



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: John Aitken

SUBJECT: SEE BELOW

DATE: March 25, 2019

Approved

Date

3-28-19

**SUBJECT: FIFTH AMENDMENT TO THE HOST INTERNATIONAL, INC.
AGREEMENT**

RECOMMENDATION

Approve the Fifth Amendment to the Host International Inc. ("Host") Food and Beverage Concession Agreement ("Agreement") to extend the term of the agreement for two years, from June 30, 2026 to June 30, 2028, modify the Street Pricing Policy from 10% to 13% above street pricing, add a new concession into the Terminal B Interim Facility, refresh the Terminal B food court, reduce the Joint Marketing Fund Fee from .50% to .25% of gross revenues, and modify the use of the Joint Marketing Fund to include customer service initiatives.

OUTCOME

Approval of the Fifth Amendment will allow Host to amortize escalating construction costs through extending the term, reducing the Joint Marketing Fund Fee (the joint marketing fund is funded by the concessions and is only used to promote the concessions at the airport) from .50% of sales to .25%, and increasing the Pricing Policy to street pricing from +10% to +13%. In addition, this amendment adds a new concession at the Norman Y. Mineta San José International Airport's ("Airport" and "SJC") Interim Facility, and will require Host to refurbish the food court in Terminal B. The Joint Marketing Fund Fee will be modified to incorporate customer service initiatives that will enhance the overall customer experience at the Airport. The extension will guarantee a total of approximately \$6.3 million in revenue to the Airport over the additional two-year term with the potential for additional revenue from the new concept in the Interim Facility.

BACKGROUND

On October 12, 2007, the City released a Request for Proposals ("RFP") for a new food & beverage program for the Airport. On June 10, 2008, Council approved Resolution No. 74413 that authorized the City Manager to negotiate and execute an Agreement with Host International, Inc. and a second concessionaire for food and beverage concessions which was executed on January 29, 2009.

On July 18, 2011, the City and Host entered into a First Amendment to the Agreement to temporarily close Chiaramonte's Deli and Bar Location TA + 2, due to the deactivation of Gates 1 through 6 and to reduce Host's Minimum Annual Guarantee; and

On November 15, 2011, the City and Host entered into a Second Amendment to the Agreement to revise provisions regarding customer pricing, amend the Concession Area and concepts, memorialize changes to the Minimum Annual Guarantee commencement date and annual adjustment date, and make a clerical correction.

On December 11, 2014, City and Host entered into a Third Amendment to the Agreement to revise the Minimum Mid-Term Concession Refurbishment Expenditure, grant the Director authority to change the required dates for the mid-term refurbishments, revise the concession area, and increase the Minimum Annual Guarantee by the amount of \$291,818.

On March 6, 2018, the City and Host entered into a Fourth Amendment extending the term of the agreement for six years, from June 30, 2020 to June 30, 2026, required Host to refresh the Concession Program with new concepts, including Great American Bagel, Chick-fil-A, Trader Vic's, Trader Vic's Express, Shake Shack, and the International Beer Union. The Fourth Amendment further required Host to expand the Starbucks and Gordon Biersch locations in Terminal A, revised the Concession Fee structure, and added a capital investment by Host of no less than \$6 million for the design and construction of the new concepts and the expansion of the Starbucks and Gordon Biersch.

In 2018, the Airport prepared for the design and construction of 14 new and re-concepted concessions throughout the terminals by Host, Hudson, and Airport Lounge Development. This new construction combined with the double-digit passenger growth by the Airport, triggered the need to complete an Americans with Disabilities Act ("ADA") Accessibility Analysis and an Egress Analysis of Terminals A and B. The Airport hired a consultant to complete the ADA Accessibility Analysis and an Egress Analysis, and based on the findings, worked with various City Departments to identify the modifications necessary to obtain construction permits. During this process, all terminal construction projects were put on hold for approximately nine (9) months while the study and modifications were scheduled, which in turn impacted Host's construction timeline, construction costs, and their ability to amortize their costs related to the projects.

Concurrently, following the execution of the Fourth Amendment between City and Host, Host submitted a request for proposals for the construction of the new concepts. Host received several proposals from general contractors and the proposal costs exceeded their estimated construction costs by more than 50%. Local market conditions have driven construction costs up considerably. Factors in the construction costs included the security restrictions when operating within an Airport environment, and the inflation of construction costs in the bay area. While Host evaluated the construction costs, they continued to move forward with the design and permitting process for the new concepts.

Following this time delay caused by the ADA Accessibility Analysis and an Egress Analysis, Host revisited the construction costs associated with the new food and beverage concepts and costs had escalated to more than \$10 million resulting in an approximately \$4 million deficit to their budget projections. Based on the increased construction costs, and the delay in starting construction because of the ADA Accessibility Analysis and an Egress Analysis, Host discerned that they could not recoup their costs within the current structure of the Agreement.

With these considerations, Host met with Airport Staff to address concerns related to the delay, the unexpectedly high construction costs, and the amortization schedule. In order for Host to properly amortize their costs and build out the concepts as originally proposed, the Airport recommends an extension of the Agreement for two years to June 30, 2028, modifying the pricing policy to allow Host to charge street pricing plus 13% at its concessions, and modifying the Joint Marketing Fund Fee by reducing the fee of .50% to .25% and incorporating customer service initiatives. The changes to the Pricing Policy and the Joint Marketing Fund Fee are consistent with the terms of the new proposed concession agreement issued through the Food and Beverage RFP. As consideration for the proposed modifications to the Agreement, Host will add an additional bar concept in the Interim Facility and refurbish the Terminal B food court.

ANALYSIS

The extension of the Agreement will allow the Airport to enrich the Food and Beverage experience for passengers at the Airport, receive a guaranteed \$6.3 million in revenue over the two-year extension, while providing the appropriate timeline for Host to amortize its capital expenses. Modifying the pricing section to allow Host to charge 13% above street pricing will enable the Airport to receive higher revenue from sales, while helping Host offset its increased construction costs.

In addition, with the projected opening of the new Interim Facility at the end of Terminal B in June 2019, the City identified a need to provide food and beverage concession services within this area by a Concessionaire that could meet the aggressive timeline and be open upon the completion of construction. This Agreement will allow the City to accommodate passengers within the new Interim Facility while increasing revenue to the Airport. The refurbishment of the Terminal B food court will align the design of the food court with the neighboring Trader Vic's and Sushi Boat concepts and enhance the overall appearance of the food court.

Modifying the Joint Marketing Fund Fee will continue to help Host offset construction costs while allowing the Airport to realize its goal to provide a comprehensive customer service program that will elevate the overall customer experience at SJC through support service metrics, improved training of staff, concession reward initiatives, and improvements to the management of the program itself, in addition to marketing the concessions.

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 elect not to execute the Fifth Amendment. After the termination of their Agreement in 2026, Host International Inc. would cease operations at the airport and would vacate their existing space. The City would prepare to issue a Request for Proposal for Host's portion of the Food & Beverage Concessions program which may not provide a comparable level of revenue that is guaranteed under the current agreement.

Pros: The Airport would go through a competitive process for Food & Beverage Concessions which would commence operations on July 1, 2026.

Cons: Host would be unable to amortize their costs, and as a result the concepts would have to be reevaluated and key elements are likely to be value engineered out of the design which could influence appearance, quality, and service. In general, the customer experience would decline resulting in lower sales and lower revenue to the Airport. Also, in order for Host to cover the costs, Hosts would employ fewer employees, lowering the overall level of service.

In addition, the Airport would forgo the approximate \$6.3 million in guaranteed revenue over the additional 2-year term and the potential additional revenue from the increase in pricing and the addition of the location in the Interim Facility. There would be no food and beverage service for Interim Facility passengers and the Airport would fail to provide the proper level of service to its passengers.

Reason for not recommending: The Airport desires to create an atmosphere in line with the Airport's Vision by providing quality food offerings, service, and revenue to the Airport. Going out to bid does not guarantee that the Airport will receive the same level of revenue.

HONORABLE MAYOR AND CITY COUNCIL

March 27, 2019

Subject: Fifth Amendment to Host International, Inc.

Page 5 of 5

PUBLIC OUTREACH

This item will be posted on the City's Council Agenda Website for the April 9, 2019 Council Meeting.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office and the 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, Agreements/Contracts resulting in no physical changes to the environment.

/s/

JOHN AITKEN, A.A.E.

Director of Aviation

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