2.7 Actions Related to the AMS SJC JV Retail Concession Agreement.

Recommendation:

Adopt a resolution authorizing the City Manager or her designee to negotiate and execute one or more amendment(s) to the AMS SJC JV Retail Concession Agreement to:

(a) Place the AMS SJC JV Retail Concession Agreement for concession locations that expire on June 30, 2024, on a month-to-month holdover tenancy effective July 1, 2024;

(b) Suspend the Minimum Annual Guarantee and allow the Concessionaire to pay a percentage of gross sales (Percentage Fee) on the two retail packages consolidated under the AMS SJC JV agreement for any period between January 1, 2025 to June 30, 2026; and

(c) Revise the Percentage Fee categories in both retail packages to one consolidated Percentage Fee for the period between January 1, 2025 to June 30, 2026.

CEQA: Not a Project, File No. PP17-005, Adjustment to Fees, Rate and Fares without changes to or expansion of services. (Airport)

COUNCIL AGENDA: 5/7/24
FILE: 24-86054
ITEM: 2.7

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Mukesh Patel

SUBJECT: SEE BELOW

DATE: April 16, 2024

Approved | Date 4/23/24

SUBJECT: ACTIONS RELATED TO THE AMS SJC JV RETAIL CONCESSION AGREEMENT

RECOMMENDATION

Adopt a resolution authorizing the City Manager or her designee to negotiate and execute one or more amendment(s) to the AMS SJC JV Retail Concession Agreement to:

a) Place the AMS SJC JV Retail Concession Agreement for concession locations that expire on June 30, 2024 on a month-to-month holdover tenancy effective July 1, 2024;
b) Suspend the Minimum Annual Guarantee and allow the Concessionaire to pay a percentage of gross sales (Percentage Fee) on the two retail packages consolidated under the AMS SJC JV agreement for any period between January 1, 2025 to June 30, 2026; and
c) Revise the Percentage Fee categories in both retail packages to one consolidated Percentage Fee for the period between January 1, 2025 to June 30, 2026.

SUMMARY AND OUTCOME

San José Mineta International Airport (Airport) has two retail concession packages currently under contract with AMS SJC JV. These packages generate a combined annual revenue of $4,027,905 for the City. Package I provides a minimum annual guarantee (MAG) of $1,328,182 and has a longer lease term, expiring on June 30, 2026. Package II provides a higher MAG of $2,699,723 but comes with an earlier expiration date of June 30, 2024.

City staff is planning to release a Request for Proposal (RFP) for all retail concession locations at the Airport in late 2024. To ensure a competitive RFP process, staff intends to create two attractive retail packages for prospective bidders that provide an even distribution of revenue and concept opportunities through the rebalancing of the two existing concession packages. The rebalancing involves strategically moving locations between the two packages, adding new locations in high-traffic areas, removing underperforming locations, and modifying concept categories.

To address these challenges, staff requests City Council approval to:

1. Place those locations under Package II, which expires on June 30, 2024, in holdover on a month-to-month tenancy until completion of the RFP; and,

2. Delegate authority to the Director of Aviation to suspend MAG payments for AMS SJC JV and to implement a new blended Percentage Fee structure for both packages.

By approving these recommendations, staff can create a retail RFP that will maximize revenue opportunities through better bid packaging, creating an exciting opportunity for prospective bidders. With a new rebalanced package, the Airport intends to enhance the passenger experience with fresh, new concepts, creating higher yields for the individual locations and the concession packages as a whole, driving a greater return for the Airport.

BACKGROUND

On October 12, 2007, the City released a RFP for a new retail program for the Airport. The RFP contained two packages for retail. The two retail packages consisted of a mix of approximately 10 spaces each with an original expiration date of June 30, 2020. Since the award of the two retail concession contracts in 2009, following the RFP, there have been numerous contract assignments and company consolidations, resulting in the same lessee, AMS SJC JV, managing both retail packages. In exchange for re-concepting some of the locations, among other factors, Package I was extended to June 30, 2026 and Package II was extended to June 30, 2024.

The Challenge of Unbalanced Retail Packages

The Airport retail concession program faces the challenge of two "unbalanced packages" in terms of number of concession locations in each package along with the revenue generated based on the concession categories. This imbalance stems from the following key factors listed below.

- **Expansion and Contraction**
  - During the initial program years, one of the concessionaires did not develop two of the allocated locations, due to a downturn in enplanements at the Airport. It was determined that these locations were no longer necessary to build out and the locations were returned to the Airport in 2013.
  - Starting in 2015, the Airport identified that there was a need to add additional retail concession locations. One of the packages was amended to incorporate three additional retail locations based on evolving passenger needs.
- **Concession Mix:** The two packages are a mix of 1) news and gift, and 2) specialty retail concession locations. The news and gift locations generate higher revenue in comparison

to the specialty retail locations. Package I consists of a blend of 80% specialty retail and 20% news and gift locations. In comparison, Package II consists of 40% specialty retail and 60% news and gift locations.

While Package I has more storefronts (11 storefronts versus eight storefronts), Package II generates significantly higher revenue, due to its mix of high-performing concession categories. This imbalance, if left unchecked, would greatly hamper the Airport's ability to attract bidders for both packages. Based on the current packages, it is likely that potential bidders would bid on Package II and not the other due to the concession type composition and revenue potential. Staff desires to address these imbalances before releasing the upcoming retail RFP to ensure that both packages are desirable to potential bidders.
Rebalancing the program is a crucial step in preparing for the upcoming retail RFP. However, achieving a truly balanced program requires more time than the Package II 2024 expiration date allows. Furthermore, as concession locations are moved between the two packages, merely adjusting the MAG based on the prorated value of each location does not account for the additional complexities involved in the rebalancing process. Most notably, this includes the differing percentage rent structures within each package and the potential that AMS SJC JV would not meet its MAG obligations as locations are returned to the Airport. By acknowledging these challenges, staff can develop a comprehensive rebalancing strategy that ensures a competitive RFP process that maximizes long-term revenue potential for the Airport and its business partners.

ANALYSIS

The Airport has two retail concession packages currently managed by AMS SJC JV under separate agreements. These agreements specify different terms and compensation structures for each package. Package I offers a lower MAG of $1,328,182, but has a longer lease term extending until June 30, 2026. In contrast, Package II brings in a higher MAG of $2,699,723, but comes with an earlier expiration date set for June 30, 2024. To create a more balanced and competitive RFP in the future, staff is planning a phased rebalancing approach as outlined below.

1. **Remove Underperforming Locations:** Remove certain concession locations in areas with low passenger activity or those obstructing visibility.
2. **Add New Locations in High-Traffic Areas:** Add new locations in high-passenger areas to increase the overall program value.
3. **Shifting Retail Locations Between Packages:** Strategically move locations between the two packages to achieve a better balance.
4. **Concept Category Modifications:** Some locations will transition from one category (e.g., specialty retail) to another (e.g., news and gifts) to provide a balanced category mix between the two packages.

Reclaiming locations for rebalancing will reduce AMS SJC JV's revenue and its ability to meet its MAG. Suspending the MAG and allowing AMS SJC JV to pay the Percentage Fee only during the rebalancing period would allow AMS SJ JV to remain financially solvent and give the Airport the mobility to properly stage the concessions for the RFP.

Additionally, the two agreements have differing Percentage Fee structures, making it difficult to move locations between the packages during the rebalancing process. The Package I Percentage Fee is structured by type of concept (e.g., news and gift, specialty retail), whereas the Package II Percentage Fee is structured by product categories sold (e.g., reading material, candy, snacks, food, and beverage). To ease the transition between the two packages, staff negotiated a new blended Percentage Fee structure applicable to both packages for any period between January 1, 2025 to June 30, 2026.

The below **table** identifies the proposed new blended Percentage Fee structure.

Percentage Fee Structure	
News and Gift and Travel Essential Locations	22% of gross sales
Bookstore Locations	18% of gross sales
Specialty Retail Locations	13% of gross sales
Food and Beverage portion of concept at locations NC-1 (Terminal B) and TA+1b (Terminal A+)	15% of gross sales
Food and Beverage, including Grab and Go portion of any location other than NC-1 and TA+1B	13% of gross sales
All goods sold from the Duty Free Concession Area	12% of duty-free gross sales

The blended structure combines and consolidates the average percentages of the two existing rent structures which helps the Airport maintain its percentage rent during the rebalancing period.

To achieve a successful RFP outcome for the Airport retail program, City Council's approval is requested on three key recommendations outlined below.

1. **Holdover Status for Package II:** Granting authority to place the Package II locations with an expiration date of June 30, 2024 under the AMS SJC JV agreement on a month-to-month tenancy holdover status effective July 1, 2024, provides flexibility for structuring the future concession packages. The current agreement does not allow these locations to be put in holdover status.

2. **Suspension of MAG:** Suspending MAG payments any time during the rebalancing period of January 1, 2025 through June 30, 2026 will mitigate financial hardship while locations are redistributed.

3. **Adjusting the Percentage Fee:** During the rebalancing period of January 1, 2025 through June 30, 2026, both packages would transition to the new blended Percentage Fee, which allows for a smoother rebalancing process.

By approving these recommendations, City Council empowers staff to create balanced and competitive retail packages. A balanced program offers a wider variety of concession options which would likely enhance passenger experience, leading to greater satisfaction and potentially increased spending. Finally, rebalancing fosters fair bidding opportunities for the future retail solicitation, attracting a wider pool of qualified candidates, and potentially leading to more competitive proposals that benefit the Airport in the long run.

EVALUATION AND FOLLOW-UP

The Director of Aviation will be responsible for the coordination of this amendment as well as ensuring the continued operation of certain retail locations during the phased rebalancing of the program.

COST SUMMARY/IMPLICATIONS

The City receives a MAG for both retail packages totaling $4,027,905. Package II has consistently exceeded the MAG obligations and historically paid additional revenue to the Airport through Percentage Fee. In comparison, Package I has consistently fallen short of generating enough revenue to meet the MAG payment, highlighting the program's imbalance. Rebalancing the program creates a fairer playing field and potentially increases revenue over the long term for future operators and increases the attractiveness of the program for potential bidders going into the bidding process.

Suspending the MAG and modifying the Percentage Fee will allow AMS SJC JV to remain solvent during the rebalancing process. It is unclear if the Airport will experience some loss of revenue due to the suspension of the MAG. Passenger levels, along with the rebalancing of concepts and locations are both large factors in the sales levels of the retail concessionaires, among other factors. While there may be a temporary revenue gap, the long-term benefits are advantageous to the Airport. A balanced program fostering a level playing field through a competitive RFP process is expected to generate higher overall revenue from future concessionaires. This approach will also enhance the passenger experience by providing a wider variety of concession options, potentially leading to increased overall spending.

COORDINATION

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

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the May 7, 2024 City Council meeting.

COMMISSION RECOMMENDATION AND INPUT

This is an administrative function; therefore, no commission recommendation or input is associated with this action.

CEQA

Not a Project, File No. PP17-005, Adjustment to Fees, Rate and Fares without changes to or expansion of services.

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

/s/
MUKESH PATEL, C.M.
Director of Aviation

For questions, please contact Mukesh Patel, Director of Aviation, at mpatel@sjc.org or (408) 392-3610.