PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA

Item No. 8a

Date of Meeting March 5, 2009

DATE: February 26, 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 Agreements of Prime Concessionaires Host International (Host), Seattle Restaurant Associates (SRA), Concessions International (CI) and Airport Management Services, LLC (dba Hudson News).

REQUESTED ACTION

Request for authorization for the Chief Executive Officer to execute amendments to the Lease and Concession Agreement of Host International (Host), Seattle Restaurant Associates (SRA), Concessions International (CI) and Airport Management Services, LLC (Hudson).

SYNOPSIS

Port staff seeks approval for lease amendments in order to address significant scheduled enplanement losses for specific Airport concessions in the wake of major airline relocations in Concourses A and D at Seattle-Tacoma International Airport (Airport). There are a total of ten potentially affected units in Concourse A and nine units in Concourse D. These are a combination of food and beverage (seven each in Concourses A and D), four news/gift retail and one bookstore. (Please refer to Exhibits A and B)

The affected units would be eligible for options to address the loss of scheduled enplanements in Concourses A and D. The options are summarized as follows:

1. Concessionaire continues to operate unit under modified lease terms.

2. Concessionaire closes unit with the intent of re-opening when enplanement levels return. The Port will provide a rent credit equivalent to the value of depreciation during the period of closure.

3. Concessionaire closes unit permanently and is purchased by the Port at its net book value.

BACKGROUND

When lease agreements were negotiated between the Port and prime concessionaires, percentage rent levels and other compensation to the Port were negotiated for a term length of 10 years, during which time both parties expected there would be years of sales growth and years of decline. However, both the Port and the concessionaires entered the business relationship with the belief that airline customers would utilize the gates adjacent to concession units to a sufficient degree to warrant the build-out of concessions spaces.

Announced operational changes at the Airport have challenged this basic premise. As a result, the Port, while under no obligation to act, has considered a range of options for concessionaires in the affected areas. Many of these concessionaires are Airport Concessions Disadvantaged Business Enterprise (ACDBE) tenants with three or fewer units airport-wide and consequently less ability than the prime concessionaires to withstand significant enplanement losses at any one location.

2009 Concourse Changes
In the fall of 2008, Sea-Tac's #1 and #6 ranked carriers (by enplaned passengers) announced changes to their operations that at this time, we believe will take effect in the first half of 2009. These changes will result in scheduled enplanement losses of such a magnitude that normal concession operations may not be possible in the affected concourses.

Alaska Airlines has reallocated its gate use at the Airport in accordance with the governing Signatory Lease and Operating Agreement (SLOA). One year ago, Alaska leased all eleven gates in Concourse D as 'preferential' gates. A preferential gate is a gate operated primarily by one carrier. Effective January 1, 2009, Alaska retained only four preferential gates in Concourse D and planned to use the other seven gates for only one departure per day. Since January 1, Alaska has been preparing to retract its operation from Concourse D in favor of its preferential gates in the North Satellite. This transition is anticipated to be complete in March. More recently, Alaska has notified the Port that it intends to release one more gate on Concourse D effective May 1. Port staff estimates an average scheduled enplanement reduction in this concourse in excess of 35% compared to 2008.

Delta Airlines and Northwest Airlines have merged to become one carrier. The new Delta/Northwest decided in accordance with the SLOA to consolidate its combined operation at the South Satellite gates, and release Delta's four exclusive gates near the end of Concourse A. Port staff estimates an overall average enplanement loss in Concourse A of approximately 26% relative to 2008 levels. However, the gate area A10-A14 will sustain an enplanement loss of approximately 60%. In contrast to these severe impacts, overall scheduled enplanement levels at Sea-Tac during 2009 are expected to drop to a much lesser degree – less than five percent.

Options for Concessionaires
For certain units, it will not be possible to continue to operate profitably due to an insufficient

number of daily arrivals and departures from their gate area. In such cases, the Port would agree to purchase the unit at net book value and remove it from the relevant prime agreement. The net book value is the remaining value of the improvements based on a 10-year depreciation of the unit. The Port would seek to re-lease the unit to a new tenant when enplanements return to a level that would sustain profitable operation.

For other units, concessionaires will need to make a decision as to whether a unit can be operated under temporarily modified lease terms, or if the unit should be shuttered for business until enplanements return to profitable levels. In the instance that a unit is shuttered, the concessionaire would continue to own the unit, but would receive a credit equivalent to the depreciation for the period of closure, in order to assist the concessionaire in paying the ongoing fixed costs associated with that unit until it reopens.

Temporarily Modified Lease Terms
The Lease and Concession Agreements of all four prime concessionaires do not require the Port to mitigate the effects of the Concourse A and D scheduled enplanement drops because airport-wide enplanements are not anticipated to drop by 20%, which is the threshold for relief in the agreements. If that were the case, the lease agreements provide for a reduction of the Minimum Annual Guarantee (MAG, also known as "guaranteed rent") due to the Port. MAG is an up-front payment made monthly for each concessions unit which is equivalent to 90% of the previous year's rent payments. If sales drop dramatically from one year to the next, a concessionaire is still obligated to pay no less than 90% of the previous year's rent.

While the criteria identified in the lease for relief are not met, Port staff recommends a modification of the MAG requirement for tenants in Concourse A beyond gate A4 and Concourse D that experience a 20% or greater drop in scheduled enplanements. The proposed modification would suspend MAG payments for affected units and allow tenants to pay percentage rent only based on actual sales, rather than based the 90% of 2008 rent payments.

Port staff also believes that a reduction in percentage rent for these concourses may be necessary to assure viability for those units that choose to remain open. Current concessions sales in general are showing great volatility, since the Airport experienced its first overall drop in concessions sales in October 2008. It is premature to determine what the specific impact of the enplanement losses will be in the two affected concourses, and the appropriate rent level reduction to mitigate that impact. Therefore, staff recommends taking immediate action to deliver cash-flow relief (suspension of MAG payments) to these tenants, while continuing to monitor developments in sales and develop the best mechanism for delivering appropriate relief.

Airport Industry Experience
Airports across the U.S. have been addressing airline carrier impacts to concessionaires for most of 2008. There are many examples of airports – most notably Dulles International, Cincinnati-Northern Kentucky, and Oakland International – that have experienced complete loss of carriers,

extreme reductions in service and/or concourse relocations. Port staff has been able to study the actions taken by these and other airports to address impacts on concessionaires. Airports have instituted relief at enplanement drop triggers varying between 10-25%. In nearly all instances, airports have offered relief when enplanement losses have severely affected one concourse or terminal, in contrast to an entire airport. However, nearly all airports already are experiencing an overall loss of passenger traffic much greater than forecast for Sea-Tac. The relief offered in the instances available for study has been 1) reduction of MAG payments commensurate with percentage enplanement drop, 2) suspension of MAG payments and/or 3) temporary reduction in percentage rent. Relief has been offered for a specific period of time, most commonly ending after 12 months (or earlier if enplanement levels return).

Specific to the situation at Sea-Tac, it is in the Port's best interest to provide an industry-consistent and appropriate relief in order to avoid concessionaires going out of business. The costs to the Port of a failed business include a complete loss of revenue as well as the costs associated with securing a new tenant for a concessions space. It also may result in additional missed revenue (and poor customer service) when enplanement levels return due to the Port's inability to mobilize quickly to open a replacement concession. Many of the affected concessionaires are ACDBE operators and the loss of such businesses jeopardizes the Airport's ability to meet its FAA-mandated ACDBE participation goal.

SCOPE OF WORK

The Port would enter into lease amendments with the Airport's three prime food and beverage concessionaires and single retail prime concessionaire making the following modifications:

Eligibility:	Relief will be made available only to tenants in Concourse A beyond gate A4 and in Concourse D.
Duration:	Duration of relief will last no longer than 12 months from the beginning of the first calendar month following a 20% drop in scheduled enplanements in the concessions area. The relief will end prior to the 12 month period if enplanements rise to 80% of 2008 enplanements in the affected concourses for three consecutive months.
Options:	Each tenant, including subtenants, will choose to either continue to operate their concession, or close the concession – permanently or temporarily.
Buy out:	The Port will purchase a permanently closed concession at undepreciated net book value.

Depreciation Credits:	For a temporarily closed unit, the Port will provide the tenant a rent credit equal to the depreciation of the unit while it remains closed. ACDBE subtenants will receive this rent credit on a monthly basis during the period of closure. Prime concessionaires will receive the rent credit once the unit reopens.
Minimum Annual Guarantee:	For units which remain open, the Port would suspend monthly MAG payments. Concessionaires with shuttered units would not pay MAG due to a lack of sales.

STRATEGIC OBJECTIVES

This proposal supports the strategy of "Ensuring Airport and Seaport Vitality" by ensuring business viability for both prime concessionaires and small businesses at the Airport.

ALTERNATIVES CONSIDERED/RECOMMENDED ACTION

- **Alternative 1: Do Nothing**
  Per terms of the lease agreements, Port staff receives only gross revenue information from the concessionaires. However, reductions in scheduled enplanements in a concourse will lead to reduced sales and impact concessionaires' ability to cover fixed costs. For the small concessionaires, the risk is significant that they may be forced to permanently close units in Concourses A and D. The risk is even greater for small businesses that do not have other units in areas where scheduled enplanements are expected to increase. This is not a recommended alternative.

- **Alternative 2: Authorize other modifications**
  Staff have carefully considered other modifications and have proposed only those which address the effects of the scheduled enplanement drops as a result of air carrier changes. They are not intended to provide relief for the effects of a poor economy or reduced consumer spending. Other possible modifications, such as extended lease term or permanently reduced rent, do not serve the purpose of helping tenants survive this specific circumstance. Such modifications also would have greater and more long-lasting impacts to concessions revenue and the integrity of the concessions program. Other modifications than those proposed are not recommended.

- **Alternative 3: Authorize proposed amendments**
  This alternative may serve to keep some small concessionaires in business which might otherwise close as a result of the scheduled enplanement drops in Concourses A and D. If modified lease terms can assist in the survival of a concession until conditions improve, it preserves some revenue and also saves the Port the cost of purchasing a concession and re-leasing the same space at a later date. This is the recommended alternative.

FINANCIAL IMPLICATIONS

Despite the loss of enplanements in Concourses A and D, the Port would expect to retain concessions revenue, because these enplanements are simply moving to different gate areas, located near different concessions units. The purpose of this relief is to help mitigate the loss of enplanement traffic for the Concourse A and D tenants at their locations, not general economic conditions. When enplanements return to 80% of 2008 levels, the relief will end.

Concessionaires in Concourses A and D have yet to make their business decisions regarding continued operation or closure (temporary or permanent). These decisions, particularly for the small tenants, may hinge on the lease conditions under which they will continue to operate. Port staff believes that it is likely that one or more concession units may need to be purchased voluntarily by the Port. It is also very likely that as many as three units will shutter temporarily. Still other concessionaires may continue to operate, only to later find operation at a loss to be untenable and choose to close temporarily or permanently. Until these decisions are clear, we are unable to understand the full financial impact of these airline changes.

It is possible to characterize a scenario – though not a realistic scenario – if ALL affected tenants were to choose the **same** option, below. Total concessions revenues in 2007 were $27.4 million.

IF ALL AFFECTED UNITS CHOOSE:	DIRECT COST TO PORT	LOST REVENUE TO PORT
Option 1: Continue to operate without MAG and possible rent reduction	$0	• No lost revenue until sales drop greater than 10% for 2009 vs. 2008. • If sales drop 15%, lost Port revenue will be approximately $100K. • If sales drop 50%, lost Port revenue will be approximately $1 million. • Additional revenue loss will result from potential reduced percentage rent.
Option 2: Close with intent to reopen	$1.1 million (rent credit)	• $3.5 million, based on 2008 sales levels, assuming closed for one year.
Option 3: Buyout at Net Book Value	$6.7 million (buyout)	• $3.5 million per year, based on 2008 sales levels. However, this would be offset with revenue from new, future tenants once units are re-leased.

ECONOMIC IMPACTS

Concessions businesses employ hundreds of full-time and part-time employees. The combined employment of Host and SRA including Anthony’s Restaurant is approximately 650 associates (not including subtenants). Hudson News Group employs approximately 230 workers. Effects of the economic downturn have and will continue to result in the loss of jobs. The number of employees working in units in Concourses A and D is approximately 238. Nearly half are employed by subtenants, with the remainder employed by Host/SRA and Hudson. The proposed amendments seek to stem the loss of Airport related jobs by supporting the continued operation of concessions.

PREVIOUS COMMISSION ACTION

January 28, 2003	Commission approved the retail concessionaire lease of Airport Management Services LLC (ACDBE joint venture dba Hudson News).
May 13, 2003	Commission approved the Host International Food and Beverage, Host Duty Free and Concessions International leases.
June 24, 2003	Commission approved the Seattle Restaurant Associates lease.
July 12, 2005	Commission approved a lease amendment to the Hudson News lease to add/substitute locations to meet Airport needs.
December 13, 2005	Commission approved amendments to the food and beverage lease agreements of Host International and Seattle Restaurant Associates to provide financial relief to these prime concessionaires and their ACDBE subtenant operators at Sea-Tac Airport.
November 6, 2006	Commission passed a resolution authorizing amendments to the lease agreement of Airport Management Services LLC to provide financial relief for higher than anticipated build-out costs for their 22 concessions units.