



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: John Aitken
Jim Shannon

SUBJECT: SEE BELOW

DATE: November 15, 2021

Approved

Date

11/17/21

**SUBJECT: DIRECT LEASE CONCESSION LOAN PROGRAM FOR
CONCESSIONAIRES AT NORMAN Y. MINETA SAN JOSE
INTERNATIONAL AIRPORT**

RECOMMENDATION

- (a) Adopt a resolution approving the Direct Lease Concession Loan Policy (“Loan” or “DLCLP”)
- (b) Adopt a resolution to delegate authority to the City Manager or designee to negotiate and execute an amendment to the food and beverage concession agreement, to incorporate direct lease business loan terms into the agreement in accordance with the DLCLP policy, in an amount not to exceed \$3 million dollars per agreement with Elevate Gourmet Brands-SFO Group (“Elevate”), and WSE Group, Inc. (“WSE”) (collectively, “Concessionaires”).
- (c) Adopt the following 2021-2022 Appropriation Ordinance Amendments in the Airport Revenue Fund:
 - (1) Increase the Transfer to the Airport Maintenance and Operation Fund by \$6,000,000; and
 - (2) Decrease the Ending Fund Balance Airline Agreement Reserve by \$6,000,000.
- (d) Adopt the following 2021-2022 Appropriation Ordinance and Revenue Resolution Amendments in the Airport Maintenance and Operation Fund:
 - (1) Establish an appropriation to the Airport Department for the Tenant Business Loan Program in the amount of \$6,000,000; and
 - (2) Increase Transfers and Reimbursements from the Airport Revenue Fund by \$6,000,000.

OUTCOME

Approval by City Council of the DLCLP and delegation of authority to the City Manager or designee to negotiate and execute amendments allows the Airport Department to alleviate some financial pressure on its smaller concession operators that have been impacted by COVID-19 and support these tenants by loaning them up to \$6,000,000 towards construction of food and beverage concession locations at the Norman Y. Mineta San Jose International Airport (“Airport and SJC”).

BACKGROUND

On May 21, 2019, Council awarded Package I, II, and III to the top-ranked proposers of the Request for Proposals for the Food and Beverage Concession Opportunities at the Norman Y. Mineta San Jose International Airport (“RFP”) as follows:

- Package I: SSP America SJC, LLC (“SSP”)
- Package II: Elevate Gourmet Brands-SFO Group
- Package III: WSE Group, Inc.

The initial term of the new food and beverage concession agreements expires on June 30, 2035, with one option to extend upon mutual agreement through June 30, 2040. SSP was awarded the Prime Operator Package, which included multiple concession locations throughout Terminals A and B. WSE and Elevate were each awarded a single direct concession location at the Airport.

Both WSE and Elevate were significantly impacted by COVID-19. Since March 2020, they faced unprecedented struggles like many in the food and beverage industry, resulting in significant revenue losses at their other airport locations. Furthermore, SJC’s enplanements fell well below 2019 enplanement numbers resulting in fewer passengers to support the new concession locations that WSE and Elevate plan to operate. Due to the low enplanements combined with a desire to conserve capital, both Concessionaires have delayed the construction of their concession locations at SJC from June 30, 2021 to June 30, 2022. The Concessionaires remain committed to resuming construction and opening their locations by July 1, 2022 and the Loan will help them start construction earlier than if they need to secure financing elsewhere.

City staff met with WSE and Elevate to identify ways to start the construction projects sooner and determined that providing a financial loan to the Concessionaires to provide immediate funding for their construction projects and overcome potential funding delays, will allow them to proceed forward with their construction projects which are estimated to open by June 30, 2022. The loan would not exceed \$3 million per Concessionaire at an interest rate of 3.5%, with a loan term of five (5) years. The loan would follow the parameters as outlined in the DLCLP. The Airport Department determined that it has sufficient funds and is able to loan up to \$3 million to each Concessionaire. Elevate has completed the design of their concession and the project is

under plan review. Upon execution of an amendment to the concession agreement, Elevate intends to start construction in the first quarter of 2022. WSE is in the design phase and anticipates starting construction in the later portion of the first quarter of 2022.

ANALYSIS

The City wants to find methods to support smaller businesses at SJC including those that qualify as Airport Concession Disadvantage Business Enterprises (ACDBE). The DLCLP program is a vital step toward creation of new opportunities to support smaller organizations within an airport environment.

The DLCLP sets forth a blueprint for the eligibility and administration of loans provided by the City to small businesses with no more than three concession locations at the Airport. The DLCLP sets forth the various loan terms including but not limited to:

1. Eligibility for Concessionaires and sets parameters including requiring that the Concessionaire have an active agreement with the City at SJC;
2. Setting the interest rate as 3.5% for loans entered into during CY 21 and 22, which would apply to WSE and Elevate, and any loans entered into after CY 22 will be set to reflect current market conditions,
3. Setting a maximum loan amount of \$5,000,000 per Concessionaire over the term of their agreement
4. Approved uses for the loan proceeds which will align with the terms in the Concession Agreement for Allowable Costs of Construction,
5. Repayment terms,
6. Underwriting guidelines to evaluate loan requests,
7. Servicing and collection of the loan, and
8. Remedies in the event of a default.

The City has two direct lease agreements with WSE and Elevate and recommends loaning funds not to exceed \$3 million per Concessionaire – less than the DLCLP maximum loan amount – to support construction of two new food and beverage concepts in locations in terminal B that are currently closed. The City has cash on hand to support this program and providing loans to both WSE and Elevate at a 3.5% interest rate is mutually beneficial. The City is expected to receive a higher rate of return than the interest rate received on the funds in their current investments, while WSE and Elevate will receive a slightly lower interest rate than what some banks are offering.

CONCLUSION

The City is able to assist WSE and Elevate with a direct lease business loan, with a reasonable interest rate and term, to fund construction of two food and beverage locations at SJC and expedite the opening of these two concession locations. The Airport wants to support smaller concession operations during these tumultuous times and provide loan funding that allows construction to commence.

Approval of the DLCLP establishes guidelines for the loan process at SJC and can be used immediately to support WSE and Elevate. The DLCLP guidelines may be used in the future as opportunities present themselves.

EVALUATION AND FOLLOW-UP

The Director of Aviation shall be responsible for the coordination of any amendments to the Airport Concession Agreements and shall render overall supervision of progress and performance including repayment of the loans.

CLIMATE SMART SAN JOSE

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

POLICY ALTERNATIVES

Alternative #1: Council can elect to not provide a direct lease business loan to WSE and Elevate and they will be required to seek a loan from an alternative source.

Pros: The City would retain up to \$6 million dollars of cash on hand that can be allocated for other uses.

Cons: Without the loan, WSE and Elevate will have to seek other loan sources which could cause a delay in construction and opening of their concession locations.

Reason for not recommending: The City has the desire and the funds to financially support its smaller operators. By providing WSE and Elevate a loan, they can commence construction to provide additional food and beverage options to passengers and improve the overall concession program at SJC.

Alternative #2: Council can elect to modify the terms of the loan as outlined in the DLCLP, including the interest rate and the payback terms.

Pros: The City may potentially increase the amount of interest received under the revised terms, and a revised timeline would either increase or decrease the amount of interest received.

Cons: This would increase the cost of the loan to the two Concessionaires.

Reason for not recommending: The City has the desire and the funds to financially support its smaller operators. By changing the terms, the two Concessionaires would incur additional costs. The Concessionaires may elect to seek out an alternative loan source which could further delay the project.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the November 30, 2021 Council Meeting.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office.

COMMISSION RECOMMENDATION

As an extension of an existing agreement, this item is an administrative function. Therefore, no action by the Airport Commission occurred.

FISCAL/POLICY ALIGNMENT

This action aligns with the City's Economic Development Strategy #9 "Keep Developing a Competitive, World Class Airport, and Attract New Air Service."

COST SUMMARY/IMPLICATIONS

The City, specifically Airport enterprise funds, can provide loans as described in the DLCLP from cash that currently resides within the Airline Agreement Reserve in the Airport Revenue Fund. This is general airport unrestricted funding and earns interest that is posted to the Airport Revenue Fund. The general interest rate earned is significantly lower than the 3.5% rate

recommended in the DLCLP. Default terms and procedures on the loans are specified in the Concession Agreement and in the DLCLP, though staff perceives the risk of default to be low. The financial impact of loaning to qualified small concession operators for the five-year term is offset by the value of supporting direct lease concessionaires and expediting construction of new concession locations at the Airport.

BUDGET REFERENCE

The table below identifies the fund and appropriations to fund the payment recommended as part of this memorandum.


Fund #	Appn #	Appn. Name	Total Appn	Rec. Budget Action	2021-2022 Proposed Operating Budget Page	Last Budget Action (Date, Ord. No.)
521	A013	Transfer to the Airport Maintenance and Operation Fund	\$111,097,447	\$6,000,000	X-5	6/22/2021 Ord. No. 30621
521	8697	Airline Agreement Reserve	\$81,226,262	(\$6,000,000)	X-5	6/22/2021 Ord. No. 30621
523	NEW	Tenant Business Loan Program	N/A	\$6,000,000	N/A	N/A

CEQA

Not a Project, File No. PP17-003, Agreements/Contracts resulting in no physical changes to the environment.

/s/

JOHN AITKEN, A.A.E.
Director of Aviation



JIM SHANNON
Budget Director

For questions, please contact John Aitken, A.A.E., Director of Aviation at (408) 392-3610.

Attachment A: Direct Lease Concession Loan Policy



Attachment A

NORMAN Y. MINETA SAN JOSE AIRPORT OF THE CITY OF SAN JOSE DIRECT LEASE CONCESSION LOAN POLICY

I. OBJECTIVES

The Norman Y. Mineta San José International Airport (“SJC” or “Airport”) is providing a Direct Lease Concession Loan Program (“Loan” or “DLCLP”) for the purpose of assisting direct lease concession operators (“Concessionaire” and “borrower”), operating up to three (3) concessions at SJC. The Loan program's objectives are to (1) enhance the concession program by shortening the construction timeline and opening date, (2) create or retain jobs, (3) increase concession revenue, and (4) initially support direct lease concession operators who have been financially impacted by COVID-19 and (5) encourage bidding competition at SJC by local, small, women, and minority-owned businesses by providing financial support for build-out costs for food and beverage and retail opportunities at the Airport.

The Loan will only be offered at the sole discretion of the Director of Aviation (“Director”). SJC reserves the right, at its sole discretion, to offer a Loan to any Concessionaire operating at SJC who meets the eligibility requirements.

II. ELIGIBILITY

To be eligible for the Loan, a Concessionaire must meet the following criteria:

1. Concessionaire must have an executed concession agreement with the City of San Jose for food and beverage and/or retail concession activity at the Airport (“Concession Agreement”)
2. Concession Agreement and the Concessionaire must be in good standing with SJC
3. Concessionaire may not have more than three (3) concession locations at SJC
4. Concessionaire must be listed as the Concessionaire on the Concession Agreement and the operator of the concession location(s)
5. No more than one application per Concessionaire is allowed every five years, and
6. Concessionaires with multiple businesses or interests in multiple businesses at SJC can only apply for a total of one Loan every five (5) years regardless of their multiple businesses or interests

Concessionaires managing four or more units at SJC and/or their subtenants/subconcessionaires are not eligible for the Loan.



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III. LOAN CHARACTERISTICS

1. The maximum term is five (5) years.
2. The current interest rate for loans entered into in calendar year 2021 and 2022, is 3.5%. The interest rate for Loan's entered into after calendar year 2022 may be adjusted by the Director to reflect then current market conditions.
3. The maximum loan amount is five million dollars (\$5,000,000) per Concessionaire over the term of their Concession Agreement.
4. Loan proceeds can be used for Concessionaire's Allowable Improvement Costs as outlined in Concessionaires Concession Agreement, including but not limited to, design, engineering, demolition, construction, equipment, furniture, fixtures, third-party project management during construction, and other normal and reasonable Concessionaire uses, subject to approval by the Director. The Director shall have the authority to allow for other costs outside of those stated in the Concession Agreement, at its sole discretion, subject to written approval.
5. Loan proceeds cannot be used for the following unless approved by the Director in writing:
 - a. Staffing or operating costs
 - b. Concessionaire's costs for internal design, review, management, and oversight of construction of its Concession Location(s)
 - c. Concessionaire's licensing or franchising costs
 - d. Routine or deferred maintenance or repairs
 - e. Expenditures or expenses associated with the sales or marketing of the Concession Location, including, but not limited to, brochures, business cards or other collateral materials
 - f. Future renovation or remodeling of Concession Location after the initial construction
 - g. Capital spent by Concessionaire prior to the date the loan is issued
 - h. Refinance an existing loan
 - i. Speculative investments, owner loan repayments, payment of owed taxes, and real estate financing
 - j. Late fees or penalties
 - k. Loss of revenue



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1. Contribute towards Concession Fees paid to the City.
6. Repayment Terms:
 - a. Loan interest will commence from the date the City makes the first distribution of Loan funds.
 - b. Repayment terms are based on a fixed or pre-determined principal and interest payment schedule.
 - c. Loan repayments will begin ninety (90) days after the opening of the first concession location and payments will be required to be made to the City on a quarterly basis on the first (1st) day of the third (3rd) month following the opening date. Should the opening date fall between the first and the fifteenth of the month, the first payment shall be due on the first day of the third month. If the opening Date falls on the sixteenth of the month or later, the first payment shall be due on the first day of the fourth month.
 - Example: Opening date is January 3rd the first payment shall be due on April 1st. Should the Opening date fall on January 16th, the first payment shall be due on May 1st.
 - d. The City shall confirm the opening date within sixty (60) days of the concession opening, The City shall confirm the total loan balance and first payment due date no later than sixty (60) days after the final payment is made by the City.
 - e. All fees or charges are required to be paid in advance quarterly on or before the first (1st) day of the month in which payment is due pursuant to the terms and conditions as outlined in the Concession Agreement without any notice from the City.
 - f. Late payment fees will be assessed on all late payments in an amount established by City Council Resolution for Airport Rates and Charges.

IV. ADMINISTRATIVE PROCEDURES

Concessionaires will be notified by SJC Finance & Administration Staff (“Staff”) of any loan opportunities from the Airport. Staff is responsible for reviewing loan applications for eligibility, completeness, and creditworthiness and informing the applicant of the results. Creditworthiness will be established using the five C’s of credit as outlined in Section V based on the financial statements provided by the Concessionaire. Applications must include all the information requested in the loan application and checklist and any related information requested by SJC.



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If the loan application is found to be creditworthy, the loan application will be forwarded to the Director with a recommendation from Staff. If Staff finds the loan application is not creditworthy, a letter will be sent to the applicant explaining the reasons for the denial. Loan applications with missing documentation will not be processed until the missing documentation is received.

The Director of Aviation at its sole discretion may waive the loan application for any Concessionaire with an active Concession Agreement in good standing and with an assurance that the Concessionaire's financial circumstances have not changed significantly since they provided financial information to the City in prior submissions. It is understood that the Concessionaire's finances have been reviewed and evaluated by Staff during the Request for Proposal process and have been determined to meet the qualifications for a Loan.

When the Director of Aviation ("Director") approves a loan request, an amendment to the Concession Agreement with the loan terms and conditions shall be executed prior to the first distribution of proceeds by the City.

V. UNDERWRITING

The SJC staff and the City will use the five C's of credit to evaluate requests for Loans. The five C's are cash flow, capacity, credit, collateral, and character.

1. **Cash Flow** - The Concessionaire must be able to pay all debt, including the Loan. A ratio of 1:1 debt service is acceptable. The City will assess the Concessionaires ability to repay the loan using standard financial analysis practices including but not limited to solvency, liquidity, and profitability ratios. Cash flows less than a 1:1 ratio and/or negative cash flows will be a sufficient reason for Loan denial.
2. **Capacity** – Concessionaire's concession and plan will be examined to ensure that the facility is adequate for the Concessionaire plan objectives. The borrower's industry experience and education will be a material consideration. A leverage ratio in the Balance Sheet greater than 4:1 is cause for denial. A current ratio of less than 1:1 is cause for denial.
3. **Credit** – A Concessionaire's credit history is material to approving any current loan request. Accordingly, credit reports will be ordered and examined. An average FICO score of 650+ is positive. Mortgage loans, car loans, credit cards, store cards that have been paid as agreed are positive. Credit histories with no judgments, tax liens, collections or bankruptcy are positive. A Concessionaire's bankruptcy within the past two years is cause for automatic denial. Consistent late pays on numerous accounts is cause for denial. Negative credit histories with understandable explanations may still be forwarded for Loan consideration.



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4. Collateral - Collateral is required in some form. The Concession Agreement, all equipment and furnishings and the letter of credit equal to six months of the Minimum Annual Guarantee will serve as collateral. The Airport reserves the right to place a lien on Concessionaire assets (past/current/future) thru a UCC-1 filing and Security Agreement or collect other forms of collateral including but not limited to: Deeds of Trust, Pledge of Funds, Guarantors, and Co-signors. Collateral ratios will be at least 1.5:1, if not greater. An inability to offer any collateral may be grounds for Loan denial.
5. Character - The applicant's entrepreneurial attitude and demonstrated Concessionaire acumen will be examined and assessed.

Staff may request various financial information from the Concessionaire to evaluate loans, including but not limited to:

1. Balance sheets and income statements for the last two (2) fiscal years prepared in accordance with generally accepted accounting principles ("GAAP") and audited by an independent accounting firm or an in-house certified financials by company officer reflecting the current financial condition of Concessionaire (and its parent corporation, if applicable). To clarify: If the Concessionaire is a wholly-owned subsidiary (fully consolidated of a publicly held corporation), the Concessionaire shall be required to submit financial information for the portion of the company that is listed on the Concession Agreement. If this is a new partnership or joint venture, submit a financial statement for each business entity of the partnership or joint venture.
2. An interim balance sheet and income statement of any significant financial events occurring after the closing date of the most recent financial statements. The person or entity covered by this statement must be prepared to substantiate all information shown.

Reasons for Loan Denial

The following items may be considered reasons for a loan denial (a) bad credit or no credit (b) lack of collateral (c) weak cash flow (d) existing debt and (e) breach of the Concession Agreement. The Director shall have the sole discretion during his/her review of the staff recommendation to make a determination if certain loan denial reasons can be waived.

VI. SERVICING AND COLLECTION

The servicing of Loans will be administrated by the Norman Y. Mineta San José International Airport Finance Division. SJC staff will set up the account, inform the borrower where and how to make their payments, and send the borrower invoices. SJC maintains an Accounts



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Receivable Billing and Collection Policy for servicing, payment and collection efforts. Concessionaire will be responsible for complying with SJC Staff Billing and Collection Policy. SJC City staff will explain to Concessionaire all insurance requirements, loan conditions, reporting requirements, check disbursement and timing requirements and policies. Concessionaire will be responsible for providing SJC staff with T copies of invoices from the contractor/vendors and any other documentation to support the request for payment along with a total amount requested for payment and any other required documents by the City.

Concessionaire will submit a request for payment from Concessionaire to staff in accordance with the SJC staff Billing and Collection Policy. Staff will review the request and approve payment. The City will not make payments towards items as outlined in Section III.5 of this policy. City will make payments directly to the Concessionaire. At no time will payments be made directly to the contractor/vendors for any reason. Payments from the City shall only be used by the Concessionaire for the reasons outlined on the approved payment request.

Airport Finance and Administration staff, the Director, or any third party hired by the City of San José to review or manage the Loan programs, will have the authority to periodically review the term, maximum loan amounts, and interest rates to reflect market conditions and make adjustments thereto.

Default by Concessionaire

The default terms and procedure for determining if Concessionaire is in default are specified in the Concession Agreement. In addition to the defaults specified in the Concession Agreement, the Concessionaire is in default of the Concession Agreement and the loan if:

(i) Concessionaire fails duly and punctually to pay the loan payments (ii) assignment, sublease, transfer, or conveyance of the rights of the Concession Agreement (iii) Concessionaire fails to pay contractors for services rendered and/or does not provide formal releases (vii) Concessionaire violates any Loan agreement covenants requiring full payment (v) any material misrepresentation in the loan application is found after closing (vi) if the Concessionaire defaults on the Concession Agreement (refer to the defaults section in the Concession Agreement), the Concessionaire shall be deemed in default on the loan.

City Remedies

The City shall adhere to the remedies for a default as specified in the Concession Agreement. In addition to the City Remedies specified in the Concession Agreement, the City reserves the right to exercise one or more of the additional remedies including:



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(i)The loan balance shall become immediately due and payable in full upon a default (ii) the security deposit shall be used to pay any outstanding balances (iii) the furnishings, trade fixtures, and equipment, would become the property of the City (iv) the Concession Agreement would be terminated and all concession locations under the Agreement would be turned over to the City in an as-is condition.

VII. DEFINITIONS

- a. **Concessionaire** – A business operating no more than three (3) food and beverage and/or retail concession location(s) at SJC.
- b. **Concessionaire's Furnishings, Trade Fixtures, and Equipment** - means all proprietary items of Concessionaire displaying distinctive features associated with Concessionaire's operations and all personal property (exclusive of "Concession Improvements"), which Concessionaire is permitted to install or locate within the Concession Location subject to the requirements of the Agreement, and such other personal property or equipment authorized by Director in writing.
- c. **Concession Improvements** – means those fixtures and other permanent improvements set forth in Concessionaire's final construction plans approved by the City, as well as areas that have been subsequently added or modified as described in the Concession Agreement, which Concessionaire is permitted to construct in, on or about the Concession Location(s) subject to the requirements of the Concession Agreement, and such other fixtures and other improvements authorized by Director in writing.
- d. **Concession Location** - means an individual unit of the concession program providing food and beverage products, retail, and/or services to the general public, pursuant to the terms of the Concession Agreement.
- e. **Concession Operations** - means the non-exclusive privilege to finance, design, construct/develop, and manage and operate a food and beverage or retail concession as described in the Concession Agreement.
- f. **Director** - means the person designated Director of Aviation by City, or such other person, division, department, bureau or agency, as may be designated by the City Council or the City Manager from time to time to exercise functions equivalent or similar to those now exercised by the Director of Aviation; the term also includes any person expressly designated by the Director of Aviation to exercise rights/and or obligations empowered in the "Director" under this policy and in the Concession Agreement.



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- g. **Ineligible Operators** - Any concessionaire at SJC with more than three (3) concession locations, offers services outside of food and beverage or retail, or a Concessionaire that does not have a current food and beverage or retail concession agreement in good standing with SJC.
- h. **Security Deposit** - Concessionaire shall deposit and maintain with City a sum equivalent to six (6) months of the proposed MAG due on the MAG Commencement Date. The Security Deposit shall be payable to the “City of San José” in the form of an irrevocable standby letter of credit.
- i. Where the singular is used throughout this document, the plural is implied, and plural uses may be interchangeable.