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

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

**Item No.** 6c

**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 – Airport Management Services LLC (Hudson)

## ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to: (1) amend the lease and concession agreement with Airport Management Services LLC (Hudson) to remove 14 units and provide for the early return of seven units; (2) terminate a separate lease and concession agreement with Airport Management Services LLC covering the "Hudson Marketplace" unit; and (3) execute two new lease and concession agreements with Airport Management Services LLC for the continued operation of convenience retail and specialty retail. The first lease and concession agreement will include seven convenience retail locations and one specialty retail location for a term that will expire in 2022. The second lease and concession agreement will include seven convenience retail locations and two specialty retail locations for a term that will expire in 2024.

## 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 these lease expirations as a means to avoid these impacts. This phasing plan also serves to create a sustainable cycle of lease expirations moving into the future beyond 2025. One key component of this plan is the proposed phasing schedule for the locations operated by Hudson. At Sea-Tac, Hudson is operated as an Airport Concessions Disadvantaged Business Enterprise (ACDBE) joint venture with two ACDBE companies, MCSB Inc. and Warren News/Gift, which together own 25% of the Hudson business at the Airport.

Hudson is a wholly-owned subsidiary of Dufry AG, a world-wide duty free company headquartered in Basel, Switzerland.

In order to advance the phasing plan, Airport Dining and Retail staff proposes to immediately divide convenience retail concession into two sustainable “packages.” To accomplish this, it is necessary to:

1) Amend Hudson’s existing lease to remove those units that will be placed in one of the two packages (with the remaining units to be returned in 2015-16 as the Port requires to advance the phasing plan);
2) Terminate Hudson’s existing lease for the Hudson Marketplace location, which will be placed into Package #1; and
3) Execute two new leases with Hudson in order to create the two separate packages, one of which will run through 2022 (Package #1) and the other through 2024 (Package #2). These two packages will be subject to new competitive processes at the conclusion of these terms.

## BACKGROUND

In 2013, passengers spent an average of $11.23 at business associated with the Airport’s Dining and Retail program yielding $195 million in total 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. Port 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’s Dining and Retail program: Hudson, which currently leases 22 units, and Host International/Seattle Restaurant Associates, which currently leases 33 units. 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 Hudson achieves the objectives of meeting passenger needs for convenience retail, 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.

In summary, Airport staff has negotiated the early return of seven current Hudson units in 2015-2016 in exchange for the execution of two new leases, generally requiring immediate investment to improve the included units, for a total of seventeen locations (including two limited duration North Satellite units). The current Hudson lease is slated to expire on May 31, 2017. The proposed two new leases will commence on March 1, 2015, and effectively create two packages of units, each of which is expected to be independently viable, with two different expiration dates.

The lease for Package #1 will expire in 2022 and contain 8 units, including two units that will operate during the NorthSTAR capital improvement project focused on the North Satellite. New permanent convenience retail locations in the North Satellite will drive the re-competition of Package #1 in approximately 2020, and the selected operator will be required to build-out and operate the North Satellite units at the completion of the NorthSTAR project. The selected operator will then assume the remainder of the units in Package #1 at the end of Hudson's Package #1 lease term. Package #2 will expire in 2024 and contains 9 units. With respect to the units that Hudson will continue to lease under the existing agreement, Hudson will be obligated to return them to the Port as they are re-competed or re-developed for other uses in the 2015-2016 timeframe.

There is a customer service and revenue impact rationale for placing the next competition for the two convenience retail packages in the 2020-2024 timeframe. The next two years (2015-2016) are critical years of preparation for the food service expirations in 2017-2019. During this time, the Airport would oversee completion of the necessary upgrades and changes to the Hudson locations. Any construction impacts to convenience retail can take place during these two years so that convenience retail is fully upgraded and operational by January 1, 2017. Convenience retail will then have the ability to absorb some of the inevitable customer service and revenue impact that will occur as result of food service transitions in 2017-2019.

For all of these benefits, the Port does not make any compromises to Hudson – financial or otherwise. To begin with, the Port secures – at no direct cost – the early return of seven units and obtains Hudson's commitment to make new investment of $12.3 million in existing units years earlier than would otherwise be possible. In addition, the current effective rent paid by Hudson under the existing agreement is 15.1%. As the result of a successful negotiation and based on the sales projections developed for the financial analysis, the new agreements will result in an effective rent of 16.4%. Effective rent is the actual rent paid as a result of sales achievement. The new agreements (when considered together) will not be completely comparable to the current agreement, due to the return of units, but the new agreements under the proposed rent structure will generate approximately $7 million in revenue to the Port more than if the current rate structure was applicable to this proposal.

The single-contract package awarded to Hudson in 2003 as the result of a competitive RFQ process contained 23 units (16 news/gift, two Alki Bakery units, two bookstores and three specialty retail). In 2013, Hudson assumed the former Borders Books location in the Central Terminal, but also returned two locations (one specialty retail and one news/gift) to the Port for short-term leases to local retailers. Currently, Hudson operates 16 news/gift units (now referred to as convenience retail), two Alki Bakery units, two bookstores and two specialty retail locations for a total of 22 units. All of these locations, with the exception of the Central Terminal location, are set to expire on May 31, 2017.

Over the last decade, both food service and retail in airports has become increasingly more competitive due to the break-up of single or dominant operator contracts. Large 20+ unit contracts are rare at airports today. Instead, contracts are being split into packages of no more than 8-10 units in a large package. At Sea-Tac, this transition has taken place to some degree over the last 10 years with the departure from the master concessionaire model in 2004-2005. The current phasing plan is intended to facilitate increased opportunities for additional businesses and thereby greater competition in the future.

The convenience retail business is unique in airports, and is fundamentally different from airport food service. Rather than multiple concepts in multiple locations, airport convenience retail is essentially one single concept in multiple locations. It is a commodity business because the same products are offered – and are expected by passengers to be offered – at every location. Passengers also expect to find convenience retail in every part of the Airport. As a result, high-volume locations are expected to subsidize the sales performance of other lower volume locations.

In recent years, with the transformation of the book and printed materials business, Hudson has been challenged to reinvent its traditional newsstand business and become a strong convenience retailer. The company also has expanded its presence in the specialty retail business, and with its acquisition by duty free retailer Dufry AG in 2009, has gained access to exclusive and highly desirable brand name concepts for airports. The phasing plan for Hudson serves to keep the Sea-Tac offering in step with the overall transition of the airport retail business.

## REQUEST JUSTIFICATION AND DETAILS

### *Request Objectives*

The drivers for phasing decisions related to convenience retail are the same as for food service:

1) Meeting future passenger demand;
2) Maintaining capacity 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 negotiations with Hudson with these further objectives:

- Split the current Hudson business into two competitive packages that would be competed in (2022 and 2024).
- Require investment by Hudson to readapt existing locations, where appropriate, to the new, more effective convenience retail concept as an evolution of the traditional news and gift business.
- Re-concept specialty retail locations with Hudson exclusive concepts in order to attract other adjacent high-quality specialty retail operators

The split of the current convenience retail business into two packages will position the business for greater competition in the future. The two packages will be appropriately sized to be attractive to industry operators. The result ultimately may be two competing convenience retailers in the Airport after 2022. The phasing plan for Hudson has been developed in tandem with the phasing plan for HMSHost. A group of HMSHost units would expire in 2023, and this schedule of convenience retail expirations in 2022 and 2024 will build the foundation for the ideal number of future lease expirations annually.

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

- Seven units will be returned early in (2015-2016), as much as two years prior to the scheduled expiration date in 2017.

- Two units (included in Package #1) in the North Satellite will continue to operate until impacted by NorthSTAR construction, and then will be operated as temporary locations during construction

- Eight and nine units will be placed in new leases with two different future expiration dates, 2022 and 2024 respectively

The composition of the new lease package locations is thoughtfully considered in order to balance the sales potential and investment requirement of both packages. Each contains high-volume locations in excess of $5 million in annual sales, as well as low-volume locations that generate as little as $366,000 annually. Anticipated sales volumes for both packages are approximately $25 million annually. The Port will re-compete the future Package #1 opportunity in approximately 2020, in conjunction with the need for permanent new convenience retail locations in the North Satellite.

***Early Return Locations – Phase I (2015 – 2016)***

Hudson has agreed to return the following units ahead of scheduled expiration with no reimbursement for remaining investment value in the spaces totaling $1.2 million:

<u>Unit 1: Central Terminal Newsstand</u>

Remaining Net Book Value 2014: $159,585

Hudson operates this 392 square foot newsstand situated around an atrium column, as well as a 3,400 square foot convenience retail on the nearby south flank of the Central Terminal. Despite the proximity, this newsstand generated $1.8 million in sales in 2013. However, due to the duplicate offering of the two locations, and the suitability of this location for specialty retail, the master plan includes the elimination of this location as a newsstand for conversion to specialty retail.

<u>Unit 2: Concourse A – Hudson Bookseller</u>

Remaining Net Book Value 2014: $226,415

The Hudson Bookseller location in Concourse A generated mediocre sales of $822,000 in 2013. Due to the Airport's square footage constraints, it no longer makes good sense to devote space to designated bookstores. In addition, Hudson's new convenience retail concept, which already exists on the south flank of the Central Terminal, has successfully integrated book sales and periodicals with its offering of grab-and-go foods, drugstore items and sundries. The master plan calls for a redevelopment of the bookstore space, as well as the adjacent underutilized seating area, to a new 6,000 square foot full-service restaurant and gourmet market. This transition should take place in order to provide new food service capacity at the end of 2016.

Unit 3: Concourse C Hudson Bookseller

Remaining Net Book Value 2014: $159,112

The return of this 990 square foot bookstore provides the Airport the opportunity to make vast improvement to space utilization in the front portion of the concourse, near the Horizon Air gate areas. Currently, the bookstore is part of the "wrap around" that begins behind a Horizon Customer Service Center that will be relocated to another part of the concourse. The space is perfectly proportioned to house manicure/pedicure services, which already successfully operates in an adjacent space. Relocation of manicure/pedicure services to the bookstore space will enable the relocation of massage services, which in turn enables the Airport to convert the current massage location into a new casual dining operation. Each operation will have square footage appropriate to the needs to its specific business type.

Unit 4: Concourse D – News/Gift

Remaining Net Book Value 2014: $164,277

This location is directly at the top of the ramp/stairs leading from the north security checkpoint (checkpoint #5). While it is a highly visible location, its position in a juncture point for travelers either headed to the Central Terminal or Concourse D has made it less effective as a news/gift location. Its location is not ideal for conversion to food service or another type of retail. Concourse D passengers will be well served by another Hudson location further down the concourse. Airport staff proposes converting this location to a second children's play area that will complement the new play area on Concourse B. Because of its high visibility, the new play area may be a good candidate for a corporate sponsorship and thus generate a future revenue stream.

Unit 5: Pre-Security North Esplanade (split unit)

Remaining Net Book Value 2014: $188,308

The Airport currently devotes 2,725 square feet of pre-security area to two large news/gift locations. Hudson can generate the same level of sales from less square footage. In the North Esplanade, Airport staff proposes reducing the size of one 1,187 square foot news/gift location to 605 square feet. The returned 582 square feet will be repurposed to a new quick serve dining offering, such as a high-volume sandwich concept, that will target the more price-point sensitive Airport employee customers.

Unit 6: Baggage Claim Alki Bakery/Hudson

Remaining Net Book Value 2014: $149,439

This location serves the south baggage carousel area in Baggage Claim. The return of this unit will enable the Airport to combine it with a post-security location that staff proposes to be returned by HMSHost in order to create a new coffee package opportunity for a competitor to Starbucks.

Unit 7: Pre-Security Alki Bakery/Hudson

Remaining Net Book Value 2014: $125,880

This 201 square foot kiosk unit is located near the exit from Concourse A. This location will be returned to the Airport in anticipation of the impact to the space from the new International Arrivals Facility. In addition, the Airport has proposed development of a new Starbucks location on the floor of the Arrivals Hall atrium below this location in order to more effectively use the space for events and musical performances.

***On-Time Expirations/Continued Operations – Phase II (2017 – 2019)***

Hudson currently operates two locations in the North Satellite. One location is a large high-volume location, and the other smaller location serves the opposite side of the satellite. The timing for the construction impact to these locations as a part of the NorthSTAR project remains unclear. Airport staff recommends that Hudson continue the operation of these units until impacted by construction, as well as build and staff any temporary locations that will be needed to serve passengers during construction. For convenience, these units will be removed from the existing lease and included in the new lease for Package #1, but Hudson’s rights will not extend the new, permanent North Satellite units on their completion. Instead, the permanent North Satellite units will drive the future competition for Package #1 in approximately 2020.

Unit 1: North Satellite (2,858 square feet)

2015 Sales Forecast: $8 million
Estimated New Investment: $224,000

Unit 2: North Satellite (891 square feet)

2015 Sales Forecast: $1.7 million
Estimated New Investment: $148,000

***New Lease – Package 1 – Phase III (2020-2024) (expiration in 2022)***

Unit 1: Central Terminal – Hudson (opened 2013)

2015 Sales Forecast: $7.2 million
Estimated New Investment: $0

The Port leased this 3,400 square foot space to Hudson following the liquidation of Borders Books. The unit is under a separate lease agreement that is due to expire in 2020. Inclusion of this location in Package #1 will ultimately make this package more attractive to competition in when the future RFP is issued in approximately 2020.

Unit 2: Central Terminal Specialty Retail – 'Made in Washington' (900 square foot reduction)

2015 Sales Forecast: $1.7 million
Estimated New Investment: $500,000

Hudson holds the exclusive rights to operate 'Made in Washington' at the Airport. The Central Terminal area should continue to offer a specialty retail concept that reflects the Pacific Northwest sense of place.

Unit 3: Concourse A – Hudson

2015 Sales Forecast: $3.97 million
Estimated New Investment: $1 million

This Hudson location is situated closest to the South security checkpoint (checkpoint #2) and is adjacent to Starbucks Coffee. It effectively serves the needs of both Concourse A and South Satellite passengers.

Unit 4: Concourse A – Hudson

2015 Sales Forecast: $1.1 million
Estimated New Investment: $155,000

This Hudson location serves passengers departing from the middle section of Concourse A near Gates A6 – A9. At 805 square feet, it is one of the smallest Hudson locations, but is appropriately sized for this part of the concourse.

Unit 5: Concourse A – Hudson

2015 Sales Forecast: $1.3 million
Estimated New Investment: $155,000

This location serves passengers departing from the end section of Concourse A, Gates A10 – A14. It is identical in size (805 square feet) to the Hudson location in the middle section of the concourse.

Unit 6: Concourse B – Hudson

2015 Sales Forecast: $3 million
Estimated New Investment: $1.1 million

This location is one of Hudson's larger locations (1,800 square feet) and is appropriate for development to include fresh grab-and-go food items, drugstore and sundries. It would be the single convenience retail location in Concourse B, but ideally placed in proximity to the Central Terminal Hudson location.

***New Lease – Package #2 – Phase III (2020-2024) (expiration in 2024)***

Unit 1: Pre-security North Esplanade – Hudson (reduce space by 582 square feet)

2015 Sales Forecast: $800,000
Estimated New Investment: $464,000

In the North Esplanade, this location occupies 1,187 square feet. The sales generated from this location can be generated as effectively in a smaller footprint. As mentioned earlier, Hudson would return half of the space for a new quick serve offering. While the Port would split the unit, Hudson will be required to build out in the new, smaller space.

Unit 2: Pre-Security South Esplanade – Alki Bakery (Re-concept, relocate and rebuild)

2015 Sales Forecast: $1.6 million
Estimated New Investment: $1.3 million

In the South Esplanade, the current Hudson occupies 1,538 square feet. In combination with the North Esplanade unit, convenience retail occupies more square footage than necessary for its sales potential. Additionally, no Hudson current location in the pre-security esplanade area offers gourmet coffee or grab-and-go food items such as salads and pastries, which are popular with employees. Hudson has partnered with Alki Bakery since 2005 and developed a loyal following for their pastries, sandwiches and salads. The South Esplanade Hudson unit would be re-concepted to an Alki Bakery that also offers newspapers, books, snacks, bottled beverages and sundries. The new location is directly opposite the Concourse B exit and will be in the direct sight line for deplaning passengers. This location would also offer a gourmet coffee alternative to Starbucks. The Port will install needed utilities to this space, and Hudson will complete the build out of this new unit. This relocation means that the current Hudson location in the South Esplanade will be returned to the Port for a planned conversion to food service. The location will be placed in a future competitive package with higher performing post-security food service.

Unit 3: Central Terminal Specialty Retail – 'Coach®' (Re-concept)

2015 Sales Forecast: $2.5 million
Estimated New Investment: $1.2 million

Hudson currently occupies an anchor/corner retail location with its "Life is Good" concept. It has been difficult to engineer an overall upgrade in retail concepts, because Sea-Tac has few existing strong brand names, which serve to generate interest from other retailers. Staff proposes that Hudson re-concept this existing location to a 'Coach®' specialty retail store. In addition to the strong revenue generation associated with this concept, the placement of 'Coach®' in this key corner location will enable the Airport to attract other high-quality retail concepts to the locations directly in front of and to the side of this space. Complimentary adjacencies of like-statured concepts are often the first consideration for retailers when considering leasing opportunities. Hudson will be required to reconfigure and re-concept this location.

Unit 4: Central Terminal Specialty Retail – 'M•A•C®' cosmetics

First Year Sales Forecast: $2.5 million
Estimated New Investment: $570,000

This 1,000 square foot space is currently occupied by The Body Shop under a lease agreement set to expire on May 31, 2015. The Body Shop has performed below expectations over the last two years. By provisions in the current lease agreement, the Port has the ability to terminate this lease due to its performance. Despite The Body Shop's performance, the space is appropriately sized for cosmetics sales, and cosmetics are a part of the optimal mix for the Central Terminal. Airport staff recommends allowing Hudson to assume this space for conversion to a 'M•A•C®' Cosmetics location. Hudson/Dufry holds the exclusive rights to 'M•A•C®' in US airports. It is one of the highest revenue generating cosmetic lines today. 'M•A•C®' is sold in airport duty free shops, but in such stores, the brand requires a minimum of 240 square foot of space. None of the Airport's current duty free stores have sufficient square footage to accommodate 'M•A•C®'. The addition of 'M•A•C®' to the North side of the Central Terminal will enable the Airport to attract other retail tenants for which adjacency to other reputable brands is a prime (and many times first) consideration. Hudson will be required to re-concept this location.

Unit 5: Concourse C – Hudson (incorporate Horizon Service Center space)

2015 Sales Forecast: $5.1 million
Estimated New Investment: $1.8 million

This Hudson location is near the entrance to Concourse C, directly opposite the Horizon Air boarding areas. The relocation of the Horizon Customer Service Center to another area of the concourse will enable the inclusion of more than 400 square feet into a newly renovated space. The addition of this square footage and re-concepting to the new expanded convenience retail offering is projected to increase annual sales by $1 million in the first full year of operation. Hudson will be required to reconfigure and re-concept this location.

Unit 6: Concourse C (Relocate and rebuild)
2015 Sales Forecast: $3.4 million
Estimated New Investment: $1.2 million

The overall space utilization in the more westerly portion of Concourse C near Gates C8 – C18 is inefficient due to a lack of contiguous space for both food service and retail. The relocation of this unit, along with the relocation of an adjacent Starbucks Coffee, will optimize the use of overall available square footage in this part of Concourse C. Even with this more effective use of space, overall available square footage will remain insufficient to meet passenger demand. Hudson will be required to relocate and build-out the new location.

Unit 7: Concourse D (Relocate and rebuild)
2015 Sales Forecast: $2.6 million
Estimated New Investment: $1.1 million

Currently, two Hudson locations exist in Concourse D. Overall square footage devoted to convenience retail exceeds demand. As noted earlier, one location would be returned early to the Port for conversion into a second children's play area to serve the north main terminal. The second Hudson location would be relocated to a corner location near the end of Concourse D. It would assume a current food service location and an adjacent vacant unit in order to create a 'corner street retail' appeal with a specialty retail component. It is a smart means to bring vacant space into revenue generation, and a better location for convenience retail than food service. Hudson will be required to build out the new space.

Unit 8: Pre-security Baggage Claim
2015 Sales Forecast: $375,000
Estimated New Investment: $123,000

In order for convenience retail to be truly convenient, it must be placed throughout the Airport. Some locations may provide a significant value to passengers, despite lower sales volumes. Baggage claim is an area where passengers often unexpectedly find the need to replace forgotten items or necessities before their departure from the Airport. In addition, baggage claim locations have extended hours to serve off-peak passenger arrivals. For these reasons, Hudson should be required to continue operating this location. Hudson will be required to make modest refurbishments to this space.

Unit 9: South Satellite
2015 Sales Forecast: $8.3 million
Estimated New Investment: $1.3 million

The South Satellite Hudson location is the only convenience retail offering in the satellite and also contains a modest offering of the only available specialty retail merchandise in the satellite. There are no immediate plans to modify or expand the South Satellite, and there is no other superior configuration for convenience retail in the satellite. Hudson will make improvements within the store to offer the convenience retail concept similar to the Central Terminal (as achievable in a much smaller space). Due to the high volumes of traffic, this location endures a significant amount of wear-and-tear and the level of investment reflects the quality and durability expected in this new investment.

## FINANCIAL IMPLICATIONS

The existing Hudson lease has a category rent structure whereby Hudson pays different percentages on different categories of sales, such as newsstand material, sundries and specialty retail. 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. When Hudson assumed the former Borders Books location in 2013, a tiered rent structure was also negotiated for that space.

In a tiered structure, tenants pay rent at progressively higher levels as sales increase over the course of a lease year and 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 AirProjects, a proposed tiered rent structure for this Hudson agreement.

With regard to percentage rent in a new contract, Airport staff expects not only that Hudson will pay at an equivalent level through the end of their current lease term, but also that the company will pay a reasonable premium for the benefit of certainty in the continuity of their operations and the cost savings of not needing to participate in a competitive RFP process at this time.

Below is the negotiated percentage rent proposal for the Hudson agreement for convenience retail:

| Tier | Percentage |
|---|---|
| 0 - $25 million | 16% |
| $25,000,001 - $45 million | 17.5% |
| Sales over $45,000,000 | 19% |

The rent structure and tiers are proposed as follows for the three specialty retail locations (Made in Washington, Coach® and M•A•C® Cosmetics. The profit margins on specialty retail merchandise are very slim, which justifies a different rent structure for the merchandise in these three locations.

| Tier | Percentage |
|---|---|
| 0 - $10 million | 9% |
| $10,000,001 - $15 million | 10% |
| Sales over $15,000,000 | 11.5% |

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 convenience retail and specialty retail are in a range consistent with industry norms.

| Proposal Summary | Package #1 | Package #2 |
|---|---|---|
| New Term Expiration | 2022 | 2024 |
| Investment | $3.3 million | $9 million |
| Est. Gross Sales Year 1 | $27.1 million | $27.9 million |
| Est. Term Revenue to the Port | $82 million | |
| NBV for Returned Units | $1.2 million | |
| Jobs Supported | 250 | |

## STRATEGIES AND OBJECTIVES

This phasing plan, including a new lease and concession agreement with Hudson, 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 seven proposed Hudson locations will lead to increased revenues over those generated today and provide new opportunities for other businesses seeking entrance to the Airport. The proposed new lease and concession agreement with Hudson will generate an estimated $82.7 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 Hudson locations included in the leases supports approximately 250 full-time jobs (See also below).

### *Environmental Responsibility*

Airport convenience retail 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 Hudson. These employees are represented by the United Food and Commercial Workers union (UFCW) Local 21. After an initial employment of 18 months, Hudson store associates earn $9.72 per hour.

Their collective bargaining agreement contains annual raises, typically about 25 cents per year. In addition, employees have access to family health care benefits at no cost to the employee. Hudson contributes $4.86 per hour for each employee to union health and welfare. Hudson pays an additional 65 cents per hour for pension, laundry and parking/local transportation subsidies for each employee. As of January 2015, the lowest wage and benefit rate paid to any Hudson employee is $14.98 (12 individuals in this category). These jobs meet the criteria for quality jobs as recently articulated by the Commission.

In addition, the Hudson business will continue to include a 25% ownership share by their current ACDBE partners, MCSB, Inc. and Warren Gift/News.

## ALTERNATIVES AND IMPLICATIONS CONSIDERED

**Alternative 1) –** Do not phase the 2017 expiration of Hudson leased units (not including the Central Terminal Hudson, which is under a separate lease). The Hudson units currently represent 100% of Airport convenience retail. Under this alternative, the Port would issue RFPs for two packages for award in mid-2016. The currently proposed two packages would be reconstructed to include the seven units that the Port would not take back early in 2015-16. The result of this approach means that these units would be in transition simultaneously in the summer of 2017. This large number of units in transition, i.e. closed for renovations with minimal temporary operations, will impact the Airport's ability to serve the passenger and negatively impact revenue generation. This volume of transition also will strain the Port's ability to manage the tenant construction activity. This would create a problem of short-term job loss due to the operational disruption. In addition, the same pattern of critical impact would re-occur when the new leases mature in 2026-2027. This is not the recommended alternative.

**Alternative 2) –** Issue an RFP for one convenience retail package in mid-2016 in order to transition approximately half of the Hudson units in mid-2017. This alternative means that Airport staff would need to renegotiate the phasing plan with Hudson with regard to which units would transition in 2017 and which would be contained in a new lease. Also in this scenario, the Port would not be able to take advantage of the early returned units for immediate redevelopment. Instead, these units would be added to the number of units to renegotiate for transition either in 2017 or later in Phase III (between 2020 and 2024). Also in this scenario, the Airport will experience operational disruption at a critical time when food service capacity is in transition. The Airport can expect a negative impact to customer service and the generation of revenue. This is not the recommended alternative.

**Alternative 3) –** Approve the proposed phasing plan for Hudson, including two new lease and concession agreements with separate expiration dates. For the benefit of these new lease agreements, Hudson will pay the Port a premium in percentage rent compared to current levels, make new investment estimated at $12.3 million, in addition to the return of seven (7) current locations without reimbursement of remaining unamortized value. **This is the recommended alternative.**

## ATTACHMENTS TO THIS REQUEST

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

## 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