CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: February 3, 2021 Budget and Finance Committee Meeting

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Item 1 **File 21-0007**	**Department:** Airport

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve the Amended Hotel Trust Agreement between the Airport and U.S. Bank, the Hotel Special Facility Revenue Bond trustee.

Key Points

- The Board of Supervisors previously approved the sale of $278 million in Airport General Revenue Bonds and $260 million in Hotel Special Facility Revenue Bonds to finance the construction of a hotel owned by the Airport and operated by Hyatt Corporation. The Airport used the proceeds from the General Airport Revenues Bonds to purchase the Hotel Special Facility Revenue Bonds, for which debt service is paid from hotel revenues. Debt service payments on the Hotel Special Facility Revenue Bonds are revenue to the Airport. The Airport uses its operating revenues to pay for debt service on the General Airport Revenue Bonds.
- According to the Airport, because of the reduction in travel due to COVID 19, the hotel did not have sufficient revenues or reserves available to make the scheduled semi-annual interest payment for the Hotel Special Facility Revenue Bonds of $3.9 million due on October 1, 2020.
- Under the proposed Amended Hotel Trust Agreement, all Hotel Special Facility Revenue Bond (a) debt service payments (interest and principal repayments) would be suspended for the period from October 1, 2020 and through April 1, 2023; and (b) interest rates would be reduced from 3 percent to 0.086 percent through October 1, 2023 and then gradually increase until the interest rate is restored to 3 percent beginning on April 1, 2029. Interest would continue to accrue on the outstanding debt between October 2020 and April 2023.

Fiscal Impact

- The total reduction in nominal (unadjusted for inflation) debt service is $47.5 million. The net present value of the interest payment the Airport will forgo under the debt restructuring is $44.1 million. This reduces the amount of Airport revenue available to pay for General Airport Revenue Bond debt that was used to purchase the Hotel Special Facility Revenue Bonds. In FY 2020-21, the reduction in revenues to the Airport from the proposed Amended Hotel Trust Agreement is $7.8 million and in FY 2021-22 is $8.6 million. According to the Airport, in response to the impacts of the COVID-19 pandemic, the Airport is implementing measures to significantly reduce operating expenses and near-term debt service costs on its General Airport Revenue Bond debt portfolio to offset revenue losses due to the COVID-19 pandemic.

Recommendations

- Amend the resolution to request a report from the Airport in May 2021 on the Airport's and Airport Hotel's revenues and expenditures in FY 2020-21, projected revenues and expenditures in FY 2021-22, and the status of outstanding debt and annual debt service.
- Approve the proposed resolution as amended.

MANDATE STATEMENT

Charter Section 9.107(4) provides for the Board of Supervisors to authorize the Airport to issue revenue bonds for any Airport related purpose and secured solely by Airport revenues.

BACKGROUND

Airport Hotel Financing Structure and Agreements

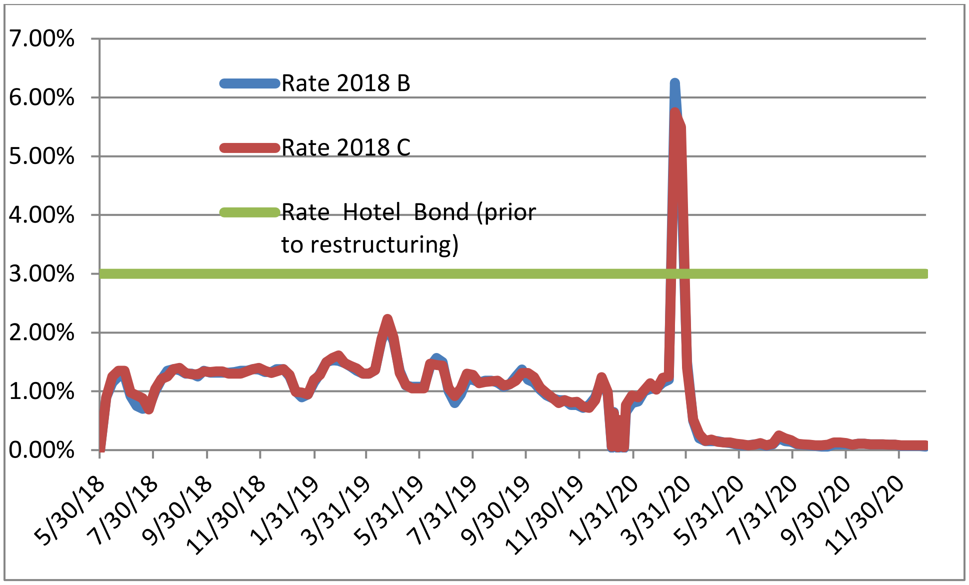
In late 2015, the Board of Supervisors approved the sale of $243 million of General Airport Revenue Bonds and $225 million of Hotel Special Facility Revenue Bonds to finance the construction of a 351-room hotel at the Airport (File 15-0987). Due to an increase in construction costs, in 2017 the Board of Supervisors approved an additional sale of $35 million of General Airport Revenue Bonds and $35 million of Hotel Special Facility Revenue Bonds to complete the project (File 17-0696).

The Airport used the proceeds from the General Airport Revenues Bonds to purchase the Hotel Special Facility Revenue Bonds. The Airport has a trust agreement with Bank of New York Mellon Trust Company, N.A., to hold the Hotel Special Facility Revenue Bonds and transfer debt service payments to the Airport. The General Airport Revenue Bonds issued to purchase the Hotel Special Facility Revenue Bonds have a variable interest rate that remained below 2 percent prior to the pandemic, while the Hotel Special Facility Revenue Bonds have a fixed interest rate of 3 percent.[1] The interest rate on the Airport General Revenue Bonds increased for two weeks in March 2020 to an average of 5.5 percent due to a short-term disruption in the financial markets caused by the outbreak of COVID-19, but have since decreased to less than 0.1 percent, on average, as shown in the Exhibit below.[2]

[1] The Airport's debt policy allows for up to 20 percent of outstanding debt to be issued at a variable rate. The Airport's variable rate General Airport Revenue Bonds represent 5.2 percent of its overall debt portfolio

[2] Under the variable rate structure of these Airport General Revenue Bonds for the hotel, the bonds are remarketed every 7 days.

Exhibit 1: Current interest rates on variable and fixed rate Hotel debt



Source: Airport

Note: Rate 2018 B and 2018 C refer to the variable rate on the General Airport Revenue Bonds issued to purchase the Hotel Special Facility Bonds

Hotel revenues pay debt service on the Hotel Special Facility Revenue Bonds. Because the Airport purchased the Hotel Special Facility Revenue Bonds, debt service payments on those bonds are revenue to the Airport. The Airport uses its operating revenues[3] to pay for debt service on the General Airport Revenue Bonds.

Airport Hotel Agreements

The Airport owns the hotel, which is operated by Hyatt Corporation under a competitively procured Management Agreement approved by the Board of Supervisors in 2015 (File 15-0988). The hotel's revenues pay for its operating costs, including the cost of the Management Agreement and, as noted above, for debt service on the Hotel Special Facility Revenue Bonds and related reserves. Hyatt receives a Base Management Fee, which is a fixed amount that escalates over the term of the Management Agreement, and a Subordinate Management Fee, which is also a fixed amount but only paid if the hotel has net revenue after debt service. If the Subordinate Management Fee is not paid in a given year, it carries over to the next year without interest. The trustee on the Hotel Special Facility Revenue Bonds has the right to apply amounts from the Subordinate Management Fee account to the extent necessary for debt service payments.

Hotel net revenue is considered concession revenue to the Airport, fifteen percent of which is transferred to the General Fund as part of the Airport Annual Service Payment (ASP) to the City. The ASP will be increased by an amount equal to the gross revenues of the hotel, less hotel operating and maintenance expenses and scheduled debt service on the Special Facility Revenue

[3] Airport operating revenues primarily consist of landing and terminal fees charged to airlines as well as parking, terminal concessions, ground leases, car rentals, ground transportation, and fee revenues.

Bonds. Increases in hotel revenues, or decreases in debt service or operating expenses increase the ASP calculation.

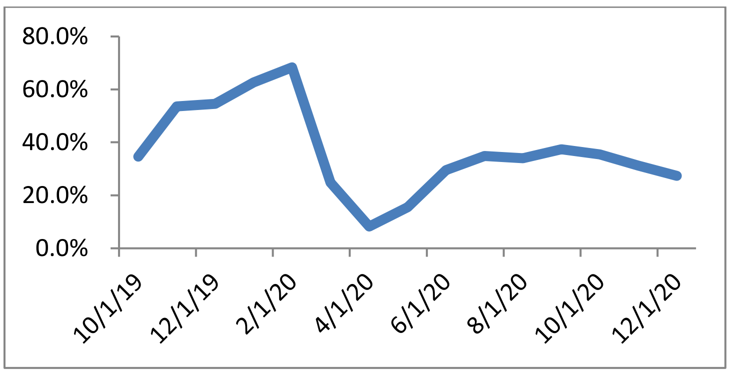
Hotel Bond Trust Agreement

The 2015 resolution approving the original General Airport Revenue Bond and Hotel Special Facility Revenue Bond sales also approved the Hotel Trust Agreement between the Airport and U.S. Bank N.A. to hold, in trust, all hotel revenues and use the hotel revenues to pay for authorized expenses, which include hotel operations, Special Facility Revenue Bond debt service, and funding required reserves.

Airport Hotel Financial Condition

The hotel commenced commercial operations in October 2019. The subsequent onset of the COVID 19 pandemic has resulted in a deterioration of the Hotel's financial position, with Hyatt reporting mounting accounting loss on hotel operations beginning in March 2020. Exhibit 2 below shows the change in the hotel's occupancy before and during the pandemic.

Exhibit 2: Airport Hotel Occupancy



Source: SFO

According to Airport staff, the hotel had a $4 million loss in FY 2019-20 and its annual budget projected an $11 million loss in FY 2020-21. If hotel revenues are insufficient to cover hotel costs (debt service, operating expenses, the base management fee and subordinate management fee, and other costs), the hotel draws on its liquidity reserves to address the shortfall. According to Airport staff, the hotel has also reduced operating expenses due to reductions in its revenues caused by the COVID-19 pandemic.[4]

Suspended Debt Service Payment

According to the Airport, the hotel did not have sufficient revenues or reserves available to make the scheduled semi-annual interest payment for the Hotel Special Facility Revenue Bonds of $3.9

[4] According to Ms. Ronda Chu, Capital Finance Director at the Airport, the payments from the hotel to the Airport comprise a very small percentage of the Airport's overall $1.2 billion budget. In response to the impacts of the COVID-19 pandemic on general Airport revenues, the Airport is implementing measures to significantly reduce operating expenses and near-term debt service costs on its General Airport Revenue Bond debt portfolio. These measures will mitigate the temporary losses incurred by the hotel.

million due on October 1, 2020. On September 15, 2020, the Airport Commission authorized the Airport Director to execute an instruction to cause Bank of New York Mellon Trust, the holder of the Hotel Special Facility Revenue Bonds on behalf of the Airport, to instruct the Hotel Bonds Trustee (U.S. Bank) to temporarily suspend the interest payment of $3.9 million that was due on October 1, 2020 and to forbear and take no action to declare a non-payment event on the Hotel Special Facility Revenue Bonds.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the Amended Hotel Trust Agreement between the Airport and U.S. Bank, the Hotel Special Facility Revenue Bond trustee.

Under the proposed Amended Hotel Trust Agreement, all Hotel Special Facility Revenue Bond debt service payments (interest and principal repayments) would be suspended for the period from October 1, 2020 and through April 1, 2023.

In addition, the proposed Amended Hotel Trust Agreement would reduce the interest rate on the Hotel Special Facility Revenue Bonds from 3 percent to 0.086 percent through October 1, 2023 and then gradually increase until the interest rate is restored to 3 percent beginning on April 1, 2029, as shown below. Interest would continue to accrue on the outstanding debt between October 1, 2020 and April 1, 2023. The restructured Hotel Special Facility Revenue Bonds will still have a principal amount of $260 million.

Exhibit 3: Proposed Interest Rate Schedule

Repayment Period	Interest Rate
April 1, 2020 to October 1, 2023	0.086%
October 1, 2023 to April 1, 2025	0.600%
April 1, 2025 to April 1, 2026	1.100%
April 1, 2026 to April 1, 2027	1.600%
April 1, 2027 to April 1, 2028	2.100%
April 1, 2028 to April 1, 2029	2.600%
April 1, 2029 to April 1, 2058	3.000%

Source: Proposed Amended & Restated Trust Agreement

In addition, the proposed Amended Hotel Trust Agreement would reduce all Mandatory Sinking Fund[5] contributions through April 1, 2029.

According to Ms. Chu, the requested debt service restructuring ensures that the suspended October 2020 Hotel Special Facility Revenue Bond debt service payment does not constitute a default on that debt.

[5] A Mandatory Sink Fund is money set aside for principal payments.

FISCAL IMPACT

The fiscal impacts of the proposed nine-year easement of debt service are shown below in Exhibit 4.

Exhibit 4: Proposed Debt Restructuring

Date	Current Debt Service	Proposed Debt Service	Nominal Savings	Savings, Present Value
4/1/21	$7,800,000		$7,800,000	$7,676,545
4/1/22	$8,565,000		$8,565,000	$8,247,940
4/1/23	$8,257,050		$8,257,050	$7,785,178
4/1/24	$8,542,650	$1,560,000	$6,982,650	$6,443,079
4/1/25	$8,734,250	$4,755,000	$3,979,250	$3,607,134
4/1/26	$8,989,400	$5,009,855	$3,979,545	$3,525,308
4/1/27	$9,226,000	$5,248,920	$3,977,080	$3,442,985
4/1/28	$9,534,350	$5,552,345	$3,982,005	$3,368,764
4/1/29	$9,722,050	$9,718,590	$3,460	$7,202
	$79,370,750	$31,844,710	$47,526,040	$44,104,135

Source: Airport

The total reduction in nominal (unadjusted for inflation) debt service is $47.5 million. The net present value of the interest payment the Airport will forgo under the debt restructuring is $44.1 million. This reduces the amount of Airport revenue available to pay for General Airport Revenue Bond debt that was used to purchase the Hotel Special Facility Revenue Bonds. In FY 2020-21, the reduction in revenues to the Airport is $7.8 million and in FY 2021-22 is $8.6 million. According to Ms. Chu, in response to the impacts of the COVID-19 pandemic, the Airport is implementing measures to significantly reduce operating expenses and near-term debt service costs on its General Airport Revenue Bond debt portfolio to offset revenue losses due to the COVID-19 pandemic.

POLICY CONSIDERATION

In January 2020, the Board of Supervisors authorized the Airport to issue up to $3 billion in new General Airport Revenue Bonds (File 19-1124). According to the Budget and Legislative Analyst's report to the January 22, 2020 Budget and Finance Committee, the Airport's consultant forecasted that debt service on all current and proposed bonds would increase from $463.5 million in FY2018-19 to more than $500 million in FY 2020-21.

In January 2020, the Airport forecasted passenger enplanements to increase from approximately 28 million in CY 2018 to approximately 31 million in CY 2021. Subsequent to the Board's authorization of the Airport's issuance of the new General Airport Revenue Bonds, Airport enplanements and revenues were significantly reduced by the COVID-19 pandemic. According to the Controller's Three-Month Budget Status report for FY 2020-21, Airport enplanements decreased by over 50 percent. The Airport projected a revenue loss in FY 2020-21 of $21.4 million, offset by expenditure savings of $47.6 million, for a projected surplus in FY 2020-21 of $26.2 million.

The Board of Supervisors should amend the proposed resolution to request a report from the Airport in May 2021 on the Airport's and Airport Hotel's revenues and expenditures in FY 2020-21, projected revenues and expenditures in FY 2021-22, and the status of outstanding debt and annual debt service.

RECOMMENDATIONS

1. Amend the proposed resolution to request a report from the Airport in May 2021 on the Airport's and Airport Hotel's revenues and expenditures in FY 2020-21, projected revenues and expenditures in FY 2021-22, and the status of outstanding debt and annual debt service.
2. Approve the proposed resolution as amended.

Item 2 **File 20-1349**	**Department:** San Francisco International Airport

Legislative Objectives

- The proposed resolution would approve Modification No. 3 to the contact between the Airport and KONE for escalator and electric walk maintenance, repair, and on-call services. The contract amount would be increased by $9,000,000 from $9,765,600 to $18,765,600 with no change to the contract term.

Key Points

- The Airport entered into the original contract with KONE, Inc. (KONE) in May 2019 following a competitive solicitation. The contract was for a two-year term from July 1, 2019 through June 30, 2021 in an amount not to exceed $9,765,600
- The Airport has entered into two prior contract modifications to (a) reallocate funds from preventative maintenance to as-needed services, and (b) decrease rates for preventative maintenance to address the Airport's revenue shortfalls due to the pandemic. The re-allocation of funds to as-needed services was based on a safety audit conducted by KONE, which identified the need for the overhaul of the escalators and electric walkways.

Fiscal Impact

- The increase of $9,000,000 under Modification No. 3 adds (a) $4,000,000 to as-needed services for a total as-needed service budget of $9,000,000, and (b) $5,000,000 to preventative maintenance, for a total preventative maintenance budget of $9,765,600.
- The Airport has paid $9,662,350 to KONE, Inc. for Airport escalator and electric walk maintenance work, comprised of $5,521,600 in preventative maintenance services paid to August 2020, and $4,140,750 in as-needed services to July 2020. According to the Airport, KONE has continued to perform preventative maintenance and as-needed services since July/ August 2020 although the contract amount for these services has been exceeded. According to Airport staff, the Airport was delayed in submitting the modified contract to the Board of Supervisors for approval due to the large number of contract modifications to address revenue shortfalls due to reduced passenger traffic at the Airport caused by the COVID-19 pandemic. The proposed Modification No. 3 would pay for preventative maintenance and as-needed services provided between July/August 2020 and January 2021 and for future services through the contract end date in June 2021.
- Based on the level of preventative maintenance service defined in the original contract and the original service rates through July 2020 and revised service rates beginning in August 2020, the Budget and Legislative Analyst estimates the budget for preventative service over the term of the contract to be approximately $9,265,600, or $500,000 less than provided in Modification No. 3.

Recommendations

- Amend the proposed resolution to decrease the contract not-to-exceed amount by $500,000, from $18,765,600 to $18,265,600.
- Approve the proposed resolution as amended.

[redacted]

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of $10 million or more, or (3) requires a modification of more than $500,000 is subject to Board of Supervisors approval.

BACKGROUND

The Airport entered into the original contract with KONE, Inc. (KONE) in May 2019 to provide for the specialized preventative maintenance, repair, and on-call services for all escalators and electric walks at the Airport. The contract was for a two-year term from July 1, 2019 through June 30, 2021 in an amount not to exceed $9,765,600. The Request for Proposals (RFP) for the contract allows for a single three-year option to extend the term.

The contract was awarded following a competitive solicitation in February 2019 for “Escalator and Electric Walk Maintenance, Repair, and On-Call Services.” Three proposals were submitted that all met the minimum qualifications of the RFP and were reviewed by a selection panel comprised of a Conveyance Specialist from Denver International Airport, a Deputy Director for Facilities Maintenance from San Francisco Recreation and Parks Department, and an Airport Duty Manager from San Francisco International Airport. KONE submitted the lowest cost proposal amount ($9,765,600) and ultimately received the highest evaluation score. KONE is an international engineering and service company headquartered in Helsinki, Finland with a branch office in San Francisco, providing new elevator and escalator installation, as well as service and repair of existing equipment.

The contract scope of services consists of preventative maintenance and as-needed services. There have been two prior modifications to the contract, and the third is now under consideration.

Modification No. 1

In October 2019, the Airport administratively modified the contract, increasing the allowance for as-needed services from $300,000 to $5,000,000, with no change to the total contract amount. According to Airport staff, the original $300,000 for as-needed services was for repairs and other services that could be required as a result of vandalism or accidents. Upon commencement of the contract, KONE performed a detailed safety audit and identified “critically ill escalators and electric walks that required overhauls.”

Modification No. 2

In July 2020 the Airport and KONE agreed on Modification No. 2, which reduced the monthly unit price for preventative maintenance effective on and after August 7, 2020, and regular work hours from seven to five days per week. There was no change to total contract amount or duration. This modification was in response to the City’s request that due to the financial impacts that the Airport and City are currently experiencing as a result of the COVID-19 pandemic, all professional service contractors reduce unit prices under their contracts in order to assist in maintaining the financial feasibility of Airport's continued procurement of services under the contract.

Airport staff report that KONE has satisfactorily provided all aspects of the maintenance and repair of Airport escalators and electric walks.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve Modification No. 3 to the contact between the Airport and KONE for escalator and electric walk maintenance, repair, and on-call services. The contract amount would be increased by $9,000,000 from $9,765,600 to $18,765,600 with no change to the contract term. The purpose of the proposed contract modification is to complete major equipment overhaul and repairs. Airport staff noted that the reduction of passenger traffic due to the COVID-19 pandemic presents opportune conditions for completing major equipment overhaul and repairs.

Original Scope of Services

Under the original contract, KONE was primarily responsible for the ongoing maintenance, inspection, testing, repair, parts and component replacement, cleaning of equipment, emergency repair, and other work for the Airport's escalators and electric walkways. The contract scope of services was separated into two basic types: 1) preventative maintenance budgeted at $9,465,600, and 2) as-needed services, budgeted at $300,000, for a total contract budget of $9,765,600. Preventative maintenance consists of monthly elevator and electric walk service. As-needed services are defined in the contract as those services required for Airport escalators and electric walks as a result of accidents, vandalism, or any other instance or circumstance that is not a result of standard operations and normal wear and tear. As-needed services are performed on an if-and-as-needed basis, at the request of the Airport documented through a written task order. [1]

Revised Scope of Services

According to Mr. Sung Kim, Airport Contracts Administration Manager, shortly after commencement of the contract in July 2019, KONE determined that the escalator and electric walkway equipment required extensive overhaul based on a detailed safety audit, as noted above. Modification No. 1 revised the contract scope of services to re-allocate the contract budget from preventative to as-needed, and increased the allocation for as-needed services from $300,000 to up to $5,000,000, offset by a reduction in the budget allocation to preventative maintenance from $9,765,600 to $4,765,600, shown in Table 1 below.

FISCAL IMPACT

The increase of $9,000,000 under Modification No. 3 adds (a) $4,000,000 to as-needed services for a total as-needed service budget of $9,000,000, and (b) $5,000,000 to preventative

[1] The contract budget for preventative services is based on the number of units to be serviced each month x the unit cost of service, defined in Appendix B of the contract. The amount for as-needed services is based on task orders for each service.

maintenance, for a total preventative maintenance budget of $9,765,600, shown in Table 1 below. The contract total under Modification No. 3 is $18,765,600.[2]

Table 1. Budget for Contract with Modifications

	Original Contract	Modification No. 1 & No. 2	Proposed Modification No. 3	Increase
Preventative Maintenance Services	$9,465,600	$4,765,600	$9,765,600	$5,000,000
As-Needed Services	300,000	5,000,000	9,000,000	4,000,000
Total Not-to-Exceed Price	**$9,765,600**	**$9,765,600**	**$18,765,600**	**$9,000,000**

Source: Contract and Contract Modifications

The Airport has paid $9,662,350 to KONE, Inc. for Airport escalator and electric walk maintenance work. This is comprised of $5,521,600 in preventative maintenance services paid through August 2020, and $4,140,750 in as-needed services through June 2020.

Contract Expenditures

The Airport expended more nearly 99 percent of the contract amount ($9,662,350 of $9,765,600) by August 2020. According to Mr. Kim, KONE has continued to perform preventative maintenance and as-needed services since July/ August 2020 although the contract amount for these services has been exceeded. According to Mr. Kim, the Airport was delayed in modifying the contract and submitting the modified contract to the Board of Supervisors for approval due to the large number of contract modifications to address revenue shortfalls due to reduced passenger traffic at the Airport caused by the COVID-19 pandemic.

Section 3.2 of the original contract provides for guaranteed maximum costs, including that the City is not required to offer or promise payments to the contractor in excess of the contract not-to-exceed amount. The proposed Modification No. 3 would pay for preventative maintenance and as-needed services provided between July/August 2020 and January 2021 and for future services through the contract end date in June 2021.

Preventative Maintenance Services

As noted above, the rates for preventative maintenance service were reduced under Modification No. 2. Based on the level of preventative maintenance service defined in the original contract and the original service rates through July 2020 and revised service rates beginning in August 2020, the Budget and Legislative Analyst estimates the budget for preventative service over the term of the contract to be approximately $9,265,600, or $500,000 less than provided in Modification No. 3.

As-Needed Services

The Airport approved ten task orders with KONE for $300,750 and approved the 11th task order with KONE effective July 2019 for $3,840,000 for overhaul of the escalators and electric walks, totaling $4,140,750. Task Order #11 added four crews of two technicians per crew for 12 months

[2] The proposed contract amount of $18,765,600 is less than the contract amount proposed by the other two proposers who responded to the RFP.

to July 2020. The proposed increase of $4,000,000 for as-needed services will pay for the continued use of the four additional crews and other as-needed works between July 2020 and the contract end date in June 2021.

Funding Sources

Preventative maintenance work is paid entirely from the Airport's operating funds, and as-needed services are funded through both operating funds (for minor repairs) and capital funds (for overhauls).

RECOMMENDATIONS

1. Amend the proposed resolution to decrease the contract not-to-exceed amount by $500,000, from $18,765,600 to $18,265,600.
2. Approve the proposed resolution as amended.