San Francisco International Airport

MEMORANDUM

March 7, 2017

TO: AIRPORT COMMISSION
Hon. Larry Mazzola, President
Hon. Linda S. Crayton, Vice President
Hon. Eleanor Johns
Hon. Richard J. Guggenhime
Hon. Peter A. Stern

FROM: Airport Director

SUBJECT: Adoption of Two Resolutions Relating to the On-Airport Hotel Project: (1) Amendment of the Fiscal Year 2016/2017 Five-Year and Ten-Year Capital Plans to Increase the Hotel Project Budget by $30 Million; and (2) Twentieth Supplemental Bond Resolution, in Connection with the On-Airport Hotel, Increasing Airport Capital Plan Bond Authorization by $35 Million from $243 Million to $278 Million in Principal Amount, and Increasing Hotel Special Facility Bond Authorization by $35 Million from $225 Million to $260 Million in Principal Amount

DIRECTOR'S RECOMMENDATION: AMEND THE FISCAL YEAR 2016/2017 FIVE-YEAR AND TEN-YEAR CAPITAL PLANS TO INCREASE THE HOTEL PROJECT BUDGET BY $30 MILLION; AND APPROVE ADDITIONAL BOND AUTHORIZATIONS FOR THE ON-AIRPORT HOTEL, INCREASING AIRPORT CAPITAL PLAN BONDS AUTHORIZATION BY $35 MILLION, FROM $243 MILLION TO $278 MILLION IN PRINCIPAL AMOUNT, AND INCREASING HOTEL SPECIAL FACILITY BONDS AUTHORIZATION BY $35 MILLION, FROM $225 MILLION TO $260 MILLION IN PRINCIPAL AMOUNT.

Executive Summary

Since the fall of 2015, the Bay Area has experienced a significant increase in construction costs, which has hampered the Airport's ability to deliver the On-Airport Hotel (the "Hotel") within the existing project budget without significantly reducing the number of guest rooms. This construction cost escalation, as well as increases in the amount of Hotel space dedicated to revenue-generating meeting facilities and food and beverage outlets, has led to a $30 million increase in the project budget.

This increase in the project budget makes it possible to construct the Hotel with approximately 351 guest rooms. This will generate more revenue than if the existing budget were adhered to and a substantially smaller Hotel with 289 rooms were to be built. The original program with 351 rooms will generate total gross revenues of $60 million annually. This is $12 million higher by the third year of operation for the 351-room Hotel than for a smaller, 289-room Hotel. A smaller 289-room Hotel will generate only $48 million annually. Further, the Hotel will be able to provide more rooms to accommodate the Airport's growing number of passengers. Updated revenue projections show that the Hotel remains financially viable, even with the higher budget.

This change in the project budget will require three actions: (1) amending the Fiscal Year ("FY") 2016/2017 Five-Year and Ten-Year Capital Plans Hotel Project Budget; (2) approving additional Airport capital plan bond authorization, and (3) approving additional hotel special facility bonds authorization.

THIS PRINT COVERS CALENDAR ITEM NO. 2

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Background

On September 22, 2015, the Commission adopted Resolution No. 15-0182, the Eighteenth Supplemental Bond Resolution, which designated the Hotel as a "special facility" and authorized the issuance of up to $243 million in principal amount of Airport Capital Plan Bonds and $225 million principal amount of Hotel Special Facility Bonds, to finance the construction and development of the Hotel.

The Hotel's cash-flow must be kept separate from that of the Airport, so that the Hotel operator can pay Hotel expenses directly from Hotel revenues. To establish this separate treatment of Hotel revenues, in 2015 the Airport Commission designated the Hotel as a "special facility" under the Airport's 1991 Master Bond Resolution. To finance the Hotel at the lowest available cost while maintaining its special facility status, the Commission has approved the issuance of two types of bonds:

- Tax-exempt Airport Capital Plan Bonds (i.e., general airport revenue bonds), which would be sold to investors; and
- Tax-exempt Hotel Special Facility Bonds, which would be purchased by the Commission with Airport Capital Plan Bond proceeds.

On June 1, 2016, the Commission adopted Resolution No. 16-0166, which approved the FY 2016/2017 Five-Year and Ten-Year Capital Plans, including a Hotel project budget of $225 million ($210 million for the Hotel and $15 million for the new Hotel AirTrain Station). Airport staff has engaged a Design-Build team and a hotel operator.

The increase in budget of $30 million is due primarily to: 1) significant construction cost escalation, particularly in the areas of electrical, mechanical, glazing and interior finishes; and 2) increases in the amount of space allocated for revenue-generating facilities (e.g., meeting facilities and food and beverage outlets). This represents a 14.3 percent increase in the construction budget since the fall of 2015. In comparison, an independent cost management firm estimates that San Francisco construction costs have increased by 17.9 percent in the past year.[1]

The Airport and its financial advisors have determined that the increase in the project budget would result in a $35 million increase in the authorization required for both Airport Capital Plan Bonds and Hotel Special Facility Bonds to cover the increase in project cost and associated financing costs. The changes in the Airport's proposed Hotel financing plan are summarized on the following page.

Costs Payable from Airport Capital Plan Bonds	**October 2015**		**February 2017 Revision**	
Hotel AirTrain station construction costs:		$ 15,000,000		$ 15,000,000
Costs of issuance:		3,000,000		3,000,000
Purchase of Hotel Special Facility Bonds:		225,000,000		260,000,000
Project Costs Payable from				
Hotel Special Facility Bonds				
Hotel construction costs (including repayment of commercial paper principal and reimbursement of operating funds):	$210,000,000		$240,000,000	
Capitalized Interest, Commercial Paper Interest:	20,000,000		25,000,000	
Less contribution from Hotel operator:	(5,000,000)		(5,000,000)	
Total Hotel Special Facility Bonds:	$225,000,000		$260,000,000	
Total Airport Capital Plan Bonds:		$243,000,000		$278,000,000

Airport staff, in consultation with the Commission's hospitality consultant and financial advisors, expects the Hotel to produce positive financial results at this new project budget, in part because the hospitality consultant's updated projections show a higher average daily room rate for the Hotel compared to projections from 2015. By maintaining the original program with 351 guest rooms, the Airport expects to

[1] Rider Levett Bucknall, "USA Report, Quarterly Construction Cost Report," December 2016.

derive higher "net profits" (i.e., total hotel revenues less total hotel operating expenses, required reserve deposits, and debt service costs) than a smaller 289-room Hotel that is within the existing project budget. Once occupancy has stabilized, total gross revenues are estimated to be approximately $12 million per year higher for the 351-room Hotel than for the smaller, 289-room Hotel.

Therefore, Airport staff requests that the Commission adopt a resolution amending the FY 2016/2017 Five-Year and Ten-Year Capital Plans to increase the Hotel project budget by $30 million, for a new total budget of $255 million ($240 million for the Hotel and $15 million for the Hotel AirTrain Station). To generate $30 million in additional Hotel project funds, and to cover associated financing costs, Airport staff also requests that this Commission adopt a resolution (the "Bond Resolution") that would authorize:

- Up to $35 million principal amount of additional Hotel special facility bonds, bringing the total approved amount to $260 million, to finance Hotel and related costs or to refinance Commercial Paper issued for Hotel costs, and fund a capitalized interest account. As currently authorized, the Hotel special facility bonds will have a maturity of 40 years and bear interest at a fixed rate to be determined at the time of issuance; and
- Up to $35 million principal amount of additional Airport Capital Plan Bonds, bringing the total approved amount to $278 million, to finance the purchase of the Hotel special facility bonds by the Commission, along with financing for the Hotel AirTrain station and/or refinancing of Commercial Paper issued for the station, and associated costs of issuance. There is no change in the maximum bond maturity of 40 years, or in the interest rate limitations set forth in Resolution No. 50-11 of the Board of Supervisors. The Airport Capital Plan Bonds will be sold prior to June 30, 2020, and may be issued as Variable Rate Bonds.

Airport staff is also requesting approval of the supplemental appropriation of the additional Airport revenue bond proceeds and Hotel special facility bond proceeds, and $60,000 in additional Airport operating funds that will support the City Services Auditor Division ("CSA") pursuant to Section F1.113 of the City Charter. As required, 0.2 percent of the project cost is budgeted to support CSA services.

Request to the Board of Supervisors

If the Twentieth Supplemental Bond Resolution is adopted by this Commission, the Commission Secretary will request that the Board of Supervisors approve the increase in Airport Capital Plan Bonds and Hotel Special Facility Bonds. The Airport will also request the necessary increase in appropriations. Once final approval is obtained from the Board of Supervisors, I will return to the Commission for approval of one or more sale resolutions prior to selling and issuing the Airport Capital Plan Bonds and the Hotel Special Facility Bonds.

Recommendation

I recommend that this Commission adopt the two attached Resolutions: (1) amending the Fiscal Year 2016/2017 Five-Year and Ten-Year Capital Plans to increase the Hotel Project budget, and (2) approving additional bond authorization for the Hotel.

Ivar C. Satero
Airport Director

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Attachment