

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: John Aitken

SUBJECT: SEE BELOW

DATE: November 6, 2017

Approved



Date

11-16-17

SUBJECT: APPROVAL OF THE THIRD AMENDMENT TO THE EXISTING AIRPORT CONCESSION AGREEMENT AND CREATION OF AN ADDITIONAL SHARED USE LOUNGE CONCESSION AGREEMENT WITH ALD DEVELOPMENT CORP.

RECOMMENDATION

- (a) Approve the Third Amendment to the Airport Concession Agreement between the City of San José ("City") and ALD Development, Inc. dba The Club at SJC (ALD) to extend the term through January 31, 2025, add a minimum Mid-Term Refurbishment Capital Expenditure to be made by ALD of \$225,000, increase the Gross Revenue percentage fee payable to the City to 13%, retroactive to June 1, 2016, and revise the minimum annual guarantee ("MAG") to account for impacts from the opening of the new shared use lounge in Terminal A.
- (b) Approve a separate Shared Use Lounge Concession Agreement between the City and ALD to design, construct, and operate a new shared use lounge in Terminal A through January 31, 2025, with a minimum of \$2,000,000 in capital investment to be made by ALD, and a concession fee payable to the City of the greater of a MAG of \$136,600 or a percentage fee of 13% of gross revenue annually.

OUTCOME

Approval of the Third Amendment will allow ALD to continue to provide a full-service, shared use airport lounge which serves all passengers in Terminals A, B, and the Federal Inspection Building ("FIS") at the Norman Y. Mineta San José International Airport ("SJC" and "Airport"). The amendment will increase the gross revenue percentage fee payable to the City from 10% to 13% retroactive to June 1, 2016, extend the term of the Agreement by six years to January 31, 2025, commit ALD to a \$225,000 Mid-Term Refurbishment Expenditure and modify the MAG

based on a three month period of gross revenues for the current lounge after the new Terminal A lounge opens for business.

Approval of a new Shared Use Lounge Concession Agreement with ALD, will provide additional shared use lounge concession services in Terminal A. ALD will design and construct a 4,030 square foot lounge space in Terminal A with a minimum \$2,000,000 capital investment from ALD. ALD will operate the concession and provide the City with the greater of a MAG or 13% gross revenue percentage fee. The MAG is adjusted annually and cannot be less than the previous year's MAG.

BACKGROUND

On October 22, 2012, the Director of Aviation executed a Concession Agreement with ALD following a Request for Proposal process, for the operation of a 7,101 square foot shared use lounge at the Airport for a term of three years. In September 2015, Council approved the Second Amendment to extend the term of the Agreement by three years through January 31, 2019. The shared use lounge is located in the FIS area of the Airport between Terminals A and B, and is available to all passengers for a fee and at no cost to airline executive members flying on airlines that have a relationship with ALD.

Since execution of this agreement, the Airport has seen a significant upward trend in flight activity due to the addition of new airlines such as Hainan, British Airways, Lufthansa, Air China, Air Canada and Aeromexico, in addition to an increase in domestic flights on Alaska, Southwest, JetBlue, Delta, American Airlines and starting October 2017, Frontier Airlines. In Fiscal Year 2016-2017, the Airport served 11.5 million passengers, and that number is expected to continue to grow to an estimated 12.0 million passengers in Fiscal Year 2017-2018.

With the growth of the Airport, the demand for additional lounge space has become evident. The Airport identified a space within the former American Airlines Admirals Club that has been closed and unoccupied since 2010, as a new location for an additional shared use airport lounge. With more than a third of the Airport's passengers flying out of Terminal A, a lounge in close proximity to the Terminal A gates will provide a needed service to the Airport's growing passenger base.

SJC notified both the airlines operating at the Airport and ALD that the vacant space in Terminal A was designated to be used as a lounge and that the City was accepting proposals that included no capital expenditure by the City. City received a proposal from ALD and entered into negotiations. The City accepted the following offer:

New Shared Use Lounge in Terminal A

- 1) ALD shall design and construct a shared use lounge in Terminal A at no cost to the City, with a minimum capital investment of \$2,000,000 by ALD. The agreement shall expire on January 31, 2025.

- 2) ALD shall pay a Concession Fee of the greater of a MAG of \$136,600 or 13% of Gross Revenue, but never less than the previous year's MAG.

Current Shared Use Lounge

- 3) Increase the gross revenue percentage fee for the current shared use lounge from 10% to 13% retroactive to June 1, 2016.
- 4) Opening a second location in Terminal A may reduce revenue in the current shared use lounge. Therefore, ALD has requested a onetime MAG adjustment following the opening of the new lounge to adjust the MAG to reflect the actual activity at the current lounge. The revised MAG will be calculated based upon a three month period of activity at the current lounge.
- 5) In order to maintain the current shared use lounge in like new condition, ALD will invest \$225,000 in Mid-Term Refurbishment Expenditures.
- 6) In order to help re-coup their capital investment on the Mid-Term Refurbishment Expenditures, the term for the current shared use lounge will be extended six (6) years.

City is requesting approval from Council of the Shared Use Lounge Concession Agreement and the Third Amendment to the Airport Concession Agreement.

ANALYSIS

ALD is a Texas based company that has an in depth understanding of the airport lounge business accumulated over 20 years. Their expertise and understanding of the SJC unique passenger base, and their proven ability to provide quality customer service, has been demonstrated through their award winning lounge at SJC. The Club at SJC has been recognized by Priority Pass, the world's largest independent lounge access program, in 2014 for Best Staff, 2015 for Best Attitude and Service, and 2016 for Lounge of the Year in North America. Over the past three years, All Nippon Airways has consistently ranked The Club at SJC in the top 3 of its 40 lounges. With their award winning concession program at the Airport, and their proven ability to provide quality customer service, the City desires to amend the current agreement and enter into a new Concession Agreement for the Terminal A location.

The execution of a third amendment will extend the term of the Agreement by six years, and continue to provide the City with the greater of the MAG or a percentage fee of 13%. By increasing the percentage fee from 10% to 13% retroactive to June 1, 2016, the City will receive an estimated \$81,189 of additional revenue. The onetime adjustment of the MAG once the second lounge opens in Terminal A will help balance the payments to the City and will not reduce the MAG below the initial MAG in the agreement. The capital investment of \$225,000 will help keep the current lounge in like new condition over the term of the Agreement.

The execution of a new agreement for the Terminal A lounge space will allow the Airport to utilize currently unoccupied space and better serve the passenger base. The minimum capital investment proposed by ALD of \$2,000,000 is a benefit to the City, as ALD will pay for all construction costs to build out the space. The new shared use lounge provides additional revenue to the City. ALD shall pay the greater of the MAG of \$136,600 or a percentage fee of 13% annually over the term of the Agreement.

EVALUATION AND FOLLOW-UP

The Director of Aviation shall be responsible for coordination of the Agreements and shall render overall supervision of its progress and performance.

POLICY ALTERNATIVES

Alternative #1: Council could choose not to enter into a new agreement with ALD for the location in Terminal A.

Pros: The Airport would have 4,030 square feet of space in Terminal A available to lease.

Cons: Passengers would not have access to additional lounge services that are conveniently located next to the gates in Terminal A, and the level of service to the passengers would not be improved. The Airport would not receive the annual MAG in the amount of \$136,600 committed by ALD under this Agreement, and would not benefit from the capital investment in the amount of \$2,000,000 to build out the space. The space in Terminal A would continue to remain unoccupied.

Reason for not recommending: The Airport desires to improve the level of customer service to its passengers, develop a currently vacant space in Terminal A, and increase the current revenue to the Airport by providing lounge services in Terminal A to the passengers. With the steady increase of passengers in the Airport, the demand to provide an additional shared use lounge to the passengers is needed as soon as possible.

Alternative #2: Council could choose not to execute the Third Amendment. At the conclusion of their Agreement, ALD would cease operations at the Airport and would vacate their existing space. In the interim, the City would issue a Request for Proposal for lounge services.

Pros: The Airport would have an additional 7,101 square feet of space on the third floor of the FIS building available to lease. A competitive process for shared use lounge services would possibly provide a greater selection of lounge operators.

Cons: ALD's departure would result in an overall decrease in customer service to passengers by eliminating lounge services to all passengers for a minimum of eight to nine months while a new operator is selected through the RFP process. City would not receive the current revenues of \$315,000, or the additional \$81,189 from increasing the percentage fee to 13%. ALD would not provide the capital investment in the amount of \$225,000.

Reason for not recommending: The Airport desires to maintain the exemplary level of customer service provided by ALD to its passengers, increase the revenue to the Airport, and ensure there is no gap in lounge services. With the steady increase of passengers in the Airport, the demand to continue to provide a shared use lounge to the passengers is needed.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda Website for the November 28, 2017 Council Meeting.

COORDINATION

This item has been coordinated with the City Attorney's Office and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

As an extension of an existing agreement and the creation of a new revenue agreement for an existing service, this item is an administrative function. Therefore, no action by the Airport Commission occurred.

CEQA

Not a Project, File No. PP17-003, Services that involve no physical change to the environment.

/s/

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

For questions, please contact John Aitken, Director of Aviation at (408) 392-3620.