

**PORT OF SEATTLE**  
**MEMORANDUM**

**COMMISSION AGENDA**  
**ACTION ITEM**

<b>Item No.</b>	4d
<b>Date of Meeting</b>	November 25, 2014

**DATE:** November 10, 2014  
**TO:** Ted Fick, Chief Executive Officer  
**FROM:** James R. Schone, Director, Aviation Business Development  
Nick Harrison, Senior Manager, Aviation Operations  
Jeff Wolf, Manager, Aviation Business Development and Analysis  
**SUBJECT:** Third Party Firm to Manage the Airport's Common-Use Premium Lounges.

**ACTION REQUESTED**

Request Commission authorization for the Chief Executive Officer to execute a contract for operation of common-use premium lounges at Seattle-Tacoma International Airport for a total contract cost to the Port not to exceed \$2,000,000 and a term of three years with two, one-year options to extend.

**SYNOPSIS**

The Airport currently has two common-use premium lounges in operation. These lounges are an essential service for the international airlines that do not operate their own lounges at the Airport, or airlines that require additional space outside of their own proprietary lounges. Both lounges are operated under a management contract with VIP Hospitality (VIP) that was executed in March 2010 and expires March 31, 2015.

The contract will have a three-year initial term along with two (2) one-year options to extend. The estimated contract value is anticipated to be \$2,000,000, which represents the estimated total management fees paid to the selected lounge operator over the potential five-year contract period. In addition to the management fees, as part of this contract the Port will be spending an estimated \$4 million over the five-year period on labor, food, and beverage, office supplies, janitorial services, and applicable licenses. Port staff has included the estimated costs associated with this contract in the 2015 operating budget.

**BACKGROUND**

A premium passenger lounge is an essential component of the services offered by airlines that target high margin first- and business-class passengers on international flights. A premium lounge offers a quiet place for passengers to relax prior to boarding their flight along with services including complimentary food and beverage, computer access, newspapers, magazines, and televisions. The Port provision of common-use lounges - Club International on the South Satellite and Club Cascade on Concourse A - (Exhibit 1) meets a critical market need for those international airlines that cannot justify building or leasing their own facility and that cannot be

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accommodated as sub-tenants in the existing airline-branded lounges at the Airport, including Delta, United, British, and Alaska. Many international carriers view the lack of access to a premium lounge at an airport as a barrier to successful entry into that market. Having common-use premium lounges available for international carriers is critical to meeting the Port's Century Agenda objective to double the number of international flights in the next 25 years.

Common-use, premium lounge services were first introduced at the Airport decades ago with a lounge called Club International, located on the Mezzanine level of the South Satellite. At the time, Club International was a no-frills common-use lounge where airlines would provide their own staffing, food, and beverages to accommodate their passengers while paying a flat per-use fee to the Port regardless of the number of passengers using the lounge.

Due to the importance of lounge space in attracting international carriers to the Airport, in 2009, Port staff decided to change the operating model in an effort to improve the level of service to all carriers and travelers utilizing the lounge. Under the operating model implemented in 2009, the Port contracted out management and operation of the lounge(s) to a third party. All expenses related to operation of the lounges, including capital and operating expenses, were funded by the Port.

The contract for this third-party management service was structured to include a fixed base management fee as well as an incentive fee that is dependent on the profitability of the lounge operation. The third-party operator is responsible for staffing, procurement of food and beverage, and management oversight. In addition, the model was changed from a fixed per-flight charge to an individual per-passenger charge applied to airlines' passengers who visit the facility. The rate to utilize the lounge was set at \$30 per passenger with a minimum of \$300 per flight.

In late 2009, a request for proposal process was conducted for the purpose of hiring a firm to manage the common-use lounges provided by the Port under this new operating model. VIP Hospitality Inc. (VIP) was selected and in March 2010, VIP and the Port entered into a three-year contract with two (2) one-year options to extend the lease. At that time, the Port also made modest improvements to the facility, including new furniture, carpet, and paint. During the course of the past 4½ years, Port staff has worked closely with VIP staff to provide regular oversight of the operations.

In 2011, when Delta Airlines decided to build a new lounge for their passengers on the roof of the South Satellite and vacate their existing lounge on the concourse level of the South Satellite, the Port made a decision to move Club International to the former Delta lounge location. The primary motivation for this move was to create a larger, more attractive, and more convenient location for the airlines using Club International. In March 2012, Club International opened on the concourse level where it continues to operate today.

Club International currently provides lounge services to passengers from eight different airlines with the majority of these passengers using the lounge between 10 a.m. and 2 p.m. Due to the

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rapid growth of international carriers calling on the Airport, the lounge reached its capacity during the summer of 2013 for the peak usage time. The other airline-branded lounges also reached capacity due to increases in scheduled departures of the airlines using those lounges. Faced with the need from existing international carriers for lounge service that could not be met, Port staff worked with VIP to open an additional common-use premium lounge located on the A Concourse, Club Cascade. This new lounge opened on October 28, 2013, and is currently being utilized by three carriers.

The financial performance of Club International has steadily improved primarily due to the increase in international airline service at the Airport. In fact, demand for these lounges has grown so quickly that this business has become a significant generator of non-aeronautical net income. The following chart shows the historical performance of Club International since its opening in 2010 along with Club Cascade starting in October 2013.

	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
	<b>Actual</b>	<b>Actual</b>	<b>Actual</b>	<b>Actual</b>	<b>Forecast</b>
Passengers	3,517	6,712	12,973	34,057	50,700
Gross Revenue	\$ 105,500	\$ 201,360	\$ 413,070	\$ 1,051,395	\$ 1,600,000
Total Operating Expenses	\$ 156,860	\$ 174,513	\$ 292,049	\$ 603,028	\$ 781,469
Net Operating Income	\$ (51,360)	\$ 26,847	\$ 121,021	\$ 448,367	\$ 818,531
Base Management Fee	\$ 68,668	\$ 73,152	\$ 73,140	\$ 87,600	\$ 87,600
Incentive Management Fee	\$ -	\$ -	\$ 9,666	\$ 42,880	\$ 57,979

### Notes:

Base Management and Incentive Management Fees are included in Total Operating Expenses

Port staff released an RFP for a new contract for common-use lounge management services at the Airport on September 3, 2014. The vendor selected as a result of this RFP will be responsible for staffing, procurement of food and beverage, and management oversight of the Airport's common-use premium lounges. This new contract will include compensation to the selected manager similar to the compensation model in place with the current contract with VIP. A base management fee will be paid by the Port to the selected firm. In addition, an incentive management fee, dependent on lounge profitability, will be paid to the operator. The base management fee will be a fixed payment, while the incentive management fee will be calculated utilizing only those costs under the control of the lounge operator, primarily food and beverage, labor, and supplies. Costs outside of the control of the lounge operator, including base utilities, janitorial services, and structural repairs and maintenance, will be excluded from the incentive management fee calculation. Port staff believes implementing this type of compensation model will result in a fair and appropriate fee paid to the selected lounge manager.

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In addition, the RFP and new contract state that the lounge operator will need to adhere to Resolution No. 3694 setting hiring standards, training opportunities, and minimum compensation associated with safety and security at the Airport for any employees that meet the criteria of a 'covered employee' as established in that resolution. Port staff will also make sure that the selected operator is aware of and complies with any decisions that the Commission makes regarding other employment criteria for firms that contract with the Port of Seattle related to its initiative on Quality Jobs.

### **SCHEDULE**

Port staff anticipates awarding the contract near the end of 2014 with commencement of the new contract following the expiration of the current contract on March 31, 2015.

### **FINANCIAL IMPLICATIONS**

Based on the current lounge operation and anticipated demand for future lounge use, Port staff has created the lounge passenger activity forecast shown below:

	<b>2015 Forecast</b>	<b>2016 Forecast</b>	<b>2017 Forecast</b>	<b>2018 Forecast</b>	<b>2019 Forecast</b>
Total Passengers	60,000	62,400	64,900	67,500	70,200
Total Lounge Revenue	\$ 1,893,000	\$ 1,969,000	\$ 2,048,000	\$ 2,130,000	\$ 2,215,000

Growth in passenger volumes is based on new lounge users, including those resulting from agreements with airlines and walk-up customers and is generally tied to new international air service. However, even with new air service, the use of Port lounges is not guaranteed, as customers may decide to utilize alternative Airport lounges. Staff intends to continue the promotion of the walk-up, or day-use, business which, in addition to growth due to new air service, is the basis for the 4% annual increase in passenger volumes shown above.

Through the RFP process, interested firms will propose amounts for both the base and incentive management fees included in total operating expenses, so final determination of the actual fees will be based on proposed amounts and actual future lounge performance. Historically, total fees paid to VIP have ranged from 12% of gross revenues (2013) to 65% of gross revenues (2010). This fluctuation in percentages is due to the nature of the mostly fixed management fee paid to VIP compared to the variable revenues generated at the lounges, based on number of carriers utilizing the lounges. When the number of carriers is low, as in 2010, revenues are low and the management fees become a high percentage of gross revenues. With higher revenues, as in 2013, the management fee as a percentage of gross revenues decreases. For purposes of projections, Port staff estimates these fees at approximately \$2,000,000, representing about 20% of gross revenues over the five-year projection period shown above. This estimate is the basis for the requested Commission authorization of \$2,000,000.

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### **STRATEGIES AND OBJECTIVES**

This request supports the Port's Century Agenda objective to advance the region as a leading tourism destination and business gateway. Specifically, this agreement ensures that the Port has uninterrupted common-use premium lounge services that will provide a key amenity in support of making Seattle-Tacoma International Airport the West Coast "Gateway of Choice" for international travel and support the goal to double the number of international flights and destinations.

This request supports the Aviation Division's strategic goal of operating a world-class international airport. It allows the Port to continue to provide a high level of customer service to airlines and their passengers and to keep airlines' cost per enplanement low by ensuring that they have existing lounge service opportunities available to them without the need to construct and operate their own lounges. It also supports the division's strategic goal of maximizing non-aeronautical net operating income.

In regards to promoting opportunities for small business participation, the project manager/requesting department representative worked with the Office of Social Responsibility throughout the RFP process to incorporate language encouraging small business participation, both in the response to the RFP and in future procurement of goods and services associated with the contract. In addition, staff will continue to work with the Office of Social Responsibility and the selected operator throughout the contract term to identify opportunities for small business participation in accordance with small business Resolution No. 3618.

### **ALTERNATIVES AND IMPLICATIONS CONSIDERED**

Alternative 1 – Do not execute a new contract. As the current contract with VIP for management of the Airport's two common-use lounges expires in March 2015, the Port would need to close the lounges. This would be a major disruption to several international carriers currently utilizing the Airport's lounges for their premium passengers. This is not the recommended alternative.

Alternative 2 – Change the business model to have Port staff operate the lounges. Operating a passenger lounge is not a core competency of Port staff and is not ideal from a staff utilization standpoint. In addition, there may not be sufficient time to hire and train Port employees prior to March 2015, possibly leading to a temporary closure of the lounges, and thereby causing a major disruption to several international carriers. This is not the recommended alternative.

Alternative 3 – Authorize execution of a new contract. The new contract would allow for continuation of lounge services potentially through the first quarter of 2020, thereby meeting the demand for these services from the growing number of international carriers serving the Airport.

**This is the recommended alternative.**

### **ATTACHMENTS TO THIS REQUEST**

- Exhibit 1: Map of the Airport showing the location of Club International and Club Cascade

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### **PREVIOUS COMMISSION ACTIONS OR BRIEFINGS**

- June 11, 2014 – A 50% notification memo was sent to Commission indicating a spending limit increase from \$500,000 to \$700,000.
- May 28, 2013 – Commission approved execution of the Second Amendment to the Management Agreement with VIP Hospitality LLC for operation of premium lounge services at Seattle-Tacoma International Airport effective March 8, 2013, to increase the contract cost for a five-year total not to exceed \$500,000.
- October 4, 2011 – Commission approved an increase to the project budget for the remodel of Club International by \$740,675 and to advertise and execute a construction contract for a total project cost of \$1,061,000.
- March 1, 2011 – Commission approved funding for design of the remodel of Club International and competitive procurement of furnishings and casework in the amount of \$320,325 of a total estimated project cost of \$971,000.