Item 3 **File 11-0109**	**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 China Airlines Limited (China Airlines), for a total of 38,082 square feet of cargo space, including reduced office space and non-exclusive ramp and parking space at the Airport.

Key Points

- China 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) 33,246 square feet of cargo warehouse space, providing 11 truck docking spaces, and (b) 5,286 square feet of office space. The lease also provides for non-exclusive use of ramps and employee and aircraft parking. Under the existing lease, China Airlines pays the Airport annual rent of $915,906 for a total of 38,532 square feet. Under the proposed five-year lease with China Airlines, the office space square footage would be reduced by 450 square feet, based on China Airlines changed office space needs, such that China Airlines would lease (a) 33,246 square feet of cargo warehouse space and (b) 4,836 (5,286 less 450) square feet of office space for a total of 38,082 square feet. The proposed lease will continue to provide for non-exclusive use of ramps and employee and aircraft parking

Fiscal Impacts

- The proposed lease renewal, which would begin on April 9, 2011, would result in a rent reduction of $100,951 or 11 percent to China Airlines, from $915,906 currently being paid to the Airport to $814,955. This reduction in rent is partially due to (a) the reduction of 450 square feet of office space in the proposed lease, and (b) 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.

- However, 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 31, 2000, the Board of Supervisors approved Resolution No. 689-00, authorizing the current lease between China Airlines Limited (China Airlines) and the San Francisco International Airport (Airport). The current lease extends for a term of ten years and four months, from December 8, 2000 through April 8, 2011, and initially included a total of 38,821 square feet, including (a) 33,535 feet of cargo warehouse space, which provides for 11 truck docking spaces and (b) 5,286 square feet of office space in Building 648. The lease also provides for non-exclusive use of ramp areas and employee and aircraft parking. The Airport previously approved reducing the amount of cargo space leased to China Airlines on August 29, 2001 by 289 square feet from 33,535 to 33,246 square feet for a total leased space of 38,532 square feet (38,821 less 289) because Airport equipment that was located in the China Airlines cargo leased space was occupying a portion of the originally leased space. 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 $761,007 per year. 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 China 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 $8,362,838 of rental revenues from the existing cargo operations and related office space lease with China Airlines.

[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.

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	$761,007
2002	20.11	774,777
2003	20.78	800,698
2004	20.82	802,318
2005	21.15	814,873
2006	21.77	838,768
2007	22.46	865,450
2008	23.08	889,319
2009	23.35	899,722
2010	23.77	915,906
Total		**$8,362,838**

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize China Airlines to renew its existing lease with the Airport for a term of five years, from April 9, 2011 through April 8, 2016. Specifically, the proposed lease would authorize China Airlines to rent a total of 38,082 square feet of space, including (a) 33,246 square feet of cargo warehouse space that provides 11 truck docking spaces, and (b) 4,836 square feet of office space in Building 648. The proposed lease would also provide China Airlines with non-exclusive use of various ramp areas and employee and aircraft parking.

As noted above, China Airlines currently rents a total of 38,532 square feet of space at the Airport, including 5,286 feet of office space. Under the proposed lease, the square footage of office space would be reduced from 5,286 square feet to 4,836 square feet, a reduction of 450 square feet, based on China Airlines' reduced space needs. Therefore, under the proposed lease renewal, the total square footage of leased space would decrease from 38,532 square feet to 38,082 square feet, a reduction of 450 square feet.

The proposed lease is based on a rate of $21.40 per square foot per year for a total annual rent of $814,955. 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 $100,951 or 11 percent for China Airlines, from $915,906 (see Table 1 above) currently being paid to the Airport to $814,955. This reduction in rent is due to (a) the reduction of 450 square feet of office space in the proposed lease, and (b) 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
Warehouse Space	33,246	33,246	0
Office Space	5,286	4,836	450
Total Space (Square Feet)	**38,532**	**38,082**	**450**
x Annual Rental Rate	$23.77	$21.40	$2.37
Annual Rent	**$915,906**	**$814,955**	**$100,951**

According to Mr. Dan Ravina, Senior Property Manager for the Aviation Division of the Airport, "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." According to Mr. Ravina, 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 China 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.