

AIRPORT COMMISSION

CITY AND COUNTY OF SAN FRANCISCO

RESOLUTION NO. 19-0213

APPROVAL OF AMENDMENT NO. 1 TO THE INTERNATIONAL TERMINAL NEWSSTAND AND SPECIALTY RETAIL CONCESSION LEASE 2 WITH DFS GROUP, LP DBA DFS WATCHES

WHEREAS, on September 5, 2017, by Resolution No. 17-0209, the Airport Commission (Commission) awarded the International Terminal Newsstand and Specialty Retail Concession Lease 2 (Lease) to DFS Group, LP (Tenant); and

WHEREAS, the Lease has a term of seven years with two 1-year options, and Staff has determined that the development costs exceeded supportable underwriting standards related to sales projections, rent structure and the term of the Lease; and

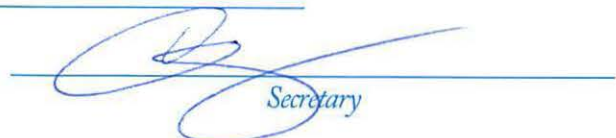
WHEREAS, Staff proposes extending the Lease by two years to improve the financial health of the Lease by allowing for a longer development cost amortization period; and

WHEREAS, Tenant has agreed to enter into an amendment so extending the term of the Lease; now, therefore, be it

RESOLVED, that this Commission hereby approves Amendment No. 1 to the Lease with DFS Group, LP, extending the base operating term of the Lease to January 31, 2028; and, be it further

RESOLVED, that the Commission Secretary is hereby directed to request approval of Amendment No. 1 to the Lease by Resolution of the Board of Supervisors pursuant to Section 9.118 of the Charter of the City & County of San Francisco.

I hereby certify that the foregoing resolution was adopted by the Airport Commission
at its meeting of SEP 10 2019


Secretary



MEMORANDUM

September 10, 2019

SEP 10 2019

19-0194 *trua* 19-0223

TO: AIRPORT COMMISSION
Hon. Larry Mazzola, President
Hon. Linda S. Crayton, Vice President
Hon. Eleanor Johns
Hon. Richard J. Guggenhime
Hon. Malcolm Yeung

FROM: Airport Director

SUBJECT: Lease Extensions for Concession Leases with Development Costs Exceeding Supportable Investment Amounts

DIRECTOR'S RECOMMENDATION: APPROVE LEASE EXTENSIONS OF TWO YEARS FOR 30 LEASES THAT HAVE COMMENCED SINCE JANUARY 1, 2017 WHICH HAVE DEVELOPMENT COSTS EXCEEDING THE SUPPORTABLE INVESTMENT AMOUNT.

Executive Summary

Since January 2017, development and construction costs at the Airport for concessionaires have far exceeded the projections upon which the business deals were underwritten. Of the 41 leases which have commenced since January 1, 2017, Staff has determined that the economics for 30 such leases are outside of standard supportable levels, as measured by development cost per square foot. Staff is recommending one 2-year lease extension for 30 recently commenced leases to allow longer amortization periods for development costs.

Background

Since January 2017, 41 new stores and restaurants have opened at the Airport. Design and construction costs (as certified by the tenants) for the majority of these new tenants exceeded the forecast costs to the point of rendering the business deals financially unhealthy. Prior to all leasing efforts for each location, Staff estimates sales, rent and construction costs. For some leases, Staff creates projected profit and loss statements that include cost of goods sold and labor, among other expenses. All of these estimates inform decisions regarding the bundling of leases and the length of lease terms.

In the last three years, design and construction costs are far exceeding minimum investment requirements, which have ranged from \$450 to \$1,000 per square foot, depending upon when the location was leased and the type of concession to be constructed. Actual costs have ranged from

THIS PRINT COVERS CALENDAR ITEM NO. 2

AIRPORT COMMISSION CITY AND COUNTY OF SAN FRANCISCO

LONDON N. BREED MAYOR LARRY MAZZOLA PRESIDENT LINDA S. CRAYTON VICE PRESIDENT ELEANOR JOHNS RICHARD J. GUGGENHIME MALCOLM YEUNG IVAR C. SATERO AIRPORT DIRECTOR

\$593 per square foot to over \$2,000 per square foot. From the time of our last significant redevelopments, Terminal 3 Boarding Area E in 2012 and Terminal 3 East in 2014, average retail development costs have risen 45% and average food and beverage development costs have risen 69%.

The business deals were crafted projecting, among other things, that development costs would not exceed \$1,300 per square foot for food and beverage locations and \$900 for retail locations (Supportable Investment Amount). These metrics were thought to be conservative when Staff created them. Each business deal is unique; however, Staff has determined that any development costs above these metrics render the business deals fragile at best, but in many cases unsupportable.

Undue pressure on a concessionaire's profit and loss statement can result in cost savings measures which are undesirable from the Airport's standpoint, such as reducing staffing and maintaining less product on shelves. In an extreme example, a tenant will request a renegotiation, an assignment or an early termination. All of our concessions locations are necessary to provide the level of customer service that our guests expect, and keeping each of them operating at an optimal level is key to that goal. Additionally, we view our concessions tenants and their joint venture partners as our business partners. We are committed to providing them sustainable opportunities.

There are currently 118 food and beverage and retail leases, excluding the duty free lease and vending leases. These leases can be described as follows:

Description	Number of leases	Action Sought
Leases commenced between 2017 and 2019	41	Lease extensions are sought under this memorandum for 30 tenants whose development costs exceeded Supportable Investment Amount.
Leases commenced between 2011 and 2016	41	None. Investment levels were supportable.
Leases in holdover status or which have been extended	10	None. Investments fully amortized.
Leases which have been awarded but not constructed or are scheduled for award in October 2019	26	None.
Total Leases	118	

Attachment A is a list of the 30 leases for which a lease extension is sought. Attachment B lists the 26 leases which may be appropriate for lease extensions in the future but are not being considered at this time. These leases are either awarded but not yet constructed or are scheduled to be awarded in October 2019. After build-out, Staff will compile the development costs and determine if extensions should be sought utilizing the Supportable Investment Amount criteria mentioned above.

Proposal

Staff is recommending one 2-year lease term extension to the base operating term of each Lease as a revenue neutral solution to ease financial pressure for 30 tenants who have opened a new location since January 1, 2017 and whose development costs exceed the Supportable Investment Amount.

Recommendation

I recommend the Commission (1) adopt the accompanying resolutions approving lease amendments for 30 leases that include premises which became operational between January 1, 2017 and July 31, 2019 and whose development costs exceeded the Supportable Investment Amount, as determined by Airport staff, and (2) direct the Commission Secretary to request the approval of the lease amendments from the San Francisco 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: Leo Fermin
Chief Business and Finance Officer

Attachments

Attachment A

List of Leases for Which Lease Extensions Are Sought

	<u>Doing Business as Name</u>	<u>Location</u>	<u>Existing Base Term / Existing Options</u>
1	Amy's Drive Thru	Harvey Milk Terminal 1	10 years + one 2-year option
2	Bourbon Pub	Harvey Milk Terminal 1	10 years + one 2-year option
3	Bun Mee	Harvey Milk Terminal 1	10 years + one 2-year option
4	Illy's Caffe	Harvey Milk Terminal 1	10 years + one 2-year option
5	iStore	Harvey Milk Terminal 1	10 years
6	Mills Cargo	Harvey Milk Terminal 1	7 years + two 1-year options
7	Skyline News	Harvey Milk Terminal 1	7 years + two 1-year options
8	Starbird	Harvey Milk Terminal 1	10 years + one 2-year option
9	The Little Chihuahua	Harvey Milk Terminal 1	10 years + one 2-year option
10	Farmerbrown	Terminal 1, Boarding Area C	7 years + two 1-year options
11	Sweet Maple	Terminal 2	10 years
12	The Chocolate Market	Terminal 2	7 years
13	Amoura Café	Terminal 3	6 years + two 1-year options
14	Ladle & Leaf	Terminal 3	6 years + two 1-year options
15	Limon Rotisserie	Terminal 3	6 years + two 1-year options
16	San Francisco Giants Clubhouse	Terminal 3	7 years + two 1-year options
17	Super Duper Burger	Terminal 3	6 years + two 1-year options
18	Black Point Coffee	International Terminal A	8 years + two 1-year options
19	Boudin Bakery & Café	International Terminal A	10 years + two 1-year options
20	DFS Watches	International Terminal A	7 years + two 1-year options
21	The Manufactory Marina's Café	International Terminal A Building 674	10 years + two 1-year options
22	The New Stand	International Terminal A	7 years + two 1-year options
23	1300 on Fillmore	International Terminal G	10 years + two 1-year options
24	Joe & the Juice	International Terminal G	10 years + two 1-year options
25	The Chocolate Market	International Terminal G	7 years + two 1-year options
26	The New Stand	International Terminal G	7 years + two 1-year options
27	Samovar Tea House	International Terminal Main Hall, Pre-Security	7 years + three 1-year options
	Napa Farms Market, and Mustards Grill	International Terminal G	10 years + two 1-year options
28	Tomokazu	International Terminal G	10 years + two 1-year options
29	Koi Palace	International Terminal Pre-Security	7 years + three 1-year options
30	Roasting Plant	International Terminal Pre-Security	7 years + three 1-year options

Attachment B

List of Leases Awarded but not Constructed

	<u>Doing Business As Name</u>	<u>Location</u>	<u>Term</u>
1	Flyaway by Drakes	Harvey Milk Terminal 1	10 years + one 2-year option
2	Goldilocks	Harvey Milk Terminal 1	10 years + one 2-year option
3	Bay Area Bistrot	Harvey Milk Terminal 1	10 years + one 2-year option
4	Departures	Harvey Milk Terminal 1	10 years
5	L'Occitane	Harvey Milk Terminal 1	7 years + two 1-year options
6	NYS Eyeware	Harvey Milk Terminal 1	7 years + two 1-year options
7	G.R. Chocolates	Harvey Milk Terminal 1	7 years
8	49 Mile Market	Terminal 1, Boarding Area C	7 years + two 1-year options
9	The Scoop	Terminal 1, Boarding Area C	7 years + two 1-year options
10	Sunglass Hut	Terminal 2	7 years
11	Hello Karl!	Terminal 2	7 years
12	XpresSpa	Terminal 2	7 years
13	Brookstone	Terminal 2	7 years
14	Green Beans Coffee & San Francisco Mac & Cheese Kitchen	Terminal 3	8 years
15	Farley's Community Café	Terminal 3	10 years
16	Sunglass Hut	Terminal 3	7 years
17	Be Relax	Terminal 3	10 years
18	InMotion Entertainment	Terminal 3	10 years
19	InMotion Entertainment	Terminal 3	10 years
20	InMotion Entertainment	International Terminal	10 years
21	Be Relax	International Terminal	10 years

List of Active RFP Processes

	<u>Concept</u>	<u>Location</u>	<u>Term</u>
22	Food and Beverage Kiosk, Small Business Enterprise (SBE)	Terminal 1, Boarding Area C	7 years
23	Food and Beverage Kiosk, SBE	Terminal 3	7 years
24	Employee Café	Terminal 2	7 years + one 2-year option
25	Gourmet Grab n Go	Terminal 3	10 years
26	News and Multi-Concept Retail Stores	Terminal 3	7 years and two 1-year options