PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA

Item No.	5c
Date of Meeting	July 28, 2009

DATE: July 1, 2009

TO: Tay Yoshitani, Chief Executive Officer

FROM: James R. Schone, Director, Aviation Business Development
Deanna Zachrisson, Manager, Aviation Concessions Business

SUBJECT: Amendment to Lease and Concessions Agreement of Host International, Inc. (Host Duty Free)

REQUESTED ACTION

Request for authorization for the Chief Executive Officer to execute an amendment to extend the Lease and Concession Agreement of Host International (Host Duty Free) for duty free retail operations at Seattle-Tacoma International Airport (Airport) in 2010.

SYNOPSIS

Port staff seeks approval for a lease amendment in order to extend the current Lease and Concession Agreement with Host International, Inc (Host Duty Free) for one year, through December 31, 2010. The need for the extension stems from the current unfavorable market conditions for conducting a competitive bid for a new long-term duty free concessionaire. In return for a one-year lease extension, Host Duty Free will provide the Port with increased percentage rent during 2010. Airport concessions staff intends to conduct a competitive bid process in 2010.

BACKGROUND

In 2003, the Port entered into a five-year Lease and Concession Agreement with Host Duty Free for the continued operation of three (3) duty free (and duty paid retail) locations at the Airport. This Agreement was negotiated concurrently with the Host International food & beverage agreement that followed the end of that company's tenure as the Airport master concessionaire.

The current Agreement provides the Port with percentage rent (16%) on gross sales, across all categories of sales. Host Duty Free also pays a monthly 'guaranteed rent' (or Minimum Annual Guarantee, MAG) of 90% of the previous year's total payments to the Port. In 2008, Host Duty Free achieved $11 million in gross sales, resulting in $1.8 million in revenue to the Port.

In the current economic downturn, international enplanements have been the most severely affected, with a year-to-date enplanement loss of -11.7% (domestic enplanements have fallen by -4.8%). Consequently, duty free shop sales have been the most negatively impacted of any type of concessions sales category at the Airport. Through the month of May, duty free shop sales are down -17%. Ideally, concessions staff would have launched a competitive ‘request for proposals’ (RFP) process this year in order to reinvigorate this business and achieve higher financial returns for the Port. However, under such adverse market conditions, staff believes that it is best to defer the competitive bid until next year, when international enplanements and sales may improve. Also, duty free operators will likely have easier access to the capital investment necessary to renovate the duty free units to a much improved standard.

Earlier this year, concessions staff undertook a survey of other U.S. airports’ duty free operator financial terms and conditions. Staff found that Sea-Tac should be able to command a higher percentage rent than the current 16% in a new duty free contract. For example, Boston Logan International Airport has comparable duty free sales ($11.4 million in 2008) and receives 25% on sales up to $7 million with percentage increases over $7 and $10 million in sales. However, this business deal and others with similar terms were struck at the height of the market. Currently, most airports – including duty free “powerhouse” airports such as Hong Kong International – are deferring the tender of new competitive bidding until market conditions improve.

Concessions staff approached Host Duty Free about continuing to operate beyond the current expiration date of December 31, 2009. The Port could either execute the ‘holdover’ clause of the Lease and Concession Agreement for a short term month-to-month duration, or seek authorization to extend the Agreement. Concessions staff does not believe that market conditions will improve sufficiently this year for a successful competitive bid, and also it is in both Host Duty Free’s and the Port’s interest that the exact duration of the contract be certain. Host Duty Free must maintain a bonded warehouse for alcohol and tobacco off airport property, and the Port must assure continued revenue from duty free sales. Therefore, staff recommends an extension of the Host Duty Free Agreement.

In exchange for the certainty of the lease extension through 2010, Host Duty Free has agreed to pay the Port increased percentage rent as follows:

- 18% on sales up to 2009 sales levels
- 20% on sales exceeding 2009 sales levels

Since there is continued concern about the volatility of the international travel market, Host Duty Free has requested, and staff concurs with a reduced ‘guaranteed rent’ (MAG) to 80% of 2009 paid percentage rent. This measure protects Host Duty Free from further extreme deterioration of the duty free business.

SCOPE OF WORK

The Port would enter into a lease amendment with Host Duty Free making the following modifications:

Term/Effective Date:	One year term extension with expiration on December 31, 2010. Other provisions such as holdover remain as is.
Percentage Rent:	The lessee agrees to pay the Port 18% on gross sales of Duty Free and Duty Paid merchandise (excluding advertising and other) at or below 2009 levels. Lessee agrees to pay the Port 20% on gross sales of same on sales exceeding 2009 levels.
MAG:	Lessee will pay a minimum annual guarantee in an amount equal to eighty percent (80%) of the total amount (whether by minimum annual guarantee or percentage rent) paid by Lessee to the Port in the previous year (2009). The minimum annual guarantee is divided into equal monthly payments.

All other terms and conditions of the Agreement will remain unchanged.

STRATEGIC OBJECTIVES

This proposal supports the strategy of "Ensuring Airport and Seaport Vitality" by ensuring business viability for the duty free concession business at the Airport.

ALTERNATIVES CONSIDERED/RECOMMENDED ACTION

- **Alternative 1: Do Nothing**
  The Concession and Lease Agreement with Host Duty Free will expire on December 31, 2009. There will be no duty free operator in place, which will mean the loss of significant revenue for the Port in 2010, as well as a loss of an important customer amenity. This is not a recommended alternative.

- **Alternative 2: Holdover Lease Agreement**
  If the Agreement moves into a holdover (or "month-to-month") status, there is a risk, though likely small, that Host Duty Free may lose the warehouse space they currently lease because this space also would become a month-to-month lease by Host Duty Free. U.S. Customs requirements for alcohol and tobacco warehousing by duty free operators are very strict, and receiving their approval of another warehouse space would be a protracted process. This is not a recommended alternative.

- **Alternative 3: Extend Lease for One Year**
  This alternative provides certainty both to the Port and Host Duty Free of the duration of this contract. Additionally, it provides somewhat better financial terms for the Port, despite the depressed state of the business. Most importantly, it allows time for the Airport enplanement and sales levels to recover, which in turn provides a more competitive basis for bidding the next long term duty free contract. This is the recommended alternative.

FINANCIAL IMPLICATIONS

If duty free retail sales remain at similar levels in 2010, the Port will still realize increased revenue from duty free as a result of the increased percentage rent. If international enplanements begin to recover, and sales begin to rise above 2009 levels, the Port will benefit from significantly increased rent. At current international enplanement levels, it is highly unlikely that the Port could command higher percentage rent than proposed in 2010 via a competitive bid process. However, the risk is great the Port would 'lock in' less favorable financial terms for many years, than if the opportunity is bid when conditions have improved.

ECONOMIC IMPACTS

Host Duty Free currently employs 17 full-time and 13 part-time sales associates, three full-time and four part-time warehouse associates, four full-time administrative staff, as well as an airport and warehouse management staff of six. This extension preserves employment in 2010 for these individuals in a very difficult job market.

PREVIOUS COMMISSION ACTION

May 13, 2003	Commission approved a five-year Lease and Concession Agreement with Host Duty Free.