PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA **Item No.** 6c

Date of Meeting September 22, 2009

DATE: August 18, 2009

TO: Tay Yoshitani, Chief Executive Officer

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

SUBJECT: Amendment to Prime Lease and Concession Agreements of food & beverage concessionaires Host International, Seattle Restaurant Associates and Concessions International.

REQUESTED ACTION

Request for authorization for the Chief Executive Officer to execute a lease amendment to the Prime Lease and Concessions Agreements of Host International (Host), Seattle Restaurant Associates (SRA) and Concessions International (CI) to cap mid-term refurbishment requirements to no more than $100 per square foot, and specify dates for completion of mid-term refurbishments in concessions units.

SYNOPSIS

In mid-2008, Port staff commissioned a respected aviation-industry consulting firm, Jacobs Consultancy (Jacobs), to analyze the contract terms currently in place for the food and beverage concessionaires at Seattle-Tacoma International Airport (Sea-Tac). The analysis took into consideration the significant financial relief – including term extension – that had been provided to the prime concessionaires (Host, SRA, CI and Hudson Group) in 2005 in response to unexpectedly high build-out costs for the new concessions program.

The 2008 Jacobs analysis led to some recommendations for consideration by Airport staff. One specific recommendation centered on modification of the Port's requirements for mid-term refurbishment to concessions units, in light of the high initial investment in the units. Jacobs suggested lowering the Port's requirement to a *maximum* refurbishment investment of $100 per square foot. Currently, the three prime food and beverage concessionaires' Lease and Concession Agreements state different requirements for the same mid-term refurbishment. Notably, the SRA agreement requires a *minimum* investment of $130 per square foot. Independent of the Jacobs recommendation, Airport staff believes that the Port should establish a schedule of specific dates for mid-term refurbishment for each unit. Since many units' build-outs were not complete until well into the lease term, it is more reasonable to use the first day of operation in a new unit as the starting point for determining the midpoint of a unit's operational lifespan.

BACKGROUND

In July 2008, Airport staff presented the findings of the Jacobs analysis to the Commission. At that time, staff committed to further study mid-term refurbishment requirements. Today's action focuses on changes to the mid-term refurbishment requirement that are deemed in the best interest of the Port, the tenants and the traveling public.

Mid-term refurbishment requirements

The Airport expects more than 30 million passengers in 2009. Accordingly, Airport concessions annually see more visitors than any "street" location, and over time, concessions begin to show the wear-and-tear of a busy airport. It is industry practice to require concessionaires to refurbish their units mid-way through the lease term. Such refurbishments add value to the unit and are an investment in its business potential.

SRA's prime lease agreement requires mid-term reinvestment of $1.8 million for all of their units (or $130 per square foot), and consistent with the amount offered in SRA's response to the Port's Request for Proposals in 2003. The 2005 amendment to Host's prime lease agreement required a mid-term reinvestment equal to 15% of the initial investment in new units on Concourse A and Central Terminal, and 25% for other units. The square foot cost will vary depending on the initial investment in each specific unit, but is less than $130 per square foot. The Concessions International lease agreement specifies no specific dollar amount required for mid-term refurbishment, stated only to be done "in a manner acceptable to the Port."

The Port has always held a pragmatic approach to mid-term refurbishment by requiring only refurbishment levels justified by the actual need, assessed through inspection of each unit at the mid-term. If a unit has been well maintained – carpets cleaned, surfaces repaired, cooking equipment maintained – the amount of investment necessary for refurbishment is reduced. All concessionaires have invested significantly in the build-out of their units. In light of the high initial investment, Port staff concurs with the Jacobs recommendation to reduce the mid-term refurbishment investment. The proposed amendment will cap the mid-term reinvestment to a maximum of $100 per square foot. Airport staff believes that a maximum refurbishment investment of $100 per square will be sufficient for all concessions units to return to a 'like new condition' as specified in the lease agreements. It will also make the requirements uniform for all three prime food and beverage concessionaires, which currently are different due to different proposals from the prime concessionaires at the time the lease agreements were written.

Additionally, lease language would be revised to clearly identify the date of mid-term refurbishment for each concessions unit, with the mid-point determined individually from the date on which business commenced in a newly renovated or built-out concession unit. Current lease language is not reflective of the earlier lease extension given in 2005, or in-step with actual completion dates of build-out/renovation work. This change benefits tenants, including small operators, who completed build-out or renovation work much later than at the beginning of the lease term, by adjusting the point of refurbishment to a later time.

In March 2009, Commission authorized amendments to the Lease and Concession Agreements of prime concessionaires (and their subtenants) located on Concourses A and D, due to the reductions in scheduled airline service from gates in those locations. Today's proposed lease amendment would specifically delay any mid-term refurbishment of a unit that is operating in an area subject to a relief provision. It would be unreasonable to require a tenant to refurbish a unit that is operating under temporary relief. However, emergency, code compliance and operational repairs always are required of all tenants.

New Concession Design Guidelines

In the build-out and refurbishment of concessions units, clear communication of Port expectations and requirements with tenants and their designers/architects is critical. If the tenant is unsure of these expectations and requirements, the result may be multiple submittals and revisions that escalate costs for the tenant. Airport concessions staff acknowledges that there are ways to improve the build-out/renovation process and are seeking to create more efficient processes. This year, Airport concessions staff undertook the work of preparing new design guidelines for concessions development. The new guideline document is easy-to-read, yet specifically addresses critical design and construction guidelines and requirements. While build-out costs for an airport restaurant or store always will be higher than for a street location, it is possible to establish realistic expectations for concessionaires at the start of the tenant-Port relationship.

A part of the new design guidelines entailed development of a specific standard and process for the mid-term refurbishment – where no guideline previously existed at all. This guideline includes the inspection checklist, which clearly explains which types of issues the Port expects tenants to address with their mid-term refurbishment. Once reviewed by internal stakeholders and tenant representatives, this new design guideline will serve to steer the mid-term refurbishments beginning in 2010, as well as new concession units.

SCOPE OF WORK

The draft lease amendment accompanies this request for authorization. Exhibit A of the lease amendment shows the specific dates for each unit's mid-term refurbishment date. If approved, Airport staff will proceed to execute these lease amendments, as well as assure that the amendment terms must be passed down to all subtenants.

STRATEGIC OBJECTIVES

This proposal supports the strategy of "Ensuring Airport and Seaport Vitality" by ensuring viability for businesses at the Airport. Appropriate re-investment in concessions units contributes to the overall high quality of the Airport program, while allowing concessions operators to be profitable.

FINANCIAL IMPLICATIONS

The proposed lease amendments do not have any negative financial implications for the Port.

ECONOMIC IMPACTS

The preservation of attractive concessions units helps assure that discretionary purchases at the Airport remain desirable to the residents and visitors of the Puget Sound area. Again, certainty in tenant contract terms helps assure concession unit viability.

ALTERNATIVES CONSIDERED/RECOMMENDED ACTION

- **Alternative 1: Do Nothing**
  The prime concessionaires and their subtenants would be required to complete mid-term refurbishments in accordance with the terms of their specific food and beverage lease agreements. The requirements in the agreements are dissimilar, and will result in a different standard for different tenants. Tenants would be required to complete mid-term refurbishment at the midpoint of the lease agreement, regardless of when a new unit actually entered operation. For example, a new unit that opened in July 2007 would need to refurbish after only four years of operation in a 12-year lease. Additionally, tenants on Concourse A would be required to do a mid-term refurbishment in 2010, when, in all likelihood, the units are still operating under terms of relief. This is not a recommended alternative.

- **Alternative 2: Other Lease Amendments**
  The Port could opt to amend the lease agreements to leave open the minimum or maximum amount of investment required for the mid-term refurbishment. While this option may work acceptably well in practice, it does not provide the tenants with assurance that Port requirements will not escalate costs beyond what is reasonable. This is not a recommended alternative.

- **Alternative 3: Amendments per Staff Recommendation**
  A lease amendment to modify the requirement to a *maximum* investment of $100 per square foot still provides the Port flexibility in its expectations, and also provides the tenants assurance that Port requirements will not be overly burdensome. Concession units will be refurbished at the true midpoint of their operational lifespan, assuring optimum value for the

Port and the tenants. For tenants on Concourses A and D, it additionally provides assurance that mid-term refurbishment is delayed until traffic levels return to those concourses. **This is the recommended alternative.**

PREVIOUS COMMISSION ACTION

May 28, 2002	Commission was briefed on the planned new three-tiered concessions program for Sea-Tac Airport.
May 13, 2003	Commission approved the Concessions International (CI), Host International (Host) Food & Beverage and Duty Free leases.
June 24, 2003	Commission approved the Seattle Restaurant Associates (SRA) lease.
August 23, 2005	Commission was briefed on sales for the new concessions program and the performance of the Central Terminal since its June 2005 opening.
December 13, 2005	Commission passed a resolution authorizing amendments to the prime lease agreements of Host and SRA to provide financial relief to prime concessionaires as well as ACDBE operators at Sea-Tac Airport.
July 22, 2008	Commission was briefed on the results of the Jacobs Consultancy analysis of the concessions program in response to complaints raised by two subtenant ACDBE operators requesting changes to lease terms.
February 24, 2009	Commission authorized the amendment of Concession International's lease agreement to provide identical relief as received by Host and SRA in 2005.
March 5, 2009	Commission authorized amendments to the lease agreements of Host, SRA, CI and Airport Management Services (dba Hudson Group) to provide financial options for operators on Concourses A and D in response to reductions in scheduled air carrier service.