

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6d
Date of Meeting November 24, 2015

DATE: November 6, 2015
TO: Ted Fick, Chief Executive Officer
FROM: James Schone, Director, Aviation Business Development
SUBJECT: The Street Pricing Policy for Airport Dining and Retail Tenants

ACTION REQUESTED

Request Commission authorization for the Chief Executive Officer to provide short-term Airport concessions pricing flexibility in order to accommodate City of SeaTac Ordinance 13-1020 (commonly referred to as Proposition One) that increases employee minimum wages to \$15.24. The Chief Executive Officer would be authorized to implement pricing flexibility by revising the Port's policy regarding street pricing in order to allow tenants in the Airport Dining and Retail (ADR) Program to set prices at not more than 10% above "street" prices for all products and services sold from December 1, 2015, through December 31, 2019. As of January 1, 2020, the policy shall revert to its current state. Consistent with this change, staff also requests the Commission to authorize the Chief Executive Officer to amend all existing leases in the Airport Dining and Retail Program to reflect this change.

SYNOPSIS

"Street pricing", a commonly-used airport industry term, references the requirement that all tenants in the ADR Program at Seattle-Tacoma International Airport (Airport) set prices for all goods and services based on prices for similar quality and quantity of goods and services sold at similar types of businesses in the Seattle-Tacoma area. This policy has been in effect at the Airport since 2004. Continuation of this policy was stated in the Commission's motion of November 25, 2014, regarding "Quality Jobs, Service and Employment Continuity Assurances for the Airport Dining and Retail Program." Specific language about this policy is included in all leases between the Port and its ADR tenants.

There are disparities in wage rates between employees of ADR tenants at the Airport and those of firms in the broader Seattle-Tacoma area as a result of the shift in minimum wage standards contained in the City of SeaTac's Ordinance 13-1020 (approved by City of SeaTac citizens as Proposition 1 in November 2013). The increased wage rates at the Airport result in higher operating costs for ADR tenants. As a result of these disparities, staff recommends changing the pricing policy to allow ADR tenants to set prices at up to 10% above street prices at their discretion from December 1, 2015, through December 31, 2019. After this period, street pricing would resume. This four-year period is deemed sufficient time for the disparities in minimum wage rates paid by ADR tenants as compared to wage rates paid by firms elsewhere in the

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Seattle area to be greatly reduced such that a return to street pricing on January 1, 2020, is warranted.

BACKGROUND

Local Minimum Wage Ordinances

On November 5, 2013, City of SeaTac voters approved an ordinance, commonly referred to as Proposition One, regarding minimum employment standards. This ordinance established minimum wage requirements and minimum standards for paid leave for safe and sick time for workers in the hospitality and transportation industries located within that city. This ordinance set minimum wages at \$15 per hour starting on January 1, 2014, for workers in those industries. This wage rate will be increased each year thereafter by the change in the Consumer Price Index. The wage rate for 2015 was set at \$15.24 per hour starting on January 1, 2015. For 2016, the wage rate will remain at \$15.24.

On June 2, 2014, the Seattle City Council approved an ordinance establishing minimum wage and minimum compensation rates for employees performing work in Seattle (see Tables 1 and 2 below). As part of this law, two classifications were established for businesses based on their number of employees: large employers are those with 500 or more employees and small employers are those with less than 500 employees. The ordinance requires that large employers steadily increase minimum wage rates starting on April 1, 2015, until reaching \$15 per hour by January 1, 2017, if no health care benefits are paid, or by January 1, 2018, if the employer pays health care benefits.

Table 1. City of Seattle Minimum Wage Summary, Large Employers

YEAR	MINIMUM WAGE only	MINIMUM WAGE with payments toward employee's medical benefits
2015 (April 1 st)	\$11.00	\$11.00
2016 (January 1 st)	\$13.00	\$12.50
2017 (January 1 st)	\$15.00	\$13.50
2018 (January 1 st)		\$15.00

Source: City of Seattle's Minimum Wage Ordinance FAQ located:

<http://www.seattle.gov/Documents/Departments/CivilRights/mwo-faq-expanded.pdf>

Small employers are required to steadily increase minimum wage rates starting on April 1, 2015, until reaching \$15 per hour minimum wage on January 1, 2021. Small employers are required to pay a temporary guaranteed minimum compensation of \$15 per hour by January 1, 2019. This minimum compensation level can be achieved by combining employer-paid health care contributions, consumer-paid tips and employer-paid wages.

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Table 2. City of Seattle Minimum Wage Summary, Small Employers

YEAR	MINIMUM COMPENSATION	MINIMUM WAGE with tips and/or payments toward employee's medical benefits
2015 (April 1 st)	\$11.00	\$10.00
2016 (January 1 st)	\$12.00	\$10.50
2017 (January 1 st)	\$13.00	\$11.00
2018 (January 1 st)	\$14.00	\$11.50
2019 (January 1 st)	\$15.00	\$12.00
2020 (January 1 st)	\$15.75	\$13.50
2021 (January 1 st)		\$15.00
2022 (January 1 st)		\$15.75
2023 (January 1 st)		\$16.50
2024 (January 1 st)		\$17.25

Source: City of Seattle's Minimum Wage Ordinance FAQ located:

<http://www.seattle.gov/Documents/Departments/CivilRights/mwo-faq-expanded.pdf>

The initial minimum wage rates of \$11 per hour for large employers and \$10 per hour for small employers took effect on April 1, 2015. Once the wage rates reach \$15 per hour, they are to increase on the first day of each year thereafter by the percentage increase in the Consumer Price Index.

On November 25, 2014, the Port of Seattle Commission approved a motion regarding "Quality Jobs, Service and Employment Continuity Assurances for the Airport Dining and Retail Program." This motion directed staff to incorporate the Commission's general expectations of employers regarding quality jobs into the Request for Proposal (RFP) and Competitive Evaluation Process (CEP) for award of contracts to restaurant, retail, duty-free and personal service providers as part of the ADR Program redevelopment. These expectations pertained to the level of wages and compensation, the amount of paid time off and compliance with the Affordable Care Act.

On August 20, 2015, the Washington State Supreme Court announced its decision in the case of *Filo Foods, LLC et al vs. The City of SeaTac, et al.* In that decision, the court ruled that the City of SeaTac's ordinance, Proposition One, does apply at Seattle-Tacoma International Airport.

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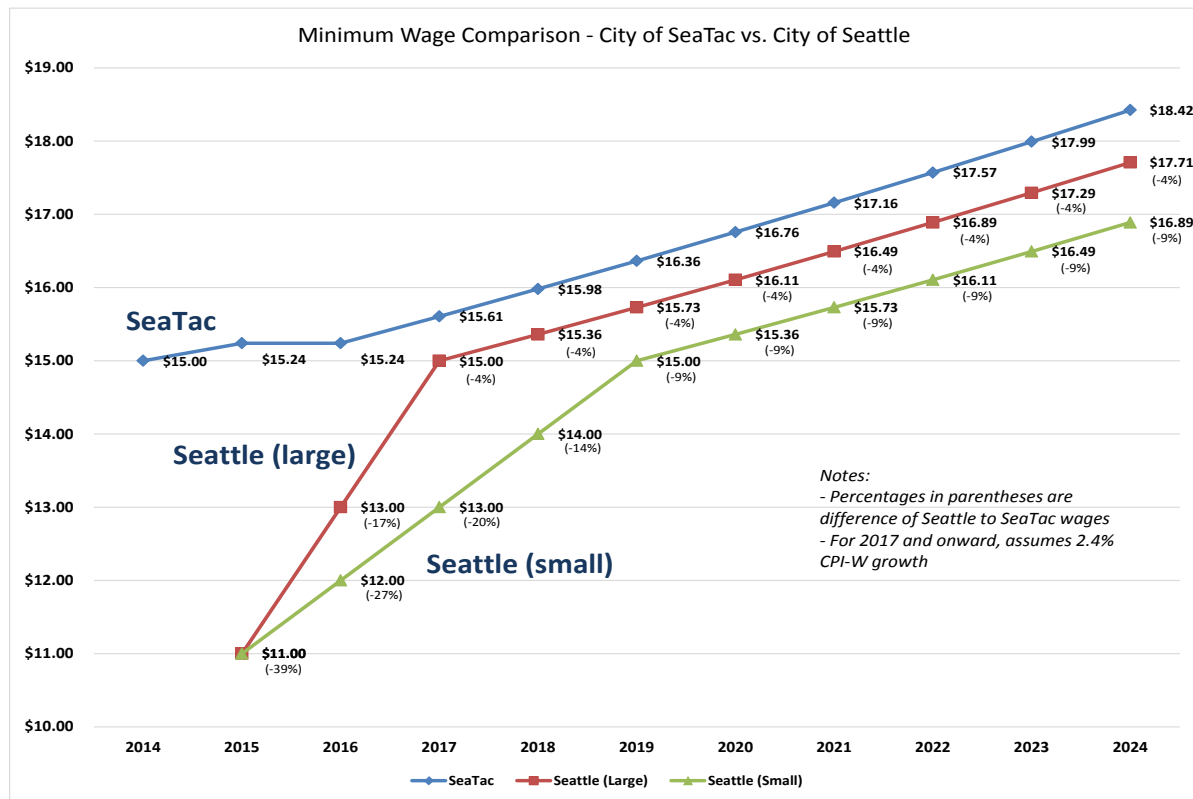
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Based on the Supreme Court’s decision, Port of Seattle staff interprets that the employment standards specified in the City of SeaTac’s ordinance should now be used to implement the expectations provided by the Commission in their motion regarding quality jobs within the ADR Program. This interpretation is explained in a memo from CEO Fick to the Commission co-presidents dated November 11, 2015 (Attachment A).

Disparity between Local Minimum Wage Ordinances

As noted above, a significant disparity exists between the minimum wage rates specified in the City of SeaTac’s and the City of Seattle’s ordinances. For 2015, the disparity in minimum wage rates between what is required by the City of SeaTac ordinance and the City of Seattle’s ordinance is 39% for both large and small businesses (see chart below). Due to the different step increases specified in the City of Seattle’s minimum wage ordinance for large and small employers, this disparity will decrease at different rates for the two classifications of businesses. For large employees, this disparity is projected to decrease to 4% by 2017, the year that large employers are required to pay \$15 per hour. For small employers, this disparity is projected to decrease to 9% by 2019 when they are required to pay \$15 in total minimum compensation. The exact amount of this disparity between now and the date at which wage rates for employees of large and small employers in the City of Seattle reach \$15 per hour cannot be determined. It will vary depending on the specific increase in the consumer price index that is the basis for the increase in the minimum wages paid to employees in the hospitality and transportation industries in the City of SeaTac as specified in that city’s ordinance.



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Street Pricing

“Street pricing” is a commonly used airport industry term referencing the pricing policy mandating that tenants in an airport must set prices for goods and services that they make available for purchase based on prices for similar quality and quantity of goods and services sold at similar types of businesses located off-airport in the local area. This pricing policy started in response to the widespread notion by much of the travelling public in the United States that merchants at airports were taking advantage of the captive nature of the market and setting prices substantially higher than those found outside of the airport where there is more competition. In accord with multiple U.S. airports, the Port of Seattle adopted a policy in 2004 that mandated adherence to street pricing by its ADR tenants. Language requiring adherence to this policy is included in all ADR leases along with specific guidance as to how this policy is to be implemented.

The Port’s street pricing policy requires all ADR tenants to submit specific comparisons to Port staff between prices for the products and services available for purchase at their stores in the Airport, and goods and services of similar quality and quantity from businesses of similar quality located in the greater Seattle-Tacoma area. Port staff evaluates each of the comparisons to ensure that firms are setting prices for goods and services available for purchase in the Airport comparable to those available outside of the Airport.

Disparity in Cost of Operations

Due to the wage disparities mentioned above, tenants in the ADR Program at the Airport will likely be paying substantially higher wages than comparable businesses in the City of Seattle during the next several years. This wage disparity creates a challenge regarding use of the Airport’s street pricing policy as prices for goods and services in the City of Seattle that ADR merchants have historically used in their street pricing comparisons will likely not rise at the same rate or rise to the same level as needed to cover the higher wage rates required by the City of SeaTac ordinance. For ADR tenants, wages as a percentage of total operating costs can reach 40%. Thus, the higher wage rates required by the City of SeaTac minimum wage ordinance as compared to those required in the City of Seattle have the potential to significantly alter the profitability of businesses operating at the Airport. This change could result in certain ADR tenants reducing or even discontinuing their Airport operations, resulting in the loss of jobs, business income and non-aeronautical revenue for the Airport.

In recognition of these impacts, staff recommends that the Commission allow a temporary change to the street pricing policy. The proposed change would allow ADR tenants, at their discretion, to set prices at up to 10% above those charged for similar quality and quantity of product or service by similar types of businesses in the Seattle-Tacoma area. This change is recommended only for the period of December 1, 2015 through December 31, 2019. At that point in time, the disparity in wage rates will have significantly decreased such that a return to street pricing will be warranted. This policy change will be of significant help to ADR tenants in coping with the disparity in wage rates that exist between the minimum wage ordinances in the City of SeaTac and the City of Seattle.

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Impact of Change in Street Pricing Policy

The impacts of a change in the street pricing policy are difficult to determine with any degree of certainty as changes in passenger purchasing behavior due to the higher prices for goods and services available in the Airport are difficult to predict. AirProjects, the consulting firm hired to assist the Port with development of its ADR master plan, analyzed the impacts of street pricing plus 10% as compared to keeping the current street pricing policy. Their analysis, when looking at the impacts on the entire ADR program, showed that a change to street pricing plus 10% is expected to result in a slight increase in the total dollar value of all goods and services sold by ADR tenants, approximately the same revenue to the Port and significantly better net operating income for the tenants. Their analysis of a 10% increase in prices also showed a greater reduction in demand for retail goods and services as compared to demand for food and beverage items due to the fact that retail purchases are more spontaneous with relatively more elastic demand, i.e., for any given % increase in price, demand will decrease closer to the % increase in price. Passengers who choose to purchase goods and service at the Airport will pay slightly higher prices than they do now. This analysis looked at the period of 2015-2020 and assumed that current ADR tenants were in place throughout the projection period.

STRATEGIES AND OBJECTIVES

This change in policy supports the Port's Century Agenda goal to "advance the region as a leading tourism destination and business gateway" by making it possible for the ADR tenants to continue their operations at the Airport in a profitable manner. This change also supports the Aviation Division's goals to grow non-aeronautical revenues.

TRIPLE BOTTOM LINE

The ADR Program places a high value on the concurrent pursuit of positive economic, community, customer service and environmental stewardship outcomes. This policy change supports all of these objectives.

Economic Development

This policy change will support ADR tenants in meeting the significantly higher minimum wage requirements specified in the City of SeaTac's minimum wage ordinance while maintaining profitable operations. This will also make leasing opportunities available through the ADR Program redevelopment more attractive to potential tenants.

Environmental Responsibility

This policy change will support ADR tenants, through profitable operations, in their efforts to continue meeting all of the environmental goals set forth in their leases.

Community Benefits

The policy change supports all current and future employees of ADR tenants as those tenants, be they large or small businesses, will have sufficient profitability to pay the higher minimum wages called for in the City of SeaTac's minimum wage ordinance.

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ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1) – Do not change the street pricing policy in ADR leases.

- **Pros:** This would keep prices for goods and services available for purchase in the Airport more affordable for the travelling public.
- **Cons:** This could lead to certain ADR tenants determining that it is no longer profitable to operate at the Airport. It would also likely serve as a deterrent to local small businesses who are interested in opportunities with the ADR Program redevelopment. This is not the recommended alternative.

Alternative 2) – Change the street pricing policy in ADR leases to allow an increase of 5% over street prices for the period of December 1, 2015 through December 31, 2019.

Pros: This would keep prices for goods and services available for purchase in the Airport more affordable for the travelling public than alternatives 3 or 4.

Cons: This level of increase in prices above street pricing is not deemed sufficient to cover the higher costs associated with the wage rates specified in Proposition One. It could still lead to certain ADR tenants determining that it is no longer profitable to operate at the Airport and thus reduce or close their operations. This alternative would also likely serve as a deterrent to local, small businesses who are interested in opportunities with the ADR Program redevelopment. This is not the recommended alternative.

Alternative 3) – Change the street pricing policy in ADR leases to allow an increase of 10% over street prices through the end of 2019 and then a 5% increase over street prices until the end of 2021.

- **Pros:** This alternative has the benefit of providing a longer period for ADR tenants to adjust to the higher wages associated with Proposition One. However, staff believes that prices for goods and services in the surrounding area will have risen to sufficiently high levels by the end of 2019, due to higher wage rates as mandated in the City of Seattle minimum wage ordinance, that an increase over street pricing will no longer be needed to offset the wage disparities that exist today.
- **Cons:** This longer time period for ADR tenants to set prices for their goods and services above street pricing would negatively impact the travelling public who purchase items in the Airport. This is not the recommended alternative.

Alternative 4) – Change the street pricing policy to allow ADR tenants, at their discretion, to set prices at up to 10% above street prices for the time period of December 1, 2015 through December 31, 2019 at which time the street pricing will be re-instituted.

- **Pros:** Staff believes that this is the best alternative to cope with the current disparity in wages that must be paid by ADR tenants and comparable businesses in the City of Seattle. The commitment to return to strict street pricing in 2020 emphasizes to the

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travelling public that this is temporary measure intended to ensure that ADR tenants are able to stay in business and pay the wage rates deemed by the Commission to be an important component of Quality Jobs here at the Airport.

Cons: This alternative will lead to higher prices for the travelling public during the proposed 4 year period.

This is the recommended alternative.

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- None.

ATTACHMENTS TO THIS REQUEST

- Attachment A: November 11, 2015 memo from CEO Fick to the Commission co-presidents regarding staff interpretation of the Commission's Quality Jobs expectations
- Attachment B: Powerpoint