

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

**COMMISSION AGENDA**

**Item No.** 5b

**Date of Meeting** March 8, 2011

**DATE:** February 22, 2011

**TO:** Tay Yoshitani, Chief Executive Officer

**FROM:** Wayne Grotheer, Director, Aviation Project Management Group  
James Schone, Director, Aviation Business Development

**SUBJECT:** South Satellite Concessions Project (CIP# C800412)

**Amount of This Request:** \$350,000      **Source of Funds:** Airport Development Fund

**Total Estimated Cost:** \$2,199,000

**ACTION REQUESTED:**

Request Port Commission authorization for the Chief Executive Officer to authorize design in support of the South Satellite Concession Project at Seattle-Tacoma International Airport (Airport). This authorization is for \$350,000 of a total estimated project cost of \$2,199,000.

**SYNOPSIS:**

This project includes the modification of the existing South Satellite duty free store footprint, creation of a new tenant-ready shell for a future duty free tenant, creation of a new food and beverage shell for a future restaurant tenant, as well as required regulated materials abatement.

The purpose of the project is to modify the front of the South Satellite duty free store footprint in order to accommodate the installation of an additional passenger escalator. This modification at the front of the store results in a loss of square footage that can be more than recaptured by expanding the rear of the store into a former smoking lounge area. Additionally, the project aims to add much needed food service capacity at the South Satellite to meet passenger demand. Design will be accomplished by a firm selected via an advertisement that has been earlier approved by the Commission.

This project is closely tied to the Additional Gate Lobby Project (CIP # C800466) approved by the Commission on January 25, 2011. The Gate Lobby Project will demolish obsolete glass partitions, a set of under utilized restrooms as well as a former smoking lounge, which will create more available square footage for both passenger hold room space and concessions uses. The coordination of each of the two projects is imperative to the success of both. The projects will

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use the same design team. The design firm has been selected as part of a recently completed competitive procurement process.

### **BACKGROUND:**

The consolidation of Delta/Northwest's operations, coupled with continued growth of international service, is straining the ability of the South Satellite to adequately serve both airlines and their passengers. To address the challenges presented by the increased passenger volumes, the Port is making a number of improvements. One such improvement is the addition of a new 40-inch wide escalator from the Satellite Transit System (STS) train level to departure (concourse) level where passengers board aircraft. While the new escalator increases capacity, safety and redundancy, it will, however, impact the adjacent duty free store (see Exhibit A). Once the escalator is in place, only 2.5 feet of passageway would remain and render the entrance blocked to passengers. In order to address this impact, the duty free shop must be pushed back approximately 6 feet. In conjunction with South Satellite gate lobby improvements, the duty free store has an opportunity to recapture lost frontage square feet by expanding at the rear to consume a portion of the former smoking lounge. In total, the duty free store footprint would increase from the current 3,434 square feet to 3,931 square feet.

Due to a modified gate configuration, the Airport has an opportunity to capture 1,556 square feet of current hold room space for conversion to a new full-service food and beverage location. This restaurant will provide much needed food service capacity to augment the offerings currently in the South Satellite food court area.

### **PROJECT JUSTIFICATION:**

The continued growth of both domestic and international departures in the South Satellite has strained the Airport's ability to serve passengers with expected food service and retail offerings. The available square footage for concessions business in the Satellite has only increased marginally since the facility was built forty years ago.

#### **Duty Free/Retail**

The majority of the Airport's international enplanements (1.4 million in 2010) are concentrated in the South Satellite, making this the primary location for duty free sales. This store is open to all travelers (and employees), regardless of destination, and sells high-end luxury brand accessories, cosmetics, perfumes, luggage and specialty retail merchandise. Only sales of alcohol and tobacco are limited to passengers departing the U.S. Sales of duty free tobacco and alcohol achieve the highest spend per enplaned passenger of any concession category, also at potentially the highest percentage rent. Duty free sales reached \$9.23 per enplaned passenger in 2010. Still, staff is confident that there is significant increased revenue potential with a larger duty free store and cutting-edge operator due to the growth in demand along with enplanement growth. The new, estimated 3,931 square foot space would still not be large by industry norms, but it would be larger than the current space and more able to accommodate most operators'

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"store within in a store" concept for merchandising of luxury brand goods and cosmetics, as well as effective showcasing of duty free tobacco and alcohol.

In combination with a new operator in 2012, staff believes that the duty free store can increase sales to \$8.8 million in its first full year of operation as compared to \$7 million in 2010. At the current percentage rent level (16%), this represents more than \$700,000 in additional revenue to the Port. Staff expects that the planned duty free tender will garner a higher rent offer than 16%. An industry survey in 2008 showed that comparable airports to Sea-Tac were receiving between 20-30% percentage rent for duty free. Because there is no available square footage for specialty retail in the satellite, the duty free store must achieve the dual objective of high duty free sales for departing international travelers as well as specialty retail sales for all travelers.

### **Food & Beverage Service**

Current food service units in the South Satellite include one full-service restaurant/bar, one quick serve burger unit, a small Asian sushi/noodle bar and a specialty coffee unit which serve approximately 2.5 million enplanements annually. Existing restaurants have no available footprint for expansion. Food & beverage sales in the South Satellite in 2010 reached a mediocre \$2.91 per enplaned passenger, compared to the airport average of \$5.55. The 2010 sales per enplaned passenger for food & beverage in the North Satellite reached \$3.77, 30% higher than the South Satellite. This metric indicates that there is inadequate capacity/productivity as well as issues with the existing concepts. Without additional food service in the South Satellite, the airport will not be able to provide adequate food service or capitalize on easily available revenue. The proposed second full-service restaurant will offer not only the highest level of customer service (full-service wait staff vs. quick serve counter service), but also the greatest revenue share for food and alcohol service sales to the Airport, due to the higher percentage rent on alcohol sales. This restaurant also would be an excellent opportunity for a local, small business operator.

The new South Satellite restaurant would mirror the configuration of the North Satellite with its newer 1,774 square foot restaurant (Bigfoot Food & Spirits). In 2010, this North Satellite restaurant achieved \$2.5 million in sales without cannibalizing sales at the other full-service restaurant. This suggests that the South Satellite restaurant, assuming an appealing concept and skilled operator, should be able to achieve sales in the neighborhood of \$2 million, or approximately \$1,500 per square foot, in its first full year, providing about \$300,000 in new revenue to the Airport.

As another means of comparison, the North Satellite has 6,832 square feet of food service capacity to support approximately 3 million annual enplanements (2.27 square feet/1000 enplanements). The South Satellite has 4,170 square feet of food service capacity to support about 2.5 million enplanements (1.67 square feet/1000 enplanements). On this measure, the South Satellite has 26% less restaurant capacity than the North Satellite. Even with the addition of a new restaurant in the South Satellite, there will still be less square footage for concessions than in the North Satellite.

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### **Highest/Best Use Considerations**

In an extremely constrained terminal space such as the South Satellite, the Airport must give careful consideration to the highest/best use for any number of activities. These considerations must first and foremost balance the sometimes competing needs of operational uses and commercial revenue uses (which often also have important value for passengers). For example, the need for additional escalator capacity will trump the needs of concession operations, as the escalator installation will cause the relocation of the duty free store as well a foreign currency exchange location.

Concession uses also often compete with the need for passenger hold room space. The International Airline Transportation Association (IATA) has established aviation industry metrics which rate the adequacy of hold room space grade A to E (A is best, E is worst). The Airport's South Satellite hold rooms (gates S-10 through S-16) currently rate an "E" based on square footage available per passenger. Even with the additional square footage allocated to concessions, the combined improvements (i.e. glass partition removal, restroom demolition, podium relocations) in the area will bring the new space to a grade "C" rating. This suggests that the Airport will achieve an adequate balance between operations and concessions needs; not taking into account that the concession spaces will "hold" passengers as well. In particular, the restaurant represents a revenue-generating seating area.

With regard to competing categories of revenue opportunities, the Airport focuses on the "primary" needs within food service, duty free/retail, and passenger services. Food service will typically generate the highest spend per passenger with the least sensitivity to economic conditions. As an exception, however, duty free shopping as a type of retail normally commands the highest spend per passenger due to high product price point and the affluence of the duty free shopper. At the South Satellite, both needs are extremely important to meet. The current and future growth of international travel at the satellite presents a tremendous opportunity for revenue, while food service is in dire need of added capacity to meet current demand. Based on staff's understanding of the concession business, the Airport is confident that both planned spaces will achieve their customer service and revenue goals.

### **PROJECT SCOPE OF WORK AND SCHEDULE:**

#### ***Scope of Work:***

This project will modify the existing duty free store. The front of the existing duty free store location will be relocated to the west by approximately 6 feet and the project will utilize a former smoking lounge to provide a larger footprint for the duty free which will improve the revenue potential for the duty free business. In addition, the project will create a 1,500 square foot full-service restaurant.

#### ***Schedule:***

Contract for Design	March 2011
Complete Design	July 2011
Request Commission Authorization to Advertise for Bid	July 2011
Bid/Award	August 2011

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Notice to Proceed  
Duty Free & Restaurant Shells Complete

November 2011  
March 2012

(Additional timeline for final tenant build-out and commencement of business is contingent upon selection of concession operators).

### **FINANCIAL IMPLICATIONS:**

#### **Budget/Authorization Summary:**

Original Budget	\$6,000,000
Budget Increase (Decrease)	(\$2,544,000)
Revised Budget	\$2,199,000
Previous Authorizations	0
Current request for Authorization	\$350,000
Total Authorizations, including this request	\$350,000
Remaining Budget to be Authorized	\$1,849,000

#### **Project Cost Breakdown:**

Construction Costs	\$0
Sales Tax	\$0
Outside Professional Services	\$262,000
Port Costs	\$ 88,000
Total	\$350,000

#### **Budget Status and Source of Funds:**

The budgeted cost for this scope of work was included in the 2011-2015 capital budget and plan of finance under CIP# C800412, South Satellite Concessions Project. The funding source will be the Airport Development Fund.

#### **Financial Analysis and Summary:**

In order to determine the return on this investment, assumptions were made – using baseline historical data – regarding sales/revenue potential for each concession unit (as detailed above in the Project Justification). Additionally, the analysis factored estimated construction costs. The escalator project which impacts the front of the duty free store will bear a cost of \$300,000.

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<b>CIP Category</b>	Revenue/Capacity Growth
<b>Project Type</b>	Business Expansion
<b>Risk Adjusted Discount Rate</b>	9%
<b>Key Risk Factors</b>	Selection of concession operators does not take place in a timely fashion to take advantage of construction completion.
<b>Nominal Construction Cost for Analysis</b>	Duty free: \$1,010,000 / Restaurant: \$889,000
<b>Business Unit (BU)</b>	Non-Aeronautical (Concessions)
<b>Effect on business performance</b>	NOI after depreciation
<b>IRR/NPV:</b>	IRR: 12% NPV: \$1,200,000 Payback: 5 years
<b>CPE Impact</b>	Less than \$0.01 due to \$300,000 of construction cost borne by the escalator project (treated as terminal costs with 80% allocated to the airline rate base).

### ENVIRONMENT AND SUSTAINABILITY:

The principles of LEED commercial interior standards will be applied as applicable to the selection of new materials for the Airport shell portion of the work.

### STRATEGIC OBJECTIVES:

The project ensures Airport vitality by providing the traveling public with the concession offerings expected while providing the Port with critical non-airline revenue. This project also has the potential to provide an entrepreneurial opportunity to local, small business in the food & beverage sector.

### ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS:

**Alternative 1:** Move forward with the South Satellite Concessions Project. Modify the existing duty free store footprint to maximize sightline potential and increase square footage, and create a move-in ready shell space for a future tenant. Build a shell space for a future, 1,500-square foot full-service restaurant. Both units would be designed and built for occupancy as soon as possible and operationally practical. **This is the recommended solution.**

**Alternative 2:** Do not modify the existing concessions footprint in the South Satellite. A 'do nothing' approach would assure that revenue from food service concessions remains far below

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the Airport average. The current food service operators are under contract through 2016, thus the Airport could not expect any changes to their offerings or capacity. Lack of adequate customer offerings in food & beverage would continue to prevail.

The current 3,439 square foot duty free store location would be reduced in size due to the installation of the new escalator in front of the store, necessitating a push-back of the store front entrances. A loss of square footage will reduce the amount of inventory available for sale and reduce sales potential. There is no available square footage for any other duty free or specialty retail elsewhere in the satellite. This is not the recommended solution.

**Alternative 3:** Move forward with either the modified duty free store footprint or new restaurant, but not both. There is no justification for choosing to solve one, but not both, problems identified in the South Satellite. Both projects will produce new revenue to the Port. This is not the recommended solution.

### **OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:**

Proposed location of duty free and food & beverage concession.  
PowerPoint presentation.

### **PREVIOUS COMMISSION ACTION:**

On November 2, 2010, Commission authorized the execution of an IDIQ professional services contract for design services in the amount of \$400,000 in support of anticipated capital improvement projects related to South Satellite Concession and Gate Lobby Projects at Seattle-Tacoma International Airport (Airport). No funding was associated with this authorization.

On January 25, 2011, Commission authorized both design services and the use of Port Crews in support of the Additional South Satellite Gate Lobby Space Project at the Seattle-Tacoma International Airport (CIP # C800466). This authorization was for \$414,000 of a total estimated project cost of \$1,257,000. This project will use the same design team and be coordinated through construction.