Item 1 **File 11-0479**	**Department:** San Francisco International Airport

EXECUTIVE SUMMARY

Legislative Objective

- The proposed resolution would authorize a modification to a recently-approved ten-year lease between the San Francisco International Airport (Airport) and Emirates Airlines to provide 9,502 square feet of additional space for a new premium lounge for Emirates Airlines customers.

Key Points

- On December 15, 2008, Emirates Airlines commenced operations at the Airport and rented space under the terms of an Airline Terminal Space and Use Permit that automatically renews every 30 days. Since 2008, Emirates Airlines has rented 1,696 square feet of space from the Airport for ticketing and administrative offices under this Operating Permit. On May 11, 2010, the Board of Supervisors approved a new ten-year lease between the Airport and Emirates Airlines commencing on July 1, 2011 through June 30, 2021 for the same 1,696 square feet of space for Emirates Airlines. Following the approval of this new ten-year lease, Emirates Airlines proposed to construct a new premium lounge for its customers and requested that the Airport modify the recently-approved ten-year lease to increase the Emirates Airlines space of 1,696 square feet by 9,502 square feet, for a total of 11,198 square feet of space in the International Terminal.

Fiscal Impacts

- The 1,696 square feet of space is currently leased to Emirates Airlines at $148.96 per square foot per year, or a total cost of $252,636 annually. On July 1, 2011, the Airport's FY 2011-2012 lease rate will increase to $161.90 per square foot per year, or $274,582 annually based on 1,696 square feet.

- If the Board of Supervisors approves the proposed lease to increase the existing 1,696 square feet by an additional 9,502 square feet of space, for a total of 11,198 square feet of space, at the Airport's FY 2011-2012 rate of $161.90 per square foot, Emirates Airlines would pay the Airport a total of $1,812,956 in FY 2011-2012. This would amount to an increase of $1,538,374 annually, or 560 percent more than the rent of $274,582 annually as previously anticipated under the ten-year lease.

- A residual rate setting methodology, or break even policy, is used by the Airport to determine annual rental rates, landing fees, and related fees for all Airlines. Under this residual rate setting methodology any budgetary surplus or shortfall resulting from an incident such as the proposed lease modification would be eliminated through decreased rental rates and related fees charged to all airlines located at the Airport. As a result of this policy, the proposed lease modification with Emirates Airlines would 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

Emirates Airlines has occupied space in the International Terminal of the San Francisco International Airport (Airport) since December 15, 2008, renting space under an Airline Terminal Space and Use Permit that automatically renews every 30 days unless the Airport or Emirates Airlines terminates the Permit, which requires 30 days' written notice.

On May 11, 2010, the Board of Supervisors approved Resolution No. 208-10, authorizing a new ten-year lease between Emirates Airlines and the Airport, which commences on July 1, 2011 and extends through June 30, 2021. The new ten-year lease includes the same provisions of the existing space Permit: Emirates Airlines will lease 1,696 square feet of space, including 331 square feet for ticket offices and 1,365 square feet for administrative offices in the International Terminal. The 1,696 square feet of space is currently leased to Emirates Airlines at $148.96 per square foot per year, or a cost of $252,636[1] annually.

Subsequent to the approval of this ten-year lease, Emirates Airlines proposed to construct a new premium lounge for its customers and requested that the Airport modify the recently-approved ten-year lease to increase Emirates Airlines square footage by 9,502 square feet.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would modify the ten-year lease, previously approved by the Board of Supervisors, extending from July 1, 2011 through June 30, 2021 between Emirates Airlines and the Airport to include an additional 9,502 square feet of space.

As noted above, Emirates Airlines currently rents a total of 1,696 square feet of space at the Airport, such that the proposed additional 9,502 square feet of space would provide a total of 11,198 square feet of space for Emirates Airlines. According to Ms. Linda Peng, Property Manager at the Airport, Emirates Airlines plans to construct a new 9,502 square foot premium lounge for Emirates Airlines customers, across from the British Airways lounge in a currently vacant area of the International Terminal. All costs of constructing this premium lounge will be the responsibility of Emirates Airlines. Construction is anticipated to be completed in the fall of

[1] The annual lease costs will increase on July 1, 2011 due to the Airport's higher FY 2011-2012 lease rate of $161.90 per square foot per year, or a total of $274,582 annually.

2011. If, at the end of the ten-year lease period in 2021, Emirates Airlines does not opt to renew the lease, the premium lounge, including all fixtures, would revert to the Airport.

FISCAL IMPACT

As shown in the Table below, based on the Airport's proposed FY 2011-2012 rental rate of $161.90 per square foot, the proposed lease, which would increase Emirates Airlines leased space from 1,696 square feet to 11,198 square feet, would result in an annual rent payable by Emirates Airlines to the Airport of $1,812,956, an increase of $1,538,374 or 560 percent from the previously anticipated annual rent of $274,582.

Proposed Increase In Leased Space			
Type of Space	**Square Feet Under Current Lease Terms**	**Square Feet Under Proposed Modified Lease Terms**	**Difference**
Total Space (Square Feet)	1,696	11,198	9,502
FY 2011-2012 Annual Rental Rate (per square foot)	$161.90	$161.90	$0
Annual Rent	**$274,582**	**$1,812,956**	**$1,538,374**

As a result of the Airport's residual rate setting methodology (break even policy) used to determine annual rental rates, landing fees, and related fees for all Airlines, the rent increase proposed in the modified lease for Emirates Airlines will not result in an overall budgetary increase for the Airport. The residual rate setting methodology, or break even policy, 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 increase proposed in the modified ten-year lease with Emirates Airlines would not have a direct fiscal impact on the Airport.

RECOMMENDATION

Approve the proposed resolution.