

# **San Francisco International Airport**

## **TERMINAL 2 TO TERMINAL 3 SECURE CONNECTOR PROJECT**

*Fiscal Feasibility Study*

June 1, 2016



## I. Introduction

The City and County of San Francisco owns and operates San Francisco International Airport (SFO), which is the primary commercial service airport for the San Francisco Bay Area. Pursuant to Chapter 29 of the San Francisco Administrative Code, prior to submitting an environmental application form to the Department of City Planning for environmental review of a proposed project, as defined by the California Environmental Quality Act (California Public Resources Code Section 21000 et seq.; “CEQA”), which is estimated to have implementation and/or construction costs greater than \$25 million and use more than \$1 million in public monies, the project must be submitted to the Board of Supervisors to determine whether the plan for undertaking and implementing the project is fiscally feasible and responsible. The proposing City department must prepare a feasibility study and submit it to the Board of Supervisors prior to submitting the project to the Planning Department for environmental review.

The Airport is submitting this fiscal feasibility study to the Board of Supervisors to comply with Chapter 29 of the Administrative Code, since the total project cost for the Terminal 2 to Terminal 3 Secure Connector Project (“Project”) is in excess of \$25 million and the project will be subject to environmental review under CEQA.

The purpose of the Project is to create a post-security connector between Terminals 2 and 3, provide additional office space for terminal related administrative functions, and free space in the International Terminal for passenger amenity and air carrier uses. The new connection would benefit passengers who are connecting from a flight at Terminal 1, Terminal 2 and Terminal 3 and International Terminal Building can do so without having to leave the sterile area and pass through a security screening checkpoint again. The office block that is proposed to be built above and adjacent to the secure connector would be up to six (6) stories tall, and is intended to house Airport Commission offices and other Airport tenants. The intent is to relocate Airport Commission and tenant offices from the International Terminal Building to the office block; this Project would allow approximately 55,600 square feet (s.f.) of leasable post security space in the International Terminal Building to be utilized for other uses to better serve passengers, and would create additional revenue generating opportunities. Additionally, the office block would provide space for several smaller terminal related administrative uses from other parts of Airport. In total, the office block would provide approximately 91,000 square feet of office space and be revenue-positive. No costs would be paid by the General Fund.

## II. San Francisco International Airport

San Francisco International Airport is owned and operated by the City and serves as the primary airport for the Bay Area. The Airport is governed by the Airport Commission, as outlined in the City Charter. The five-person Airport Commission is primarily a policy-making body, establishing the policies by which the Airport operates. The Airport Director oversees the operation and management of the Airport. The Airport also operates under the regulations of the Federal Aviation Administration (FAA) and the Transportation Security Administration (TSA). The Airport’s mission is to provide safe and secure facilities for airlines, tenants, employees, and the traveling public and to be fiscally prudent and contribute to the health of the local economy.

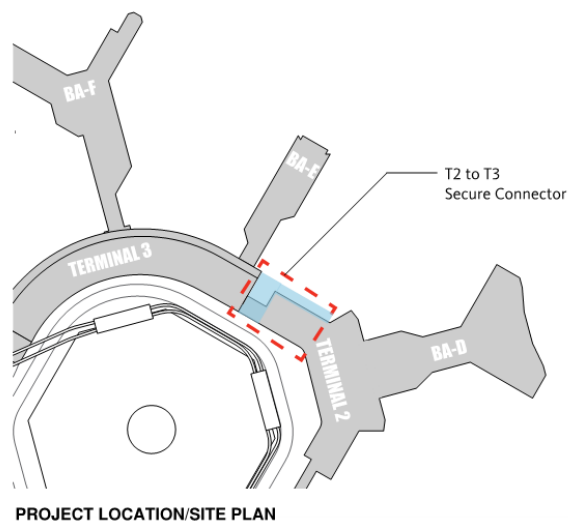
### III. Project Overview

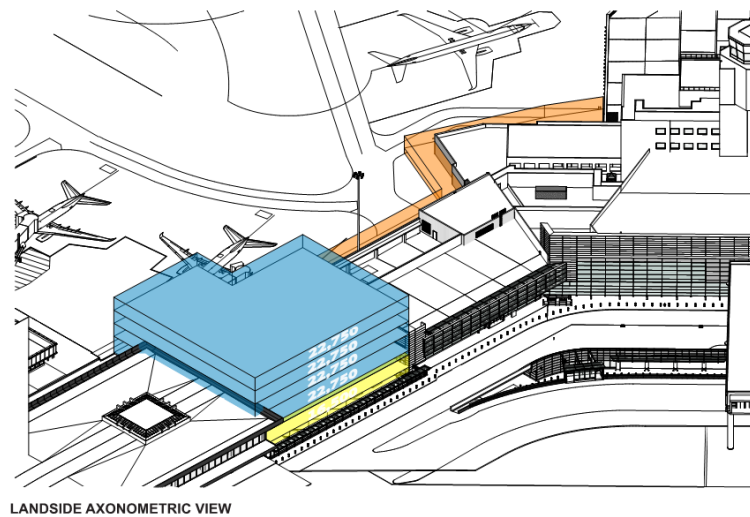
The purpose of the project is three fold: 1) to address the need to complete the last section of the post-security passenger connections between International Terminal Building (ITB), Terminal 1, Terminals 2 and Terminals 3; 2) to facilitate the repurposing of post-security leasable space in the International Terminal Building for its highest and best use as airline functions; and 3) provide space for terminal related administrative activities in a centralized office block.

#### Rationale for Secure Connector

Approximately 21 percent of the passengers who travel through the Airport are connecting passengers. The secure connector between Terminal 2 and Terminal 3 would benefit connecting passengers because it would eliminate the extra time and stress associated with clearing security for their connecting flight. The secure connector would also benefit the airlines serving those passengers by allowing them to schedule connecting flights more efficiently, by making it easier for an airline to operate in two different boarding areas, and by permitting airlines in strategic alliances to be located in adjacent boarding areas with the ability to transfer passengers without the need to exit and re-enter security. Finally, the secure connector would benefit the Airport by reducing queuing at security checkpoints, by giving passengers more time to make purchases from Airport concessionaires prior to their connecting flight, and by giving passengers in Terminals 2 and 3 post-security access to all concessions in both terminals, even if they are not connecting from one terminal to another. For these reasons, the Airport's goal is to connect all of its terminals with secure connectors:

- Secure connectors already exists between Terminal 1 and Terminal 2, and between Terminal 3 and Boarding Area G in the International Terminal.
- The Airport's Terminal 1 Redevelopment Program, which is underway, will build a secure connector between Terminal 1 and Boarding Area A in the International Terminal.
- The secure connector from Terminal 2 to Terminal 3 would be the final element needed to provide secure connectors for all of the Airport's domestic terminals post-security.





### Rationale for Office Block

The Airport faces severe space constraints within the terminals. Only approximately 25,000 s.f. of space remains available throughout the terminals, and approximately 50 percent of these spaces are already earmarked for upcoming capital projects and tenant relocations. The remaining spaces are non-contiguous, averaging 500 to 600 s.f. in size, and are located in areas that present operational challenges to tenants and Airport staff. This lack of inventory has resulted in significant issues affecting the operations of the Airport and its tenants, including:

- A lack of space to accommodate new tenant operations and temporary tenant relocations; and
- Overflow of equipment and other items by tenants into Airport common space; and
- Delays to Airport capital projects due to lack of flexibility.

An office block located above and adjacent to the secure connector between Terminal 2 and Terminal 3 would add much-needed, readily accessible office space within close proximity of all terminals. The office block would:

- Provide an effective means for the coordinated relocation of various critical Airport Commission divisions and support agencies located throughout the Airport; and
- Offer centrally-located flexible space that is capable of housing tenant terminal related uses, which does not exist today.

That, in turn, would make valuable space in the ITB and post- security Boarding Areas A and G available to:

- Alleviate the current shortage of post security rentable space; and
- Meet the operational needs of new and existing international carriers; and

- Allow for the development of additional lounges and potential concession opportunities.

The proposed office block would consist of approximately 91,000 square feet of space, of which:

- Approximately 70,000 s.f. would be utilized to house portions of the Airport's Administration, Business and Finance, Marketing and Communications, and Operations divisions, as well as offices for the TSA, Federal Bureau of Investigation (FBI), and Airline Liaison Office (ALO); and
- Approximately 22,750 s.f., would be developed as rentable tenant administrative space. The tenant space will generate revenue, reduce operational impacts and cost of interim and permanent tenant relocations, and allow for tenant growth within the terminal complex.

### Estimated Construction Cost

A summary of construction costs is provided in the table below.

**Table 1**  
**Terminal 2 to Terminal 3 Connector Construction Costs<sup>1</sup>**

Project Components	Construction Cost
Level 1- Ramp level and Site Improvement	\$2,618,448
Level 2- Post Security Connector	\$21,103,934
Level 2- Departures	\$16,524,460
Level 3- Tenant Flex Space (Office)	\$9,100,000
Level 4 to 6- Commission Space (Office)	\$41,746,250
T2 Improvements	\$4,820,600
<b>Total Construction Cost</b>	<b>\$95,913,692</b>

The **Terminal 2 to Terminal 3 Connector Project** location is diagrammed in Appendix I, and includes:

**Level 1- Ramp level and Site Improvements:** This scope includes fire truck access to the runways, building cores, storage, 3,200 square foot rentable area, underground utility relocations and concrete paving upgrades.

<sup>1</sup> The cost estimates presented here are based on planning-level requirements and are preliminary in nature as developed by SFO. Final cost estimates will be prepared once the environmental process is complete and detailed design drawings are prepared.

**Level 2- Post-Security Connector:** This scope includes the elevated 16,500 square foot passenger walking bridge between Terminal 2 and Terminal 3, and Baggage Handling System right of way.

**Level 2- Departures:** This scope includes pre-security walking bridge between Terminal 2 and Terminal 3, building core, building lobby, 5,000 square foot of new rentable area and art enrichment.

**Level – Temporary (flexible) office:** This scope includes a minimal interior build out with building system (mechanical, electrical, and telecommunication), restrooms, building core and no furniture. The users would be airlines and Airport Commission offices that are required to be relocated from the foot prints of future large-scale terminal construction projects.

**Level 4 to 6- Office (Commission) spaces:** This scope includes a full office interior build out with furniture for the Airport Commission offices relocating from the International Building Terminal, restrooms and building core.

**T2 Improvements:** This scope includes selective demolition, foundation modifications, structural reinforcements and Communication Center temporary relocation with system upgrades.

## IV. Environmental Review

The Environmental Planning Division of the San Francisco Planning Department (SFEP) will act as the lead agency with regard to environmental review under the California Environmental Quality Act (CEQA) for the Terminal 2 to Terminal 3 Connector Project. SFEP will proceed with preparing a formal Initial Study and Mitigated Negative Declaration (MND) or Environmental Impact Report (EIR) for the proposed Project. The MND or EIR will include impact analysis for 18 resource categories according to the procedural requirements of California Public Resources Code Section 21000; Title 14 CEQA guidelines of the California Code of Regulations, Section 15000; and Chapter 31 of the San Francisco Administrative Code. Staff anticipates completion of the CEQA review for this project within 12-18 months from the start of the Initial Study.

## V. Fiscal Feasibility Analysis

Under the provisions of the San Francisco Administrative Code §29.2 there are five criteria to evaluate the project's fiscal feasibility. The five criteria to study the fiscal feasibility are as follows:

- (1) Direct and indirect financial benefits of the project to the City, including to the extent applicable cost savings or new revenues, including tax revenues generated by the proposed project;
- (2) The cost of construction;
- (3) Available funding for the project;

- (4) The long-term operating and maintenance cost of the project; and
- (5) Debt load to be carried by the City department or agency.

The fiscal feasibility of the Terminal 2 to Terminal 3 Secure Connector Project is analyzed based on the five criteria below.

## (1) Financial Benefits to the City

The Airport provides both direct and indirect financial benefits to San Francisco, including employment and tax revenues. With regard to direct benefits, this Project may provide the City with the opportunity to increase Airport concessions and airline tenant revenues, and thereby increase the Annual Service Payment that is made by the Airport to the City's General Fund. The Project is expected to generate a significant amount of additional operating revenue from the airlines by providing additional space for airline passenger lounges in the ITB. While the incremental revenue from airline passenger lounges does not represent "concessions revenue," and therefore would not contribute to the Annual Service Payment, it would help make the Project nearly financially self-supporting.

### 1. Direct Financial Benefits to the City

The City receives numerous direct financial benefits resulting from the operation of the Airport in the most efficient and effective manner possible.

#### 1.A - City Revenue

Under the Lease and Use Agreement between the Airport and the "signatory airlines" serving the Airport, SFO provides 15% of its gross concession revenues to the City's General Fund through what is known as the "Annual Service Payment." These General Fund revenues can be applied to any use determined by policy makers. The Annual Service Payments provided by the Airport to the City's General Fund over the previous five fiscal years totaled over \$179 million. In FY 2015, the Airport transferred \$40.5 million in revenue to the City. The five-year breakdown of the Annual Service Payments is shown in the table below.

**Annual Service Payment  
FY 2011 to FY 2015  
(in millions)**

Fiscal Year	Annual Service Payment
FY 2011	\$30.2
FY 2012	34.0
FY 2013	36.5
FY 2014	38.0
FY 2015	40.5
<b>Total</b>	<b>\$ 179.2</b>

*Source: San Francisco International Airport Annual Financial Statements*

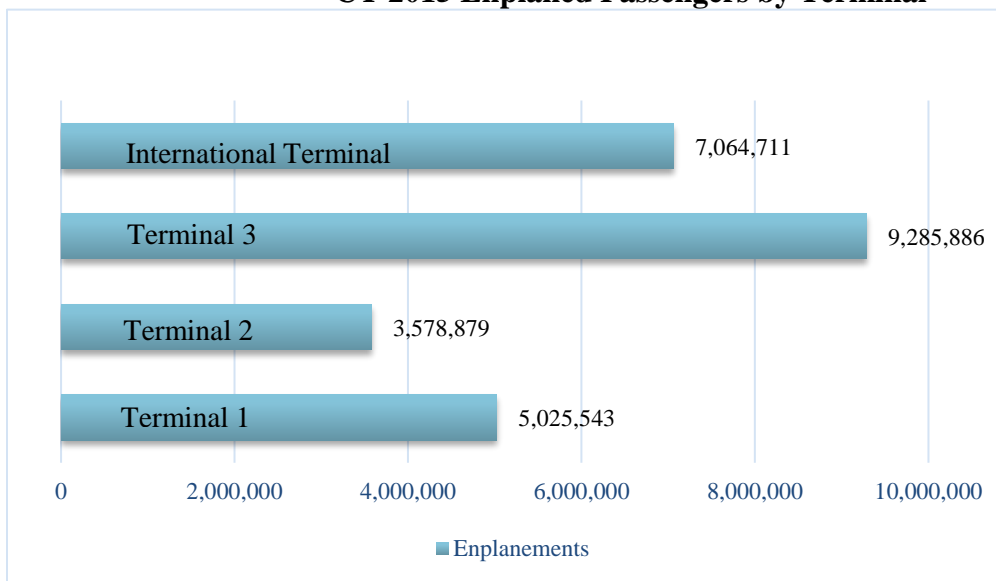
The Annual Service Payment received by the City has increased by over 34% over the past five years. The current Lease and Use Agreement between the Airport and signatory airlines operating at the Airport includes the Annual Service Payments through FY 2021.

### 1.B - Impact of Project on Concessions Revenue

The Terminal 2 to Terminal 3 Secure Connector would facilitate increased concessions revenues in two ways: 1) By providing connecting passengers with more time to make concessions purchases, because they do not have to go through security screening prior to their connecting flight; and 2) By providing all passengers using Terminals 2 and 3 with post-security access to the full range of concessions available in both terminals.

As the chart below indicates, Terminal 3 is the Airport's busiest terminal in terms of the number of enplaning passengers, handling nearly 7.1 million enplanements in CY 2015, while Terminal 2 served almost 3.6 million enplanements.

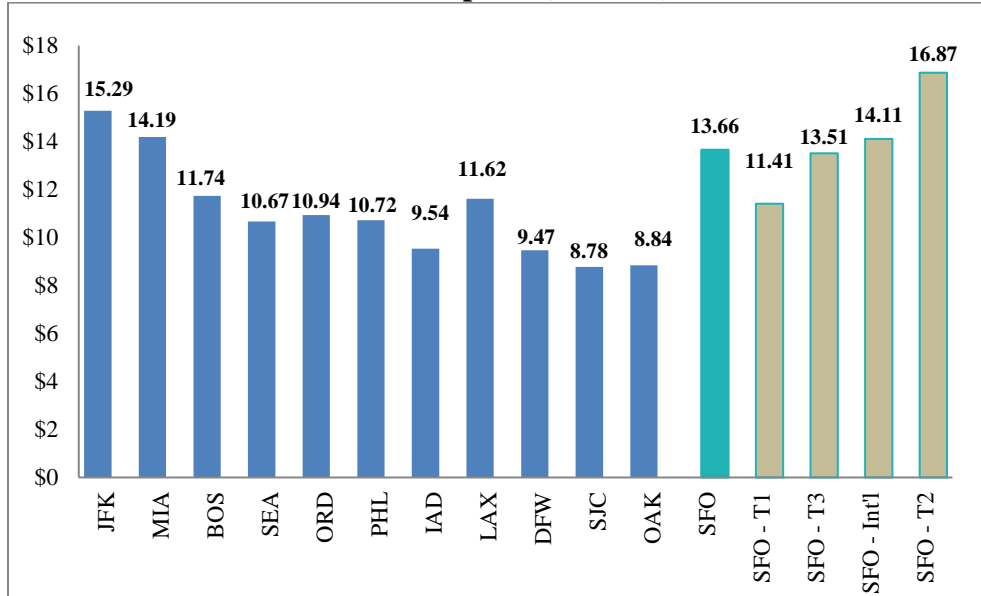
**CY 2015 Enplaned Passengers by Terminal**



While Terminal 3 served the largest number of passengers, the chart below indicates that Terminal 2 has the highest rate of concessions spending per passenger of any of the Airport's four terminals, and that the Airport overall exceeded the concessions spending rate of all but two other major hub airports in the United States.



### SFO Concessions Spending Per Passenger by Terminal (FY2015) vs. Other Airports (CY2014)



The Airport is seeking to replicate the success of the Terminal 2 concessions program in its other terminals. In January 2014, the Airport opened a renovated Boarding Area E in Terminal 3, adding 11 new dining and retail outlets. And in November 2015, as part of the Terminal 3 East capital project, the Airport added eight more newly renovated retail and food and beverage locations in Terminal 3. These two projects have significantly enhanced the opportunities for concessions revenue growth in Terminal 3.

By providing connecting passengers with more time post-security to make purchases, and by providing all passengers in Terminals 2 and 3 with more concessions choices by making it much easier for them to make purchases in an adjoining terminal, the Airport could realize an increase in overall passenger concessions spending from resulting the Secure Connector. At this time, the Airport does not have an estimate of the incremental concessions revenue that could result from the implementation of the Secure Connector. However, in terms of order of magnitude, hypothetically, if the Secure Connector between Terminals 2 and 3 were to result in a one percent increase in concessions revenue in both Terminals, then that would produce a net increase of approximately \$493,000 in annual Airport concessions revenue, and approximately a \$74,000 increase in the Annual Service Payment to the City's General Fund.<sup>2</sup>

#### Impact of Project on Non-Concession Airport Operating Revenues

In addition to the benefits generated by the Secure Connector, the Airport also expects significant benefits to result from the Office Block portion of the Project. The Airport anticipates that by freeing-up leasable space in the International Terminal Building for higher and better uses, as a consequence of the construction of the Office Block, the Airport would be

<sup>2</sup> In CY 2015, the Airport received \$14,531,054 in concessions revenue from Terminal 2, and \$34,732,545 in concessions revenue from Terminal 3, for a total from these two terminals of \$49,263,599. A 1% increase in Airport concessions revenue from these two terminals would increase concessions revenues by \$492,636. The City would receive 15% of that amount in the form of the incremental increase in the Annual Service Payment, or \$73,895.

able to generate approximately \$15.8 million in incremental annual rental revenue from the airlines, as shown in the table below.

### Incremental Airport Terminal Rental Revenue Associated with Construction of Office Block

Available Leasable Space If Office Block Is Constructed	Square Footage	Terminal Rental Rate Category [1]	FY16/17 Rental Rate [2]	Estimated Annual Rent Revenue
Int'l Terminal - Boarding Area A Shoulder Building	14,919	Category II	\$212.22	\$3,166,110
Int'l Terminal - Boarding Area G Shoulder Building	31,202	Category II	\$212.22	\$6,621,688
Office Block - "Flex Space" for interim tenant relocations	22,750	Category II	\$212.22	\$4,828,005
Office Block - Departures Level	5,000	Category II	\$212.22	\$1,061,100
Office Block - Ramp Level	3,200	Category V	\$28.30	\$90,560
<b>Totals</b>	<b>77,071</b>			<b>\$15,767,464</b>

[1] Terminal space is divided into 5 categories, each of which has its own annual rental rate. Category II rental rate applies to VIP clubs and lounges, baggage claim lobbies, baggage service offices, curbside check-in and other enclosed space on departure level or above. Category V applies to Ramp Level covered area and other unenclosed spaces

[2] Preliminary rates for FY16/17 as of April 13, 2016. These rates are subject to change, and will be finalized in May 2016

From the Airport's perspective, the incremental rental revenue associated with leasing the space freed-up in the International Terminal Building by the Office Block would more than cover the entire Project's annual debt service and O&M costs (debt service and O&M costs are discussed below). To the extent that incremental revenue exceeds debt service and O&M costs, that would reduce the terminal cost center rate base that is charged to the airlines through terminal space rental rates. No costs would be paid by the General Fund.

#### 1.D - Direct Employment

The Airport is an economic driver for the City and County of San Francisco and also the entire Bay Area. A key measure of economic activity is the direct employment based on activities related to the Airport. These jobs are within the aviation sector, transportation, professional services, or construction services. According to Economic Development Research Group, Inc., nearly 36,400 direct jobs are dependent on the activity of SFO.<sup>3</sup> The table below provides a breakdown of the types of direct jobs by category created by the Airport.

<sup>3</sup> Economic Development Research Group, Inc., "2014 Economic Impact Study Update, San Francisco International Airport", December 2014, pg. 19.

### Direct Job Impacts from SFO for FY 2013/14<sup>4</sup>

Classification of Activity by Sector	Employment
<b>Passenger Services &amp; Airport Administration</b>	
Passenger Airlines	14,520
Airport Retail & Concessions	3,858
FBOs & General Aviation & Aviation. Services	1,817
City of San Francisco Airport Commission	1,668
Security Firms	1,367
Federal Government	1,166
State/Local Government	574
Parking & Misc.	226
Mgmt., Maint/Cleaning, & Facilities Services	238
Other/Non-Profit	23
<i>Sub Total</i>	<i>25,457</i>
<b>Freight Transportation Services</b>	
Freight Airlines & Couriers	875
<b>Passenger Ground Transportation Services</b>	
Limos/Buses/Vans/Transit	3,091
Taxi Cabs	948
Rental Car	3,663
All Other Ground Transportation	1,409
<i>Sub Total</i>	<i>9,112</i>
<b>Contract Construction &amp; Consulting</b>	
Capital Construction	949
<b>Total-Airport-Based</b>	<b>36,392</b>

The total payroll from direct jobs in FY 2013/14 was estimated at \$2.4 billion. These jobs provide tax revenue to the City and County of San Francisco and throughout the Bay Area.

If the Project does not proceed, the Airport is unlikely to experience a decline in Airport-based employment. However, the Airport may forego opportunities to increase direct employment by airlines and Airport concessionaires, because it would not have the space to allow for expanded passenger lounges or other passenger amenities.

<sup>4</sup> Economic Development Research Group, Inc., "2014 Economic Impact Study Update, San Francisco International Airport", December 2014, pg. 22.

As indicated in the table below, the Project is expected to generate 802 total jobs.

Project Components	Constructions Cost	Total Job Impacts
Level 1- Ramp level and Site Improvement	\$2,618,448	22
Level 2- Post Security Connector	\$21,103,934	177
Level 2- Departures	\$16,524,460	138
Level 3- Tennant Swing Space (Office)	\$9,100,000	76
Level 4 to 6 Commission Space (Office)	\$41,746,250	349
T2 Improvements	\$4,820,600	40
Total	\$95,913,692	802

Source of employment impacts: *Regional Economic Models, Inc. (REMI)*.

The construction impact is a one-time job creation impact for the City and County of San Francisco, but the project duration is expected to 2-1/2 years from the start of design to the end of construction.

## 2. Indirect Financial Benefits to the City

The indirect financial benefits derived from the Airport are substantial. In FY 2013/14:

- The Airport directly accounted for \$6.3 billion in business activity supporting the nearly 36,400 jobs at the airport<sup>5</sup>;
- Off-site business activities that depend directly on local air service for staff movements, cargo deliveries, or customer visits (visitor spending) together raise the direct airport economic contribution to the Bay Area to \$35.4 billion in business sales with approximately 155,800 jobs;
- There are also spin-off activities in the region (indirect and induced multiplier effects) associated with suppliers of goods and services to the directly affected businesses, and the re-spending of additional worker income on consumer goods and services. Adding in these effects raise the Airport's total economic footprint in the Bay Area to almost \$59.7 billion in business sales, including \$21.2 billion in total payroll, and more than 285,000 jobs in the region.

<sup>5</sup> This total includes the Virgin America airline headquarters located in Burlingame CA. If the merger between Alaska Airlines and Virgin America is implemented, then corporate positions currently located in Burlingame may be moved to Alaska's headquarters in Seattle, WA.

- In addition to the indirect job impact, activities from the Airport generate significant tax revenues for San Francisco and the Bay Area. State and local taxes linked to the Airport are estimated at \$2.4 billion in FY 2014/15<sup>6</sup>.

## (2) Costs of Construction

The Airport estimates that the total cost is \$172 million for the Project. This amount includes construction costs, internal costs for Airport staff, external professional services to provide project management and construction management support, and associated design and engineering work for the project. The full breakdown of the project costs including construction costs and soft costs are shown in the table below.

**Total Project Costs**

Project Components	Construction Cost	Soft Costs	Total Costs
Level 1- Ramp level and Site Improvement	\$2,618,448	\$2,068,574	\$4,687,022
Level 2- Post Security Connector	\$21,103,934	\$16,672,108	\$37,776,042
Level 2- Departures	\$16,524,460	\$13,054,323	\$29,578,783
Level 3- Tennant Swing Space (Office)	\$9,100,000	\$7,189,000	\$16,289,000
Level 4 to 6 Commission Space (Office)	\$41,746,250	\$32,979,538	\$74,725,788
T2 Improvements	\$4,820,600	\$3,808,274	\$8,628,874
		<b>Total Project Cost</b>	<b>\$171,685,509</b>

\* Soft costs include project management, design, inspection, and construction management.

Source: SFO

## (3) Available Funding

The Airport anticipates having sufficient funding for the Project. The Airport's Plan of Finance and the Airport's Five-Year and 10-Year Capital Improvement Plan (CIP) includes this Project. The Airport anticipates funding this project from future general airport revenue bond issues, and will not utilize any General Fund support. With regard to appropriations authority, the Airport currently has remaining appropriation authority from its \$1.97 Billion supplemental appropriation for capital projects, which was approved by the Board of Supervisors in 2014 (Ordinance No. 64-14). The Airport expects to seek additional capital project appropriation authority from the Mayor and the Board of Supervisors in calendar year 2017.

<sup>6</sup> Ibid, pg. ii.

#### **(4) Project Long-term Operating and Maintenance Costs**

The long-term operating and maintenance costs from the proposed project are approximately \$375,000 annually for custodial staff, as well as elevator and escalator maintenance expenses.

#### **(5) Debt Load Carried by the Airport**

The Airport will finance the construction costs associated with this Project using general airport revenue bonds, and thus will incur additional debt. The Airport has an active Capital Finance Unit that manages the Airport's \$4.5 billion debt portfolio. The estimated amount of debt to be incurred for this Project would be approximately \$185.7 million (including the debt service reserve and issuance costs), based on the project budget of \$172 million. Debt service payments are estimated to be approximately \$12.8 million per year, and would total of \$379.9 million over the 30-year term of the bonds<sup>7</sup>.

The debt service costs associated with this project would not impact the General Fund. Rather, the debt service payments would increase the costs borne by the airlines doing business at the Airport, and would be paid through the terminal rental rates that they pay the Airport. The Airport anticipates debt issuance requirements for the project would be spread out over the 2 and 1/2 year construction period, and as a result, it is likely that the full debt service amounts would not impact the Airport's budget until FY 2018/19.

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<sup>7</sup> This assumes an all-in true interest cost of approximately 5.55%.

## VI. Conclusion

The Terminal 2 to Terminal 3 Secure Connector project is designed to:

- Improve convenience for passengers making connections between Terminals 2 and 3 by allowing them to use a secure connector between the terminals, and avoiding the need to pass through security prior to their connecting flight;
- Reduce queuing and waiting times at security check points in Terminals 2 and 3;
- Enhance opportunities to increase concessions revenue and the Airport's Annual Service Payment to the City's General Fund by increasing the amount of time that passengers have to make their connecting flights, reducing the level of stress associated with making those connections, and allowing passengers in Terminals 2 and 3 to have post-security access all concessions in both terminals;
- Improve flexibility for the Airport and airlines to handle airline operations or alliances in adjoining terminals;
- Creating new in-terminal office space that allows space in the International Terminal Building, which is currently used for Airport staff and other offices, to be used for higher and better uses, such as airline passenger lounges and concessions; and
- Improve the Airport's ability to flexibly meet terminal-related administrative space demand.

At this time, the Airport does not project any change in the Annual Service Payment to the City's General Fund as a result of this Project, although the Airport recognizes that the Secure Connector may provide passengers with more opportunities to increase their concessions spending. To the extent that this occurs, this could facilitate increases in Airport concessions revenue in Terminals 2 and 3, and an increase in the Annual Service Payment. In addition to the potential impacts on concessions revenue, the Project also provides the opportunity to free-up leasable space in the International Terminal Building for higher and better uses that would generate significant non-concessions revenue for the Airport.

If the Airport cannot proceed with this Project, then the Airport would forego the opportunity to improve the experience for connecting passengers, to better utilize its terminal space, and to generate additional concessions revenue. The City would forego the opportunity to increase the Annual Service Payment that it receives from the Airport.



# Appendix I Project Overview

