Port of Seattle

AGENDA MEMORANDUM **Item No.** 7a

ACTION ITEM **Date of Meeting** February 27, 2018

DATE: February 9, 2018

TO: Executive Director Stephen P. Metruck

FROM: Lance Lyttle, Managing Director, Aviation Division
R. Borgan Anderson, Director, Aviation Finance & Budget

SUBJECT: 2018 – 2022 Signatory Lease and Operating Agreement between the Port and the Airlines operating at Seattle-Tacoma International Airport ("Airport")

ACTION REQUESTED

Request Commission authorization for the Managing Director, Aviation Division to (1) execute a 2018-2022 Signatory Lease and Operating Agreement ("SLOA IV") between the Port and signatory airlines for the use of facilities at the Airport and (2) to approve the Memorandum of Understanding ("MOU") between the Port and airline(s) to work together to develop a strategic plan to reduce carbon emissions and air pollutants, and the community and environmental impacts from existing and forecasted aviation growth at Sea-Tac Airport.

EXECUTIVE SUMMARY

A signatory lease and operating agreement dictates the conditions under which airlines use airport facilities and the methodologies the airport employs to charge airlines for use of the space and facilities. The purpose of this request is to approve SLOA IV as the successor lease agreement to the 2013-2017 Signatory Lease and Operating Agreement ("SLOA III") which expired on December 31, 2017. Based on the Commission Motion of October 10, 2017, SLOA III has been in month-to-month holdover status. The Commission Motion of February 13, 2018 amended this motion to extend SLOA III to May 31, 2018 in order to provide time for airlines to execute SLOA IV by April 25, 2018, and to execute the MOU by April 25, 2018.

The Port and the airline negotiations committee reached agreement on the term sheet for SLOA IV on February 9, 2018. The Term sheet included an approval threshold with two conditions: 1) airlines representing 66 2/3% of Terminal Rents and Landing fees must sign SLOA IV by April 25, 2018, and 2) airlines representing at least 40% of Terminal Rents and Landing Fees must sign the MOU by April 25, 2018. If both conditions are met, SLOA IV will become effective June 1, 2018, and will be implemented retroactive to January 1, 2018 (except for the preferential gate allocation formula, which will be implemented for 2019).

The purpose of the MOU is to formalize a commitment between the airlines and the Port to work in partnership to make progress on the goals set forth in the Commission Motion of December 19, 2017 to develop a comprehensive Port of Seattle sustainable aviation fuels strategy. The Motion outlines specific goals, the first of which states: "By 2028, ten percent (10%) of jet fuel available at Sea-Tac will be produced regionally from sustainable sources." The MOU calls for the development of a strategic plan to reach this goal. The plan will identify and make recommendations as to how to create and benefit from opportunities, address challenges, and support policies and financial incentives needed to meet this goal. The plan will also analyze and recommend additional mechanisms that could contribute to carbon and air emission reductions and the environmental impacts from aviation growth at Sea-Tac, including technology, operations, infrastructure and future aircraft technology.

JUSTIFICATION

A multi-year lease agreement provides a greater degree of certainty to the airport and the airlines than shorter-term alternatives. The only practical alternative to a new lease agreement would be for the Port to implement rates by resolution. Resolution 3677, as amended, describes the methodologies the Port would use to charge airlines in the absence of a lease agreement. The Port and the airlines agreed that a negotiated lease agreement is preferable to implementing rates by resolution.

DETAILS: COMPARISON OF KEY LEASE TERMS

Provision	**SLOA III (2013 – 2017)**	**SLOA IV (2018 – 2022)**
Term	5 Years	5 Years
Definition of a gate	Those portions of the terminal comprised of a passenger loading bridge, if any, and a passenger hold room	Distinction and weighting difference between a passenger loading bridge gate (1.0) and a ground boarded gate (0.5)
Limit on common use gates Port can withhold	None	2019: 16 2020: 18 2021: 18 2022: 21
Preferential gate allocation formula • Threshold • Months of seats data	None 1 (August – peak month)	6.0x average daily weighted turns 9: 6 months of actual (February – July) and 3 months of forecast (August - October)
Capital Approval: • Minimum annual activity to vote	None	100,000 units of landed weight

• Vote by cost center • Majority-in-Interest threshold • Implications of MII vote • Other	No $3.0 million ($5.4 million for roadway projects) Negative MII vote requires 12 month delay.	Yes $10.0 million for aeronautical rate base costs No change Pre-approved up to $300 million for planning and design for projects needed to construct new gates on north side of the Airport.
Revenue Sharing	Port will share with airlines 50% of net revenues in excess of 1.25x debt service.	Port will share with airlines a percent of net revenues in excess of 1.25x debt service as follows: • 2018: 40% • 2019: 20% • 2020-22: 0%
Cruise baggage	No provision	Include 50% of cost for baggage handling from ship to airport in rate base for Bag Makeup.
Signatory status	No minimum requirements	Regularly scheduled service
Debt service coverage	Included in airline rate bases if overall airport debt service coverage falls below 1.25 times	No change
Insurance	$500M aviation liability per occurrence; $10M commercial general liability per occurrence.	No change
Security Deposit/ Security Fund	Security Fund eliminated. If SLOA III executed in 2013, airline revenue requirement in 2013 will be reduced by an amount equal to Security Fund balance. No surety required for carriers operating in good financial standing at the Airport for at least 24 months.	No change

The final term sheet does not include any language relating to use of Port funds to be devoted to sustainable aviation fuels.

ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Reject approval of SLOA IV and implement rates in accordance with Resolution 3677, as amended.

Pros:

(1) No limit on the number of common gates the Port can withhold
(2) Port has flexibility to determine the optimal gate allocation methodology
(3) Capital approval involves consulting with airlines, but there is no majority-in-interest vote
(4) No revenue sharing, so airport keeps more net income

Cons:

(1) Failure to reach agreement indicates airport and its major airline customers are not in alignment
(2) Rate methodology does not offer economies of scale to benefit airlines with multiple flights per day (most fees are based on a per use basis), consequently, the largest airlines, including the hub airlines, tend to oppose this.
(3) While the rate methodology incorporated into Resolution 3677, as amended, was designed to conform to federal Department of Transportation requirements and thus withstand a legal challenge, airlines at Sea-Tac could elect to mount a legal challenge.

This is not the recommended alternative.

Alternative 2 – Approve SLOA IV

Pros:

(1) Agreement on a five-year lease provides level of certainty for both the Airport and the airlines though 2022.

Cons:

(1) With SLOA IV airlines have gained limits on the number of common gates the Port can withhold, thus potentially limiting the Port’s flexibility.

This is the recommended alternative.

FINANCIAL IMPLICATIONS

The lease provisions of SLOA govern in excess of $300 million aeronautical revenues annually. Due to a reduction in 2018 revenue sharing from 50% under SLOA III to 40% under SLOA IV, airline revenues will be approximately $7 million higher. Thus, Airport net operating income will be $7.0 million above budget. Similarly, the passenger airline cost per enplaned passenger (CPE) will be approximately $0.27 higher in 2018 than budgeted. The debt service coverage trigger permits the Airport to include in the airline rate base debt service coverage up to 25% of debt service as needed to bring total Airport debt service coverage up to 1.25x. This ensures that the Airport will maintain at least 1.25x debt service coverage. This provision is the same as in SLOA III.

ATTACHMENTS TO THIS REQUEST

(1) 2018 – 2022 Signatory Lease and Operating Agreement (SLOA IV)

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

September 12, 2017 – The Commission was briefed on the status of negotiations
October 10, 2017 – Commission motion to extend SLOA III to March 31, 2018
November 28, 2017 – Commission guidance to restart negotiations
December 19, 2017 – Commission motion regarding sustainable aviation fuels
February 13, 2018 – Commission motion to extend SLOA III to May 31, 2018 to facilitate approval and implementation of SLOA IV by June 1, 2018 (retroactive to January 1, 2018).