving Amendment No. 5 providing that Percentage Rent is 33% for the entirety of Lease Year 4 (calendar year 2023), notwithstanding the reinstatement of MAG. Staff further recommends that the terms of both Amendment No. 4 and this proposed Amendment No. 5 be contingent upon the construction of one store in Harvey Milk Terminal 1 by December 31, 2024, and one store in Terminal 2 by March 31, 2025.

Recommendation

I recommend the Commission adopt the accompanying Resolution: (1) approving Amendment No. 5 to the International Terminal Duty Free and Luxury Stores Lease No. 17-0303, which provides for a Percentage Rent of 33% for the entirety of calendar year 2023, notwithstanding any reinstatement of MAG, and making such rent relief contingent upon Tenant's construction of its location in Harvey Milk Terminal 1 no later than December 31, 2024 and its other location in Terminal 2 no later than March 31, 2025; and (2) directing the Commission Secretary to request approval of Amendment No. 5 from the Board of Supervisors 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 Financial and Commercial Officer

Attachments

Attachment 1

International Terminal Duty Free and Luxury Stores Lease No. 17-0303

