PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6b

Date of Meeting December 9, 2014

DATE: December 3, 2014

TO: Ted Fick, Chief Executive Officer

FROM: James R. Schone, Director, Aviation Business Development
Deanna Zachrisson, Business Leader, Airport Dining and Retail

SUBJECT: Authorization of Prime Lease Modifications – HMSHost/Seattle Restaurant Associates

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to: (1) amend the current lease and concession agreements with Host International (Host) and Seattle Restaurant Associates (SRA) to remove eight units and provide for the early return of six units, and (2) execute a new lease and concession agreement with Host International to operate ten food service locations at Seattle-Tacoma International Airport for a term that will expire in 2023.

SYNOPSIS

At Port Commission meetings on May 27 and September 30, 2014, Airport staff outlined the phasing strategy for the Airport's future dining and retail program, stemming from the work over the last three years to prepare for the beginning of program redevelopment in 2015.

The Airport Dining and Retail program currently consists of 92 locations providing food service, retail and personal services to the traveling public. In the categories of both food service and retail, the leases for 60 prime operator units are scheduled to expire within a six-month timeframe in 2016-2017. If these leases were allowed to expire as scheduled, there would be severe impacts to customer service, Port revenue and employment. Airport staff has developed an alternative phasing schedule for lease expirations as a means to avoid these impacts (Exhibit B). This phasing plan also serves to create a sustainable cycle of lease expirations moving into the future by making adjustments to expiration dates in order to stagger future lease expirations. One key component of this plan is the proposed phasing schedule for the locations leased by Host. Host leases 33 locations in the Airport under two separate lease agreements (Host International, which includes 24 units and Seattle Restaurant Associates, a joint venture between Host and Uwajimaya, which includes nine units). Both of these agreements expire on December 31, 2016. Twenty-four of these locations are operated by Host/SRA, and nine units are operated by Airport Concessions Disadvantaged Business Enterprises (ACDBE) subtenants.

In order to advance the phasing plan, Airport Dining and Retail staff proposes to separate the Airport's food service units, including the Host and SRA leased units, into a number of independently viable "packages" consisting of one to ten units. Some of these packages will be offered following the expiration of Host's leases. But to start the process today, staff seeks to remove eight of the 33 units from the leases to create a new (primarily coffee) package and secure the early return of six units to begin offering other food service packages before the expiration of Host's leases. To accomplish this, it is necessary to: 1) amend Host's existing leases to remove those units that will be placed into the new packages (with the remaining units to be returned in 2015-16 as the Port requires to advance the phasing plan), and 2) execute a new lease with Host in order to create the new (primarily coffee) package, which will run through 2023.

BACKGROUND

In 2013, passengers spent an average of $11.23 at businesses associated with the Airport's Dining and Retail program, yielding $195 million in sales and $28.3 million in revenue to the Port. It is widely understood at the Port that the leases for 90% of the dining and retail program spaces are scheduled to expire in a very short span of time in 2016-2017. Passenger offerings of food service and retail are a key component in operating a world-class facility. The impacts to customer service, Port revenues and the hundreds of jobs dependent on the program would be severe if these leases were allowed to expire as scheduled. Airport staff has taken proactive steps to mitigate these potential impacts, specifically the development of a phasing plan that includes negotiated solutions with the two largest operators within the Airport Dining and Retail program: Host and Airport Management Services LLC (Hudson). This phasing plan has been developed with the assistance of AirProjects, Inc., a recognized industry leader in airport dining and retail program development. The Port contracted with AirProjects Inc. in 2012 for the purpose of assisting Airport staff with the Airport Dining and Retail Master Plan. This negotiated solution with Host achieves the objectives of meeting passenger needs for food service, particularly during the critical construction and transition peak of 2017-2019, and also takes strategic steps toward the optimal mix of offerings in the best use of space for the program in the long-term.

As the largest food service operator in the Airport, Host's operation has the greatest importance for continuing to meet passenger needs in the transition. This is particularly critical in the satellites where the capacity shortages are greatest. Host is nearly the exclusive food operator in the North Satellite and operates a key full-service restaurant in the South Satellite.

In summary, the new phasing schedule would return some units early to the Port, provide new term for some units in a new lease agreement, and allow other units to expire as scheduled. Provisions for continued operations beyond lease expiration dates will be used when necessary as facility construction and new competitive processes are completed. The majority of units that will continue in operation beyond 2017 without new investment are Host's ACDBE subtenants.

The locations identified for a new lease agreement serve to create the first building block for the future leasing plan. These locations will be scheduled to expire in 2023. Other Host and SRA units that are planned to expire on-time or move into a period of extended operation will be grouped together in new independently viable packages for multiple future competitive processes. The airport food service industry has changed dramatically in the last 10+ years since nearly every U.S. airport has moved away from a master concessionaire operator model. Traditional airport food service companies have encountered competition from restaurateurs in local markets, which has led to even greater competition for opportunities. Staff anticipates that there will be fierce competition for future food service opportunities at the Airport.

PROJECT JUSTIFICATION AND DETAILS

Project Objectives

In general, there are three drivers for phasing decisions: 1) meeting future passenger demand, 2) maintaining capacity and revenue during construction/transition, and 3) execution of the overall intent of the future program to create an optimal mix of offerings in an effective use of space. In addition, Airport staff entered into the Host negotiation with three other objectives:

- Negotiate a reasonable 'premium' percentage rent in exchange for negotiated contract.
- Focus on Host's exclusive, proprietary concepts for which there is high passenger demand, e.g. Starbucks Coffee.
- Balance desired new investment in as a short a lease as possible to amortize.

Based on these considerations, Airport staff has developed the following phasing proposal for the Host units:

- Six units will be returned to the Port in (2015-2016) prior to their current expiration dates in order to be made available as new competitive opportunities.
- Eighteen units will either expire per the current lease in Phase II on December 31, 2016, or transition into "hold over" status under the terms of the existing lease (including three units in the North Satellite that will remain operational until they are impacted by NorthSTAR construction) for up to two years.
- Ten units will be placed in a in a new lease commencing on June 1, 2015 and expiring in 2023. Among these ten units, there is one currently vacant location included.

The current Host and SRA leases will be amended to remove early-returned units. The units that remain in the current Host and SRA leases will either expire as scheduled or move into "holdover" status in accordance with the terms of the lease.

Early Return Units – Phase I (2015-2016)

Host will to return the following units ahead of scheduled expiration with no reimbursement for remaining investment value in the spaces, totaling approximately $352,000.

Unit 1: Central Terminal Starbucks Kiosk

Remaining Net Book Value 2014: $75,056

The current Central Terminal Starbucks kiosk generates the highest gross sales ($3.3 million in 2013) of any Starbucks in the Airport. However, it is much too small (594 square feet) to adequately handle the volume of business in this location and particularly the logistics of milk storage and housekeeping. Staff recommends the removal of this kiosk from the Central Terminal atrium and the relocation of gourmet coffee to an in-line location (See below under new lease units).

Unit 2 & 3: South Esplanade Kathy Casey Dish D'Lish & Pilot House Bar

Remaining Net Book Value 2014: Both units $201,924

These adjacent units combined are approximately 2,800 square feet. Their sales productivity in the pre-security area south of the central checkpoint is relatively poor (2013 Sales $798,000 and $473,000 respectively). In general, Airport employees make up a significant amount of the business that supports pre-security locations. Although Dish D'Lish has a loyal following for its gourmet sandwiches, it has a price point that does not encourage employee business. The Pilot House bar is a generic concept with limited appeal for meeters and greeters, and as a bar, is not patronized by Airport employees.

At the same time, *post*-security square footage is in short supply. Host's early return of the space would allow the Port to convert it to post-security facing food service near the Central Terminal. The estimated post-security sales in this location as one casual dining restaurant are $4.1 million in its first year of operation. The master plan does include food service capacity pre-security; however, that capacity will be in other locations and with concepts more suited to the casual visitor or Airport employee.

Unit 4: Concourse B Sbarro Pizza
Remaining Net Book Value 2014: $57,328

This location is nearly 2,600 square feet and a modest generator of sales due to its outdated concept. It generated only $638,000 in sales in 2013. The master plan calls for a division of this space in which e side would become a new children's play area. The new play area is in close proximity to the current play area near Central Terminal (which will close), and also close to other quick serve restaurants such as McDonald's. This is an opportunity to replace the current children's play area that is more than 10 years old and in need of refurbishment, as well as relocate it from an area of higher and better use for revenue generation. The other half of the space would be converted to a café/market concept with family appeal. This redevelopment also would assure that adequate food service will be available when other nearby units are in transition.

Unit 5: Concourse B Starbucks Coffee (by Gate B3)
Remaining Net Book Value 2014: $0

This is one of two current Starbucks locations in Concourse B. Host would return this unit early so that the Port can incorporate it into a specialty retail package of units for a new competitive process in 2015.

Unit 6: Concourse D Sports Page Pub

Remaining Net Book Value 2014: $17,548

This unit is the first food service that travelers pass in Concourse D when entering from the north security checkpoint (checkpoint #4). The concept is the oldest generic concept in the Airport. Staff believes that this location will better serve the traveling public as an independent, possibly local, brand gourmet coffee location. It also represents an opportunity to strike a strategic balance with the otherwise dominant Starbucks. This unit would be paired with another coffee unit location (proposed to be returned by Hudson in the south Baggage Claim) in a two-unit package for a competitive process in 2015.

On-Time Expiration/Continued Operation – Phase II (2017-2019)

There are two factors that influence exactly which Host units will be scheduled to expire on-time and which will continue in operation under the existing lease agreements for another 1-2 years. In two cases, 1) the seating court area of Concourse A and 2) the end of Concourse C, the areas will be completely redeveloped in order to create a much more effective use of the available square footage with the optimal mix of offerings. This requires units to cease operations on-time for redevelopment to take place in 2017. The new anchor retail locations flanking the Central Terminal must be converted from food service as soon as possible, also in 2017.

In other instances, such as between Gates A9 and A14 in Concourse A as well as in Baggage Claim, passengers will benefit from continued service while other transitions are taking place. The North Satellite must continue to be served until impacted by NorthSTAR construction.

The following Host units are expected to expire on time (December 31, 2016) and be repackaged in accordance with the overall leasing plan:

Units 1-10: On-Time Expiration

Pre-Security – Vintage Washington Wine Bar

Concourse A – Africa Lounge, Great American Bagel Bakery, Manchu Wok and Seattle Taproom

Concourse B – Starbucks Coffee (by Gate B10)

Concourse C – Wolfgang Puck

Concourse D – Chili’s Too and Great American Bagel Bakery, Alaska Lodge

The following units are expected to remain in operation past expiration dates in order to mitigate impacts on food service during the transition period and NorthSTAR development:

Units 11-18: Continued Operation under Existing Lease

Pre-Security – Diva Espresso

Concourse A – La Pisa Café, Coffee Bean & Tea Leaf and Mountain Room

Concourse C – Waji's

North Satellite – Burger King, Great American Bagel Bakery, and Seattle Seahawks 12 Club

New Lease Unit Locations – Phase III (2020-2024)

A fundamental starting point for the Host negotiation has been to provide a new lease for units/concepts that only Host can provide the Airport. For example, Host has the nationwide exclusive to operate Starbucks Coffee in airports; there is no other means of contracting for Starbucks locations in a U.S. airport than via Host. Starbucks is a unique 'staple' or must-have concept for Sea-Tac. This is due to its local brand identity and the extraordinary sales performance of the concept. The current seven Starbucks Coffee locations produce nearly half of Host's total annual sales (out of a total 16 company-operated units under the Host lease).

However, one consequence of Starbucks' hometown status is that Starbucks places very high investment expectations on Host for its Sea-Tac locations. Visitors to the Starbucks corporate office pass through Sea-Tac and corporate leadership views the Airport as its 'marquee' for the company. Starbucks has emphasized with Airport staff that they would like to see upgrades to many of the Sea-Tac locations. For this reason, it has been a challenge to balance the desire to limit new term for Host with the cost for investment required by Starbucks.

In addition to Starbucks, Host has exclusive agreements with two other local concepts/celebrity chefs included in this proposal: Kathy Casey and Tom Douglas. These are proposed as re-concepts of existing Host locations. This new lease with Host creates Package #1 among future food service packages in the overall leasing plan.

Each unit proposed to be included in the new Host lease is described below, along with estimated investments and anticipated first year sales (2016) for each proposed unit. Eight of these units are currently leased to Host and will be removed, without payment of any net book value, from those leases effective May 31, 2015, immediately prior to the commencement of the new lease. The other two units are new locations, one of which is located in the Arrivals Hall and the other will be constructed as part of the North Satellite project. Proposed rent structure and term will follow.

Unit 1: Central Terminal Starbucks (Relocation)
First Year Sales Forecast: $4.3 million
Estimated New Investment: $1.5 million

As explained above, there are operational issues with the Starbucks kiosk in Central Terminal. Staff proposes that Starbucks Coffee be relocated to the current Kathy Casey Dish D'Lish space in the Central Terminal. This nearly 1,700 square foot in-line space is large enough to allow for adequate staffing, handle queuing within the space and has sufficient space for milk and other perishable goods storage. The unit also has existing cooking exhaust ventilation that would allow for the installation of a convection warming oven for the Starbucks full line of hot sandwiches and pastries. The current Central Terminal kiosk cannot accommodate the warming oven in the atrium due to inadequate HVAC (heating, venting, air conditioning) capacity. Host will be required to build out this new unit and remove the kiosk from the Central Terminal atrium once the new inline Starbucks location is operational.

Unit 2: North Esplanade Starbucks (Refurbishment)

First Year Sales Forecast: $1.9 million
Estimated New Investment: $300,000

The North Esplanade Starbucks is currently the only pre-security Starbucks location. It is a popular destination for Airport employees, as well as meeters-and-greeters. The popularity of the concept is evidenced by sales twice those achieved by a nearby Seattle's Best Coffee. Nonetheless, the master plan calls for the development of a second gourmet coffee concept pre-security in order to assure that travelers will have choices. This location already has a convection warming oven, but Host will still be required to invest in the unit's refurbishment.

Unit 3: Concourse A Starbucks (Refurbishment)

First Year Sales Forecast: $2.4 million
Estimated New Investment: $250,000

The Starbucks location near the Concourse A/South Satellite checkpoint is another high volume unit. Due to ventilation issues, it does not currently have a convection warming oven to be able to offer the popular assortment of warm sandwiches and pastries. For those South Satellite customers who prefer Starbucks, this location is the only opportunity to purchase from a Starbucks before boarding the train to the satellite. Host will be required to invest in the refurbishment of this Starbucks location, including adding needed venting for the warming oven.

Unit 4: Concourse B Starbucks (Relocate and Rebuild)
First Year Sales Forecast: $2.3 million
Estimated New Investment: $650,000

Host currently operates two Starbucks locations on Concourse B. Staff proposes reducing this to one single location. However, neither of the current locations on Concourse B is ideal to become the single location. The smaller unit at the front of the Concourse is better suited for future retail in proximity to the new children's play area and a larger unit is at the very end of the concourse. Staff proposes that Host convert another unit that they currently operate as a Quiznos to a new Starbucks location. This alternative location will be appropriately sized and closer to the middle of the concourse. Host will be required to invest in the build-out of this new Starbucks location. The conversion of this unit also provides the advantage of being able to incorporate an awkwardly positioned part of the space into the adjacent full-service restaurant and create a more adequately sized kitchen for that restaurant (see new concept below).

Unit 5: Concourse B Tom Douglas Casual Dining (New Concept in Current Unit)
First Year Sales Forecast: $2.6 million
Estimated New Investment: $1.3 million

As noted above, Host currently operates two Starbucks locations in Concourse B. With the reduction of Starbucks to one location in the middle of the concourse, staff proposes that Host be allowed to develop a casual dining concept in partnership with local chef Tom Douglas in the space adjacent to the new Starbucks, currently occupied by Casa del Agave, a generic concept. Host has negotiated the exclusive rights to Tom Douglas restaurants at the Airport. The re-purposing of this space would preserve needed food service capacity once the current sandwich concept becomes a coffee location. The ability to vent cooking exhaust exists at this location. Tom Douglas has provided his preliminary approval for this location, and will personally develop the concept. Host would be required to invest in this completely new build-out.

Unit 6: Concourse C Kathy Casey Dish D'lish (Re-concept)

First Year Sales Forecast: $1.5 million
Estimated New Investment: $300,000

Host has agreed to either return or re-concept two large Kathy Casey Dish D'lish locations, which despite the loyal following occupy too much square footage. Staff proposes allowing Host to re-concept their 335 square foot Freshens Frozen Treats space to a Dish D'Lish grab-n-go unit. The Concourse C Starbucks (see below) would be relocated to be adjacent to the new Kathy Casey location. While this change would create one single two-concept unit, there is an elevation change between the two units that would make them appear to be separate locations. From an operational standpoint, this would be a very smart use of somewhat difficult space. Host will be required to invest in the re-concept of this unit.

Unit 7: Concourse C Starbucks (Relocate and Rebuild)

First Year Sales Forecast: $1.5 million
Estimated New Investment: $700,000

Currently, there are two gourmet coffee brand choices in Concourse C: Café Vita and Starbucks. Based on sales performance, this choice should continue to be available to Alaska and Horizon travelers. However, the Concourse C location should be relocated in order to make best use of limited space and reside adjacent to the Dish D'Lish space as mentioned above. The relocation of the Starbucks enables the Airport to take advantage of nearby vacant space for reconfiguration in Concourse C in order to fully utilize the available space. Even with these changes, Concourse C is expected to be under-served due to lack of any other available space. Host will be required to invest in this completely new build-out.

Unit 8: Arrivals Hall Starbucks Evenings (New Construction)

First Year Sales Forecast: $1.2 million
Estimated New Investment: $1.1 million

The Port has long sought to develop restaurant service in the Gina Marie Lindsey Arrivals Hall. However, finding an appropriate tenant has been difficult. Nearly all pre-security spaces are more risky than a post-security space and tend to generate lower sales volumes. In the case of the Arrivals Hall, there is seasonality to the potential passenger capture. At least 1,200 daily cruise ship passengers will traverse and dwell in the Arrivals Hall during May – September. The hours of these passengers are concentrated to the middle of the day. During evening hours and during the off-season, business will be less robust. When Airport staff conducted outreach for this opportunity in May 2013 as a stand-alone operation, the Port did not receive any viable proposals. As a result, staff drew the conclusion that a location in the Arrivals Hall would be best to combine in a package with multiple other units.

In addition to the full Starbucks menu and coffees, a Starbucks Evenings would offer beer and wine along with a tapas-style afternoon/evening menu. This concept in the Arrivals Hall creates a unique opportunity for the Port. Infrastructure to support live musical performances has already been installed. Staff is investigating the possibility of developing an events business in the Arrivals Hall space, particularly in the off-season when the space is underutilized and garage parking is plentiful. Starbucks corporate leadership was initially reluctant to allow the Starbucks Evenings concept to be proposed for the Arrivals Hall as it was considered an 'unconventional' location. However, Starbucks agreed to the location, once they understood the prominence of the unit for international arriving passengers, and the potential for other event activity in the space.

Unit 9: South Satellite Dungeness Bay Seafood House (Refurbishment)

First Year Sales Forecast: $4 million
Estimated New Investment: $200,000

This 1,809 square foot full-service restaurant was renovated in 2012 and sales increased by 91% in 2013. This dramatic increase is due to the much higher quality food, better-equipped kitchen, and a much more attractive restaurant décor. This restaurant is essentially brand-new and also represents key food service capacity in the satellite. Host invested nearly $1 million in the remodel and re-concept of the space. Staff recommends that the Dungeness Bay Seafood House be included in the new Host lease in order to assure continued quality service in the South Satellite. Host will be required to refurbish this space no later than 2019.

Unit 10: North Satellite Starbucks (New Construction estimated open 2018)

2018 Sales Forecast: $2.9 million
Estimated New Investment: $900,000

The North Satellite has been an extremely popular location for Starbucks. The demand has far outstripped the capacity for a small food court location. The current airline tenant, Alaska

Airlines, has expressed strong interest in placing a new Starbucks location in the center rotunda area at the top of the escalators. Staff agrees that Starbucks has a place in the North Satellite and would propose that Host be provided a space for future build out in approximately 2018. Host will be required to invest in the build-out of this new Starbucks location.

In addition to the units above, staff proposes that Host continue to operate the Seahawks 12 Club, Great American Bagel Bakery, Burger King and the existing Starbucks (all located at the North Satellite) until they must be demolished for the NorthSTAR project, most likely in late 2017. Host will agree to operate temporary locations in the North Satellite for all of their operations as needed to serve passengers until permanent locations are brought into service in accordance with future competitive processes.

FINANCIAL IMPLICATIONS

The existing Host/SRA leases have a category rent structure whereby Host pays different percentages on different types of sales such as branded food, non-branded food and alcohol. Since 2005, the Port has adopted either flat or tiered rent structures due to benefits in administration and the ability to more easily audit such structures. Staff proposes a new, tiered rent structure for all of the units in this Host agreement. The tiers are as follows:

Tier	Percentage
0 - $10 million	12%
$10,000,001 - $20 million	13%
Sales over $20,000,000	15%

With regard to percentage rent in a new contract, Airport staff expects not only that Host will pay at an equivalent level through the end of their current lease term, but also that Host will pay a reasonable premium for the benefit of certainty in the continuity of their operations.

In a tiered structure, tenants pay rent at progressively higher levels as sales increase over the course of a lease year. These types of rent structures are much easier to administer and audit, and they provide for the potential for increased revenues as sales grow over the term of the lease. Also in this instance, Airport staff has developed, in collaboration with its consultant, a proposed tiered rent structure for this Host agreement. In addition to the pro forma analysis, Airport staff has surveyed five west coast airports as well as reviewed recent industry survey data to confirm that these rent levels for this food service is in a range consistent with industry norms.

Airport staff also proposes a change in structure for the Host minimum annual guarantee (MAG). This new structure includes a defined MAG for each agreement year that is billed based on monthly sales seasonality. The new annual MAG will increase an average of 8% per year. This change alleviates the administrative need of recalculation of the MAG each year and ensures the Port and Host a predictable MAG for budgeting and forecasting needs.

This package of 10 units is projected to have first year gross sales of about $26.1 million (compared to Host/SRA's $60 million in gross sales in 2013). Airport staff engaged its consulting firm, AirProjects, to conduct a feasibility analysis for 10 units in order to test Host's assumptions compared with the program master plan demand analysis. AirProjects has additionally compared the rent revenues to the Port from the existing Starbucks and Dungeness locations as a means of comparing the current rent received with the proposed. This analysis suggests that Host's sales projections are realistic and that the new proposed rent structure will yield a premium percentage rent as compared to current levels.

Under this proposal, Host will lease 11,689 square feet of space, less than the 13,606 square feet leased today for 10 units with a similar or identical concept. However, the configuration and locations for this square footage is anticipated to be superior to the current leased space. Airport staff and AirProjects estimate that per square foot productivity will increase by approximately 33%. The effective rent that Host will pay is estimated at 13.5% compared to the current effective rent of 12.6% for comparable square footage and type of operations. These productivity and effective rent levels are based on the pro forma analysis developed to evaluate the proposal. Due to the dominance of Starbucks in the square footage allotment and its ability to generate high sales per square foot, it is highly unlikely that another gourmet brand coffee operator would be able to generate the same high level of sales.

This proposal is a reasonable outcome for the Port and the traveling public. The Port will not be making any compromises on revenue in order to achieve the overarching goal of achieving a more sustainable lease renewal schedule in the future. By negotiating a new lease with Host, the Port benefits from the operator's commitment of new capital investment in the facility that is anticipated to drive higher sales volumes and the return of units early with no reimbursement for remaining investment value. In tandem with re-negotiated rental terms, the Port is able to fully share in the benefit of the extended operation of the locations.

Proposal Summary	
Term	8 years (2016-2023)
Investment	$7.2 million
Est. Gross Sales First Year	$26.1 million
Minimum Annual Guarantee for Term	$13.150 million
Est. Term Revenue to the Port	$27.3 million
NBV for Returned Units	$352,000
Jobs Supported	250

STRATEGIES AND OBJECTIVES

This phasing plan, including a new lease and concession agreement with Host, supports the Port's Century Agenda goal to "advance the region as a leading tourism destination and business gateway" by providing an extraordinary customer experience at the Airport. The project also supports the Aviation Division's strategic goals to operate a world-class airport and grow non-aeronautical revenues.

TRIPLE BOTTOM LINE

The Airport Dining and Retail program places a high value on the concurrent pursuit of positive economic, community, customer service and environmental stewardship outcomes in the selection of new operators. The pursuit of this opportunity is clearly consistent with these values.

Economic Development

The return of the six (6) proposed Host locations will lead to increased revenues over those generated today. The proposed new lease and concession agreement with Host will generate an estimated $27.3 million in Port revenues over the life of the lease, and will lead to approximately $7.2 million of new investment in the Port's facility. In addition, the operation of the 10 locations included in the lease supports approximately 250 full-time jobs with Host (see also below).

Environmental Responsibility

Airport restaurant locations are built to the strictest of Port standards for environmental sustainability with includes durable materials that can withstand high traffic volumes without the need for frequent replacement.

Community Benefits

This proposal supports the continuity of approximately 250 employees with Host. The employees are represented by the Hotel Employees Restaurant Employees union (UniteHERE!) Local 8. Starting wages in 2015 will range from $9.44 for tipped servers to $13.91 for a cook. The collective bargaining agreement contains annual raises between 5 and 13 cents depending upon type of job classification (non-tipped, tipped and bartender). In addition, employees have access to family health care benefits at a very minimal cost to the employee ($40 or $50 a month depending on tenure). Host contributes $5.09 per hour for each employee to union benefit plans. Host pays an additional 62 cents per hour for pension for each employee. As of January 2015, the lowest wage and benefit rate paid to any Host employee is $15.15 (server category, not including tips). These jobs meet all of the criteria for quality jobs as recently articulated by the Commission.

Five of 9 units currently operated by ACDBEs will have extended operations for an additional 15-24 months. Host's current lease agreements will continue to generate sales toward the Port's ACDBE participation, and the Port will encourage Host to create additional opportunities in this agreement as practicable.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Do not phase the expirations of the 33 Host units. This would require that all locations would be competed for new tenants in 2015 and early 2016. This work would require an increase in in-house staffing resources to manage multiple Request for Proposal (RFP) and

Competitive Evaluation Process (CEP) competitions, as well as the resulting legal and contract administrative work. Once locations are awarded, an increase in staff resources will be required in 2016 to review and approve tenant designs for new construction in 2017. Additionally, such concentrated design and construction activity has historically led to a shortage of available designers/contractors, which drives up design and construction costs for tenants.

Unless competitively awarded for continued operation to Host, all prime operator food service locations would all close on January 1, 2017 and remain closed for approximately 4-5 months for construction. The customer service impact would be severe as more than three-quarters of the Airport food service would be out of operation. If the Port also chose not to phase the expiration of the convenience retail operation, even more severe loss of service would occur in the summer of 2017 as it is unlikely that all of the food service operators would resume operations prior to May 31, 2017. Some capacity still could be maintained with temporary refrigeration cases and other merchandise display cases. However, the likely loss of revenue could reach as much as 40-50% of 2017 food service revenue, or approximately $10-15 million. This volume of transition also will strain the Port's ability to manage the tenant construction activity. This approach would lead to significant job loss due to the operational disruption. In addition, the same pattern of critical impact would re-occur when these new leases mature in 2027. This is not the recommended alterative.

Alternative 2) – This alternative would require placing all prime units into holdover status (month-to-month lease). A contractual holdover clause is not intended to function as a broad strategy for managing lease expirations. Staff only recommends the use of these provisions for the purposes of phasing expirations where there is specific plan that coincides with continued operation of a unit, such as the completion of an RFP or construction. Generally, Port Internal Audit and Legal advise the length of holdover to be limited to no more than two years. Widespread holdover also represents a loss of revenue opportunity for the Port. In holdover, the percentage rent and other contractual terms remain the same, and the operator benefits from the additional revenue from operation beyond the expected lease termination date. If an operator has fully amortized their investment, this additional time represents a much higher margin of profit. The Port derives no benefit from the extended term; rather the benefit goes solely to the operator.

Alternative 3) – Approve the proposed phasing plan for Host, including a new lease and concession agreement for 10 units. For the benefit of this new lease agreement, Host will pay the Port a premium in percentage rent compared to current levels. The majority of Host's current locations would be subject to competition in new packages in the 2017-2019 timeframe. **This is the recommended alternative.**

ATTACHMENTS TO THIS REQUEST

- Exhibit A: PowerPoint Presentation
- Exhibit B: Phasing Plan Overview

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- September 30, 2014 – (Staff Briefing) Drivers for Phasing Decisions.
- May 27, 2014 – Briefing about Airport Dining and Retail Master Plan
- September 11, 2012 – (Briefing) Airport Concessions Master Plan Update
- March 27, 2012 – Briefing about Interim Concessions Leasing
- February 14, 2012 – Commission Motion Concerning the Airport Concessions Program
- December 13, 2011 – Program Principles and Practices (Stakeholder Process) briefing