COUNCIL AGENDA: 9/21/2021
FILE: 21-2043
ITEM: 2.10

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: John Aitken
Jim Shannon

SUBJECT: **HEWLETT PACKARD GROUND LEASE TERMINATION**

DATE: September 2, 2021

Approved Date 09/10/21

RECOMMENDATION

(a) Adopt a resolution authorizing the City Manager or designee to negotiate and execute a Third Amendment to the Ground Lease of Parcel W-9 Agreement ("Agreement") with Hewlett Packard Enterprise Company to terminate the agreement early, effective upon execution by the City with a payment to Hewlett Packard Enterprise Company of $1,500,000;

(b) Adopt the following 2021-2022 Appropriation Ordinance Amendments in the Airport Renewal and Replacement Fund:
   (1) Establish the Hewlett Packard Enterprise Lease Buyout appropriation to the Airport Department in the amount of $1,500,000; and
   (2) Decrease the Ending Fund Balance in the amount of $1,500,000.

OUTCOME

Should Council approve, the City Manager or designee will finalize an amendment to terminate the Agreement and the City will pay Hewlett Packard Enterprise Company ("H.P.E.") $1,500,000 for the leasehold improvements and buy-out the remaining seven years of the lease. This action allows the City to issue a Request for Proposals for new corporate aviation tenants with a more advantageous rent structure than the existing Agreement provides. The City will negotiate a contract with a current subtenant, Hewlett Packard Company ("H.P.I."), for the term of the sublease, which expires in October 2023.

BACKGROUND

Hewlett Packard has operated a corporate aviation operation at the airport since 1973. On May 29, 1986, the City and H.P.E. entered into a ground lease agreement for 7.08 acres on the airport to build and operate a corporate aviation operation on the west side of the airport. H.P.E. and their subtenant Hewlett Packard Company occupy a facility that is comprised of 56,804 square feet of hangar and office space, 112 parking spaces and associated ramp for aircraft operations, which H.P.E. built in 1986. The use of the facility is limited to corporate aviation operation. H.P.E. spent just over $9.6 million in capital improvements on the site since 1986 and the current lease has just over 7 years left before it terminates. Based on the terms of the Agreement, the leasehold improvements revert to the Airport at the end of the lease term, which is November 2028.

In December 2020, H.P.E. announced plans to relocate their corporate headquarters from San Jose, California to Houston, Texas. H.P.E. then contacted the City to discuss the possibility of the City buying out H.P.E. from the remainder of the lease or marketing the lease to another party. City staff recommends buying out the remainder of the lease now, as current corporate aviation lease market trends indicate a favorable return on investment during the remaining term of the lease. The Airport would conduct a Request for Proposals (RFP) to find a new Specialized Aviation Service Operation to lease the site with a rent structure that includes the ground as well as the cost of the improvements.

ANALYSIS

Under the current lease, H.P.E. is allowed to assign or sell their ground lease to another party and the new entity would continue on with payments to the City in accordance with the lease terms. H.P.E would leave and the City would not have any input on the selection of the new tenant. The relocation of corporate headquarters prompted H.P.E. to inform City staff that they intended to market the lease opportunity, but they also provided an opportunity for the City to negotiate a buy-out of the remaining leasehold including improvements.

The negotiated purchase price of improvements, $1.5 million, is approximately one-half of what H.P.E. reported to City staff as the unamortized capital expenses. Staff believes the buyout of the leasehold improvements would be beneficial to the City as the Airport could market the ground lease and improvements for greater revenue than the current ground rent. The current ground rent to the City is approximately $900,000 and staff estimates the overall rent could increase to approximately $1.4 million with the ground rent and improvements.

H.P.E. has requested that the City allow their current subtenant, H.P.I. to stay for the term of the current sublease, which expires in October 2023 and generates revenue of $546,949 annually. Staff will enter into a new lease with H.P.I. for the time it takes to award a new master lease with a new master tenant who then will manage the H.P.I.'s agreement under the new master lease. The Airport will provide some maintenance of the facility until the new master tenant lease is executed.

CONCLUSION

By the City buying out the remaining leasehold interest including improvements, alterations, betterments, structures, construction additions and fixtures and allowing H.P.E. to terminate the Agreement, it permits the Airport to provide future opportunities for new aviation operations, with the potential to generate added revenue for the Airport.

EVALUATION AND FOLLOW-UP

The Director of Aviation shall be responsible for coordination of the Third Amendment to the Agreement and shall render overall supervision for development of a RFP for a new aviation tenant. The Director will keep Council apprised of progress, performance and return with a recommendation for award.

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: The City Council may choose to not approve the Third Amendment to the Agreement to terminate the H.P.E. lease and buy-out of the leasehold interest for $1.5 million.

Pros: The tenant, or an assigned tenant will continue to be financially responsible for the maintenance, upkeep and lease of premises until the end of the term resulting in approximately $900,000 in revenue per year.

Cons: The Airport would forgo potential additional annual revenue of $500,000 over the next seven years and would not be able to determine the new entity who obtains the ground lease.

Reason for not recommending: By having the Airport manage the property, the Airport can leverage additional revenue from the developed site and ensure the property use complies with FAA guidelines as well as current goals for general aviation at the Airport. The City would also be in a position to choose the new tenant using a competitive process.

PUBLIC OUTREACH

This memorandum will be posted on the City Council's Agenda website for the September 21, 2021 Council meeting.

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

COMMISSION RECOMMENDATION

This item does not have explicit input from the Airport Commission, although Commission members are provided with regular updates of airline services and proposed program changes.

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

Buying out the remaining term of the lease requires a one-time cost of $1.5 million and an initial reduction of annual revenue to the Airport by approximately $353,000, as H.P.I.'s continued use of the site under a new agreement directly with the City will provide annual revenue of approximately $547,000 until the City awards a new lease to a new master tenant. The loss of revenue for 2021-2022 is not anticipated to impact airport operations.

Buying out the H.P.E. lease enables the City to conduct an RFP and select other tenants at rates the City identifies, which is expected to increase annual revenue to approximately $1.4 million, or an increase of approximately $500,000 over the existing agreement terms. When compared to the existing lease, this action plan is expected to generate total net additional revenue of over $1 million over the life of the new master tenant lease and positions the Airport to more effectively use the space for aviation operations.

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 Capital Budget Page	Last Budget Action (Date, Ord. No.)
527	8999	Unrestricted Ending Fund Balance	$2,802,319	($1,500,000)	V - 499	6/22/2021, Ord. No. 30621
527	NEW	Hewlett Packard Enterprise Lease Buyout	N/A	$1,500,000	N/A	N/A

CEQA

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

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

Jim Shannon
JIM SHANNON
Budget Director

For questions, please contact John Aitken, Director of Aviation at (408) 392-3611.