

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA

Item No. 6b

Date of Meeting November 1, 2011

DATE: October 24, 2011

TO: Tay Yoshitani, Chief Executive Officer

FROM: James R. Schone, Director, Aviation Business Development
Jolene Culler, Senior Property Manager, Aviation Properties

SUBJECT: Second Amendment to Lease and Concession Agreements for Rental Car Companies

ACTION REQUESTED:

Request Commission authorization for the Chief Executive Officer to execute the Second Amendment (Amendment) to the Rental Car Lease and Concession Agreement (Agreement) to modify the payment terms of the Minimum Annual Guarantee (MAG) for the rental car companies operating at Seattle-Tacoma International Airport (Airport) for a partial year beginning November 1, 2011 through spring 2012, or until the Consolidated Rental Car Facility (CRCF) opens.

SYNOPSIS:

The CRCF is scheduled to open in spring 2012. When it opens, the rental car companies will operate under the terms of the new Consolidated Rental Car Facility Lease Agreement (CRCF Agreement). Until that time, the rental car companies continue to operate from their existing locations in the Airport garage and at various off-site locations under the terms of the current Agreement. Given the projected schedule for the CRCF opening, the current Agreement will only be in effect for a partial year during the months of November 2011 through spring 2012. This creates a unique situation with respect to the payment of the MAG.

Per the terms of the current Agreement, each rental car company pays the Port the greater of the MAG or a percentage fee equal to ten percent (10%) of gross revenues. The MAG is calculated annually each November, based on the previous twelve months of gross revenue. The Agreement stipulates that payment of this MAG shall be divided into twelve equal monthly installments. However, the Agreement does not contemplate how the MAG should be prorated for either a partial concession year or a partial month of operation. Since the Airport's rental car business has significant seasonal fluctuations, with the summer months having more transactions and higher gross revenues, this Amendment proposes to have the MAG divided into seasonally

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adjusted amounts (rather than equal monthly amounts), and to further prorate the seasonally adjusted amount for the partial month within which the opening date falls.

The changes proposed in this Amendment are temporary and will only be in place for the partial concession agreement year prior to the opening of the new CRCF. After the CRCF opens, the new CRCF Agreement will commence and the normal MAG proration will go back into effect. This temporary change in the way the MAG is calculated will result in less revenue for the Port during the approximate six month time period it is anticipated to be in effect. However, in consideration of this Amendment, the rental car companies agreed to forego the annual reconciliation which typically results in them receiving year-end refunds because they've overpaid over the course of the full twelve months.

Since there will be no reconciliation in 2012, and since we don't know what the gross revenues will be during this time period, it is hard to predict the financial ramifications. Although we don't know the exact financial implications, Port staff believes that this Amendment is the appropriate and fair action given our relationship with the rental car companies will extend into the thirty-year lease term for the CRCF. The rental car companies also fully support the Amendment.

BACKGROUND:

The norm throughout the airport rental car industry is for the rental car companies to pay a percentage fee equal to ten percent (10%) of their gross revenues to each airport where they operate. However, it is also the norm for airports to require the payment of a MAG by the rental car companies. Often times, MAG proposals are based on an operator's desire to secure a more desirable space in a given airport rental car facility. When the rental car companies submitted their MAG proposals in 2004, several of the rental car companies initially bid MAG's that turned out to be substantially in excess of 10% of their gross revenues. This was due in large part to the rental car companies seeing an opportunity to gain market share ahead of moving into the CRCF, and ultimately, a way to influence the allocation of space in the new facility.

When it became obvious that the CRCF was not going to open in 2009, as originally intended, the Port and the rental car companies agreed to amend the current Agreement to extend the term and modify the MAG. In October 2009, the Commission approved the First Amendment. However, this Amendment did not address how the MAG should be prorated for a partial year, and it is now apparent that with a planned opening of the CRCF in spring 2012, the current Agreement will likely terminate before a full year has elapsed. When the CRCF opens, the current Agreement terminates, and the new CRCF Agreement will go into effect.

The MAG is calculated annually each November, based on the payments to the Port over the trailing twelve months and then billed to the companies in twelve equal monthly amounts. Each month, the rental car companies pay 10% of their gross revenues or the MAG, whichever is

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greater. Typically the first six months of the Agreement Year (November through April) are the months with fewer transactions and lower gross revenues, so many of the rental car companies pay only the MAG because it is the greater amount. Then, in the busy summer months (May through October), there are usually many more transactions and higher gross revenues, so many of the rental car companies pay 10% of their gross revenues, because it is the greater amount. At the end of the year, Port Accounting staff performs a reconciliation, and if the companies have overpaid the Port, they are issued a refund.

The current Agreement does not contemplate how the MAG should be prorated for a partial concession year. This creates a problem because the first five months of the Agreement are the ones with the lowest gross revenues and without this amendment, the rental car companies will not get the benefit of the off-setting months with the highest gross revenues. To address this issue, this Amendment proposes to have the MAG divided into seasonally adjusted amounts (rather than equal monthly amounts). In addition, due to the possibility of a mid-month CRCF opening, it proposes to prorate the seasonally adjusted amount for the month within which the opening date falls.

The proposed seasonal adjustment is reflected on Exhibit A of the Amendment. The percentages were calculated by taking the gross revenues by company for the past three full Agreement years, calculating the monthly gross revenue as a percentage of the total gross revenue for each of those years, and then averaging the percentages for each month for those three years. This average serves to minimize the ups and downs of these past few years and better reflects each company's monthly percentage. An example of how this Amendment would work is shown in Exhibit C.

SCOPE OF AGREEMENT:

The Port would enter into a Lease Amendment (attached as Exhibit A) to the Agreement (Exhibit B as provided electronically) with each of the rental car companies to make the following modifications:

Term/Effective Date: No change.

MAG: Calculation of the MAG will not change, but it will be divided into twelve seasonally adjusted amounts rather than twelve equal monthly amounts. In addition, partial months will be prorated based on the actual number of days of occupancy in the month. The annual reconciliation will be eliminated.

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

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FINANCIAL IMPLICATIONS:

If the Amendment is implemented, it will result in the Port receiving less money in this time period than if the rental car companies paid the MAG in equal monthly installments. This is because the current Agreement's provision for equal monthly proration of the MAG serves largely as cash-flow device to ensure the Port receives equal monthly payments regardless of the seasonal fluctuations in Seattle's rental car market. In a full Agreement year situation, the year-end reconciliation process would identify any overpayment made by the rental car companies, and the Port would issue a refund.

Due to this unique partial Agreement year situation, enforcing the equal monthly proration of MAG will not afford the rental car companies the opportunity to enjoy the up-side of the higher gross revenue producing months, due to the seasonal highs and lows of the rental car business in Seattle. Therefore, the seasonal adjustment to the MAG is recommended with the stipulation that the rental car companies forego the annual reconciliation.

Since there will be no reconciliation in 2012, and since we don't know what the gross revenues will be during this time period, it is hard to predict the financial ramifications. Although we don't know the exact financial implications, Port staff believes that this Amendment is the appropriate and fair action given our relationship with the rental car companies will extend into the thirty-year lease term for the CRCF. The rental car companies also fully support the Amendment.

ECONOMIC IMPACTS AND BUSINESS PLAN OBJECTIVES:

There are no economic impacts.

STRATEGIC OBJECTIVES:

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

ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS:

- Alternative 1: Do Nothing. Without this modification, under the terms of the existing Agreement the rental car companies will be required to pay the MAG in twelve equal monthly installments. Since the companies disagree that this is the intention of the lease, they will likely petition the Commission to modify the lease as proposed. This is not the recommended alternative.

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- Alternative 2: Amend the lease to modify the MAG payment terms. This alternative provides a fair approach to dealing with this unique partial year situation by establishing MAG payments based on the seasonal fluctuations of the rental car business in Seattle. **This is the recommended alternative.**

OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:

Exhibit A: Second Amendment to Rental Car Lease and Concession Agreement

Exhibit B: Rental Car Lease and Concession Agreement (available electronically)

Exhibit C: Minimum Annual Guarantee Comparison

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:

May 13, 2008, the Commission authorized execution of the new Consolidated Rental Car Facility lease.

October 13, 2009, the Commission authorized execution of the First Amendment to the Rental Car Lease and Concession Agreement to extend the Lease term and modify the MAG requirement.