COUNCIL AGENDA: 01/15/19
FILE: 18-1803
ITEM: 6.1

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: John Aitken

SUBJECT: **SEE BELOW**

DATE: January 2, 2019

Approved D. DSyC Date 1/2/19

SUBJECT: APPROVAL AND DELEGATION OF AUTHORITY OF THE SIGNATORY AND NON-SIGNATORY AIRLINE-AIRPORT LEASE AND OPERATING AGREEMENTS BETWEEN THE CITY AND ALL AIRLINES OPERATING AT THE AIRPORT

RECOMMENDATION

Adopt a resolution authorizing the Director of Aviation to:

(a) Negotiate and execute Signatory Airline-Airport Lease and Operating Agreements with any current or new passenger or cargo airlines at the Norman Y. Mineta San José International Airport that meet the minimum requirements to be a signatory airline, for the 10-year term of the new lease, starting on July 1, 2019, with two 5-year options to extend subject to the mutual agreement of the City and the airlines.

(b) Negotiate and execute Non-Signatory Airline-Airport Lease and Operating Agreements with any current or new passenger or cargo airlines at the Norman Y. Mineta San José International Airport that do not meet the minimum requirements to be a signatory airline or choose not to enter into a signatory lease, for the 10-year term of the new lease, starting on July 1, 2019, with two 5-year options to extend subject to the mutual agreement of the City and the airlines.

(c) Negotiate and execute agreements and amendments with airlines for leases of premises through the term of the Signatory and Non-Signatory Airline-Airport Lease and Operating Agreements that adhere to standard rates and charges for Airport premises.

OUTCOME

Adoption of this resolution will authorize the City to finalize and execute the new Signatory and Non-Signatory Airline-Airport Lease and Operating Agreements ("Agreements") for current and new passenger or cargo airlines at the Norman Y. Mineta San José International Airport for implementation effective July 1, 2019. The Agreements will terminate and supersede the existing airline agreements, which are due to expire on June 30, 2019.

The new agreements allow the airlines to continue to conduct operations and occupy leased space through the updated term. The new Airline-Airport Agreement updates and clarifies several key components of the previous lease including a provision that the City does not pay for its office and administrative space, that a new terminal project is pre-approved, and that the Airlines share in key components of financial risk with the City. The new Agreements are for a ten-year term with two consecutive five-year extensions upon mutual agreement of the City and the airlines.

BACKGROUND

The last Airline-Airport Agreement was adopted at the March 27, 2007 City Council meeting with the adoption of Resolution 73708 with a term expiring on June 30, 2012. This Agreement was extended two more times:

- Resolution 75950 authorized a five-year extension to June 30, 2017.
- Resolution 78176 authorized a two-year extension to June 30, 2019.

These Agreements provide that any passenger or cargo airline that signs the Agreement and meets certain minimum operational requirements shall be a "Signatory Airline." Any passenger or cargo airline that does not meet the minimum operational requirements to be a Signatory Airline is given the opportunity to become a "Non-Signatory Airline" by executing a non-signatory agreement in a form similar to the Agreement. Non-Signatory Airlines are charged a premium of 25% over the rates and charges applicable to Signatory Airlines.

Previous resolutions have also included the authority to negotiate and execute other Lease Agreements for airline support space. These leases are related to providing airline services at the Airport, which without authorization would likely exceed the Director's authority under Municipal Code 25.08.310.

ANALYSIS

Throughout the negotiations with the Airlines, City staff used the following goals, objectives, and guiding principles based on prior input from the City Council, the Airport Commission, and City senior management. These included:

- Protect the long-term financial stability of the Airport that maintains the Airport's favorable bond rating
- Use simplified, predictable and reasonable rate setting methods that provide stability over the term of the lease
- Allocate rent for City and select government used space to all terminal tenants

- Preserve the ability of the Airport to expand terminal capacity to meet growing demand
- Provide the Airport with the appropriate policy tools to optimize the utilization of existing terminal capacity
- Ensure that the Airport remains a competitive and attractive location for airlines to maintain and expand service
- Creating an airline-airport partnership that aligns and balances the risks and rewards

While the new Airline-Airport Agreement represents an important update and clarification of key components of the previous Airline-Airport Agreements, many of the fundamental elements of the original lease remain unchanged.

<u>Top Level Elements of the Lease Agreement</u>

Some of the major elements of the new lease agreement include:

- **Term**. The new Agreements will take effect on July 1, 2019 and will have a ten-year term. The Agreements will replace the existing Airline Agreements, which expire on June 30, 2019. The Agreements will provide for two consecutive five-year extensions upon mutual agreement of the City and the airlines. The Non-Signatory Agreement will be terminable be either party on 30-days notice.
- **City not paying for City-used space in the Terminal.** The new Agreement allocates the cost of the office and administrative space used by the City and the City's contractors at the Airport to all terminal tenants. This also includes: basement space, Federal Inspection Services (FIS) Facilities and Baggage Claim Area serving international scheduled operations, space used by federal agencies for which the City receives no rent, the military lounge, and temporary concession space.
- **Capital Projects**
    - **Pre-Approval of a New Terminal Project.** The new Agreement reiterates that the Terminal Area Improvement Program for the Phase II of Terminal B is pre-approved.
        - The new terminal project can include new FIS Facilities when the Airport reaches an annual rate of 550,000 international deplaning passengers for 18 consecutive months.
    - **Capital Projects.** Increases the current spending limits for terminal and airfield projects that may be constructed by the City at the Airport without consultation or approval from the Signatory Airlines from the current $5 million to $10 million, and any grants or other financial assistance will not be counted toward the $10 million threshold. In addition, the Agreement provides that should the City use Airport funds (as opposed to debt financing) to fund a capital project, the Airport funds will be repaid through the airline rates and charges calculation for the original cash investment, plus interest at the rate that the City otherwise would have paid for debt financing.
- **Provides Incentives for Airlines to Make a Long-Term Commitment to SJC.** For the City it is important that the Airlines commit to the long-term health and vitality of the Airport. As such, the new Agreement provides incentives to airlines to encourage and

recognize their commitment to San José. Signatory Airlines are those airlines that sign onto this lease for the duration of the term, and Non-Signatory Airlines are those that fly to SJC but have not made a long-term financial commitment to the Airport. The incentives for becoming a Signatory Airline are:

- Non-Signatory Airlines pay a 25 percent premium over the rates and charges applicable to Signatory Airlines.
- Non-Signatory Airlines are required to provide a security deposit. Signatory Airlines are not.
- Non-Signatory Airlines do not participate in revenue sharing with the Airport.

- **Revenue Sharing.** In any year when there is net remaining revenue generated at the Airport, after all requirements of the Bond Trust Agreement have been satisfied, including the minimum rate covenant requirements, the remaining revenues shall be divided between the Airport and the Signatory Airlines. The revenue sharing shall be as follows:
    - Until the New Terminal Project is completed and occupied, the Airport will receive the first $4 million of net remaining revenue.
    - Once the New Terminal Project is complete, the Airport will receive the first $2 million of net remaining revenue.
    - After the Airport receives its initial share before and after the New Terminal Project, the rest of the net remaining revenue will be split 60%/40% (Signatory Airlines/Airport) throughout the term.
- **Maintains Extraordinary Coverage Protection.** The Airlines continue to make extraordinary coverage protection available to the Airport for covering annual debt service and coverage requirements should the amount of revenue less operating expenses be insufficient to meet the Airport's debt service obligations.
- **Continuation of Indirect Overhead Brackets.** Because the operation and management of the Airport is supported by some City resources that are not directly charged to the Airport operating budget, the City allocates a percentage of its total indirect overhead expenses to the Airport operating budget. As a commitment by the City to the airlines, this lease continues the previous practice of providing consistency by bracketing this expense to no less than 15 percent and no more than 25 percent of the Airport's operating budget.

EVALUATION AND FOLLOW-UP

The Airport Director shall monitor and regularly report to the Council and its relevant Committee on rates and charges, airline activity, and Airport activity over the term of these Agreements and Leases. The Airport Finances will be regularly reported through the normal City budget process and the Comprehensive Annual Financial Report (CAFR).

POLICY ALTERNATIVES

Alternative: Establish Airport rates and charges by ordinance.
Pros: This alternative eliminates the need for an airline-airport lease and operating agreement.
Cons: Rates by ordinance would not provide the long-term commitment by the airlines needed to be able to finance the New Terminal Project. Furthermore, the Airport will still need to negotiate individual leases with the airlines for exclusive use space.
Reason for not recommending: In the interest of establishing and maintaining a collaborative partnership between the City and the airlines operating at the Airport, approval of the Agreement is recommended.

PUBLIC OUTREACH

The Airport Commission held a public special meeting on January 22, 2018 to discuss the Airline-Airport Lease and this memo will be posted to the City Council website for the January 15, 2019 meeting.

COMMISSION RECOMMENDATION/INPUT

The general components of the Airline-Airport Lease were discussed at a special meeting of the Airport Commission on January 22, 2018. This special meeting was specifically called to provide an open and public forum on the issue of the Airline-Airport Lease negotiation. The Commission provided feedback on the key items to be included in the lease.

COORDINATION

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

FISCAL/POLICY ALIGNMENT

The Agreement is consistent with the Envision San José 2040 General Plan amended on February 27, 2018 to continue developing a world-class airport and build national and international connections by attracting new air service to it (Goal IE-4.2).

CEQA

Not a Project, File No. PP17-003, Agreements and Contracts, Services that involve no physical changes to the environment.

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

For questions, please contact Matthew Kazmierczak, Manager of Strategy and Policy for the Airport, at 408-392-3640.