Item 1 **File 11-0542**	**Department:** San Francisco International Airport (Airport)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve Amendment No. 1 to the existing Domestic Terminal Food and Beverage Lease agreement between J. Avery Enterprises and the City and County of San Francisco, acting through its Airport Commission (Airport).

Key Points

- On December 9, 2003, the Board of Supervisors approved Resolution 775-03 authorizing the Airport to enter into a ten-year lease with J. Avery Enterprises for two concessions (a) Klein's Deli comprising 518 square feet in Terminal 1, and (b) Klein's Deli comprising 642 square feet in Terminal 3. This ten-year lease agreement became effective on February 4, 2005, upon completion of the space to be occupied by the lessee. The ten-year lease included a two-year option, which was subsequently exercised by the Airport such that the current lease extends through February 3, 2017.
- The Airport is renovating Terminal 1 and Terminal 3, requiring J. Avery Enterprises Klein's Deli concessions in each area to close and to relocate to expanded areas in Terminal 3.
- The proposed resolution would approve Amendment No. 1 to the existing lease to (a) reflect a new ten-year lease effective retroactive from April 14, 2011 through April 13, 2021, (b) permanently relocate and expand J. Avery Enterprises current Klein's Deli 518 square feet of space from Terminal 1 to 998 square feet of space in Terminal 3, (c) expand the existing 642 square feet of space in Terminal 3 to 1,323 square feet of space, (d) amend the rent to reflect both the larger amount of space for J. Avery Enterprises and suspend rent payments for the time that J. Avery Enterprises deli locations will not be able to operate due to Airport renovations, and (e) reimburse J. Avery Enterprises for its unamortized $390,773 cost of improvements that J. Avery Enterprises invested in its current locations in Terminal 1 and Terminal 3 due to J. Avery Enterprises inability to use the space during the Airport's renovations.

Fiscal Impacts

- Under the existing lease, J. Avery Enterprises pays the Airport the <u>greater</u> of a Minimal Annual Guarantee (MAG), which is $48.57 per square foot for a total of $ 56,341, or a specified percentage of gross revenues. J. Avery Enterprises also pays the Airport a $15 per square foot annual Infrastructure Fee ($17,400 annually) plus a $1 per square foot Promotional Program Fee of $1,160 annually. Based on a percentage of gross revenues, J. Avery Enterprises paid total rent to the Airport of $397,082 and also paid $18,560 in fees to the Airport, for a total of $415,642 in the FY 2009-2010. In addition, J. Avery Enterprises is required to make a Minimum Annual Investment of $250 per square foot in their leased space.
- Because J. Avery Enterprises has temporarily closed its two locations and will be unable to utilize their prior capital investment, the Airport will also reimburse J. Avery Enterprises for its unamortized cost of improvements totaling $390,773.

- Under the proposed lease, the MAG would increase from $56,341 to $112,731, an increase of $56,390 or 100 percent. In addition, J Avery Enterprises would pay proposed Infrastructure Fees of $9,630 plus Promotional Program Fees of $2,321 annually.

Recommendation

- Approve the proposed resolution.

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 December 9, 2003, the Board of Supervisors approved Resolution 775-03 that authorized the Airport Commission to enter into a ten-year lease with J. Avery Enterprises to provide food and beverage concessions in Terminal 1 and Terminal 3 at the Airport. This ten-year lease agreement, effective February 4, 2005, upon completion of the space to be occupied by the lessee. This ten-year lease included a two-year option to extend the lease, which was subsequently exercised by the Airport on May 22, 2009, such that the current lease extends through February 3, 2017. According to Ms. Cathy Widener, Government Affairs Officer at the Airport, the Airport exercised this lease extension in conjunction with all Domestic Food and Beverage tenants that were in “good standing” with the Airport Restaurant Employers Council.

Under the existing lease, J. Avery Enterprises leases two spaces: (a) Klein’s Deli comprising 518 square feet in Terminal 1, Boarding Area B, and (b) Klein’s Deli comprising 642 square feet in Terminal 3, Boarding Area E. On, May 10, 2011 and April 14, 2011, the Airport began renovations in Terminal 1 and Terminal 3, respectively, requiring the J. Avery Enterprises deli concessions, in each area, to close. While Boarding Area E in Terminal 3 is scheduled to reopen in May, 2012, Ms. Nanette Hendrickson, the Airport’s Senior Principal Property Manager, has noted that the Boarding Area B in Terminal 1 remodel schedule is not yet known. As a result, the J. Avery Enterprises location in Boarding Area B in Terminal 1 will be permanently relocated to Boarding Area F in Terminal 3.

As a result of J. Avery’s inability to operate its two business locations during the Airport’s renovations, the Airport is requesting approval to amend the existing lease agreement with J. Avery Enterprises.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve Amendment No. 1 to the existing lease between the Airport and J. Avery Enterprises in order to (a) amend the term of the lease to reflect a new ten-year lease effective retroactive from April 14, 2011 through April 13, 2021, (b) permanently relocate and expand J. Avery Enterprises current Klein's Deli 518 square feet of space from Terminal 1 to _998 square feet of space in Terminal 3, (c) expand the existing 642 square feet of space in Terminal 3 to 1,323 square feet of space, (d) amend the rent to reflect both the larger amount of space for J. Avery Enterprises and suspend rent payments for the time that J. Avery Enterprises deli locations will not be able to operate due to Airport renovations, which has already begun and is projected to end in May, 2012, and (e) reimburse J. Avery Enterprises for its $390,773 unamortized cost of improvements that J. Avery Enterprises invested in its current two locations in Terminal 1 and Terminal 3 due to J. Avery Enterprises inability to use the space during the Airport's renovations.

The Table below summarizes the major provisions in both the existing lease as well as the proposed amended lease in the proposed resolution.

Comparison of the Existing Lease between the Airport and J. Avery Enterprises and the Proposed Amended Ten-Year Lease

	Existing Lease	**Proposed Amendment No. 1**
Premises	2 locations for total of 1,160 square feet, including Terminal 1 (518 square feet) and Terminal 3 (642 square feet)	2 locations for total of 2,321 square feet, including Terminal 3 (1,323 square feet) and Terminal 3 (998 square feet)
Term	12 Years (including exercised two year option); Expires: 2/3/2017	Ten Year Lease Retroactive from 4/14/11 through 4/13/21
MAG	$56,341 ($48.57 x 1,160 sq ft)	$112,731 ($48.57 x 2,321 sq ft)
Percentage Rent	Greater of the MAG or Percentage of Gross Revenues: • 6% of Gross Revenues up to and including $600,000; plus • 8% of Gross Revenues from $600,001 up to and including $1,000,000; plus • 10% of Gross Revenues over $1,000,000	Same as existing lease
Infrastructure Fees[1]	$15 per square foot or $17,400 annually ($15 x 1,160 sq ft)	$15 per square foot or $9,630 annually ($15 x 642 sq ft)
Promotional Program Fee	$1 per square foot or $1,160 per year	$1 per square foot or $2,321 per year
Minimum Annual Investment by Lessee	$250 per square foot annually invested by tenant in the leased space	Airport will repay lessee $390,773 for the unamortized cost of prior lessee improvements; subsequently, lessee will make an investment of $350 per square foot annually for the 2,321 square feet of leased space

[1] Under the proposed Amendment No. 1, J. Avery Enterprises would be required to fund all of its new infrastructure and capital construction needs. This capital investment for tenants is typically provided by the Airport, and then the Airport includes the repayment of this investment as a prorated amount in each year of the tenant's lease as the "Infrastructure Fee". As a result, J. Avery Enterprises will not be responsible for repaying the Airport this capital repayment and will pay decreased Infrastructure Fees based on 642 square feet of space, instead of the actual 2,321 square feet of space, as shown in the Table above.

J Avery Enterprises currently pays the Airport the greater of the (a) MAG, based on a rate of $48.57 per square foot and 1,160 square feet of space or a total of $56,341 annually, or (b) percentage rent, as identified in the Table above. Under the proposed Amendment No. 1, J. Avery Enterprises would continue to pay the Airport an annual rent of either the greater of the MAG or the percentage of gross revenue rent based on a total of 2,321 square feet of space, an increase of 1,161 square feet, resulting in a 100 percent increase of space. Therefore, under Amendment No. 1 the MAG will increase from $56,341 by $56,390, to $112,731, based on the same rate of $48.57 per square foot and 2,321 square feet of space.

The Airport also charges lessees a Promotional Program Fee of $1 per square foot to lessees which allows the Airport to recover a portion of the costs to advertise and promote the retail stores in the Airport. Under the existing lease, J. Avery Enterprises, with 1,160 square feet of space, paid the Airport $1,160 annually. Under the proposed Amendment No. 1, with an expansion to 2,321 square feet, J. Avery Enterprises would pay the Airport $2,321 annually in Promotional Program Fees.

In addition to these fees, J. Avery Enterprises is currently required to make a Minimum Annual Investment of $250 per square foot into the leased space. Because J. Avery Enterprises will be required to temporarily close its two locations, and will be unable to utilize their prior capital investment, the Airport will reimburse J. Avery Enterprises for its unamortized cost of improvements totaling $390,773.

FISCAL IMPACT

Under its existing lease with the Airport, which was previously awarded under a competitive Request for Proposals process, J. Avery Enterprises pays the Airport the greater of a Minimal Annual Guarantee of $56,341, or a percentage of gross revenues as specified in the Table above. In FY 2009-2010, J. Avery Enterprises actually paid a total rent of $397,082 to the Airport based on a percentage of gross revenues for the two locations comprising a total of 1,160 square feet, plus $18,560 in fees to the Airport, for a total of $415,642 in the FY 2009-2010.

The Airport has not made projections pertaining to the gross revenues J. Avery Enterprises would realize under the proposed amended lease. However, the MAG, as reflected in the Table above, would increase from $56,341 to $112,731, an increase of $56,390 or 100 percent. In addition, as shown in the Table above, J Avery Enterprises would pay the Airport Infrastructure Fees of $9,630 plus Promotional Program Fees of $2,321 annually.

Under the Airport's Lease and Use Agreement, 15 percent of all concession and Airport parking revenues generated at the Airport is paid by the Airport to the City's General Fund as part of the Annual Service Payment. As a result, of the $397,082 in rent plus $18,560 in fees payable to the Airport, or a total of $415,642 paid by J. Avery Enterprises to the Airport in FY 2009-2010, 15 percent, or $62,346, was transferred from the Airport to the City’s General Fund. Fifteen percent of any future revenues from J. Avery Enterprises will similarly be transferred by the Airport to the City’s General Fund.

Although under the proposed Amendment No. 1 rent payments and fees will be suspended while the Airport’s space is renovated, and a reimbursement by the Airport to J. Avery Enterprises for J. Avery Enterprises $390,773 of related unamortized cost of improvements would occur, 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.

RECOMMENDATION

Approve the proposed resolution.