



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: William F. Sherry, A.A.E.

**SUBJECT: Rate Stabilization: Approval to
Negotiate and Execute Amendments
To the Airline-Airport Lease and Operating
Agreements**

DATE: July 28, 2008

Approved

Date

7/29/08

Council District: City-Wide

RECOMMENDATION

Adoption of a resolution authorizing the City Manager to negotiate and execute Second Amendments to the Airline-Airport Lease and Operating Agreements with all passenger airlines operating at the Norman Y. Mineta San José International Airport and First Amendments to the Airline-Airport Cargo Operating Agreements with all cargo airlines operating at the Airport, to use a portion of the City's Airline Rate Stabilization Fund in an amount not to exceed \$2,172,000 to reduce projected 2008-2009 terminal rents below the projected terminal rental rates included in the Adopted 2008-2009 Airport budget, retroactive to July 1, 2008.

BACKGROUND

The current San José International Airport (SJC) Airline-Airport Lease and Operating Agreements (Airline Agreements) include a revenue sharing provision to evenly divide net, unobligated Airport revenues between the Airport and the airlines currently operating at the Airport after each fiscal year. In any fiscal year in which there are net unobligated Airport revenues and all requirements of the City's Airport financing documents have been satisfied, the remaining net unobligated Airport revenues are to be evenly divided between the City and the airlines. To the extent that net revenues do not exceed the projected levels outlined in the Airport Forecast identified in the Airline Agreements, the airlines' share of the net revenues is applied as a credit to the terminal rents due for the following year. If net revenues exceed the projected levels outlined in the Airport Forecast identified in the Airline Agreements, then the airlines' share of the difference will be deposited into the Rate Stabilization Fund up to a cap of \$9 million. As a result of conservative cost management and reserve savings in fiscal years 2006-2007 and 2007-2008, the Airport was able to fully fund the Rate Stabilization Fund under the revenue sharing terms of the December 1, 2007 Airline-Airport Lease and Operating Agreements.

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Over the past year, the steep increase in the cost of fuel has created serious instability in the nation's aviation industry. This situation was described in the Airport's information memo to the City Council on June 19, 2008. The industry as a whole is facing record financial losses, and several airlines have filed bankruptcy or ceased operations altogether, others have grounded aircraft, reduced flights and capacity, and many have announced layoffs of thousands of employees. The impacts of these losses will affect airports across the country, including San José, as well as aviation-related businesses and local community economies.

At the quarterly meeting of SJC Airport Airline Affairs Committee (AAAC) on June 11, 2008, representatives of the airlines and the Airport reviewed the Proposed 2008-2009 Airport Budget and Airline Rates and Charges. In light of the challenges currently faced by the airline industry, SJC's passenger carriers requested that the City consider replenishing the Rate Stabilization Fund over time rather than fully during the 2008-2009 fiscal year, and instead to use these resources to reduce 2008-2009 Airline Rates and Charges.

In the interest of the positive partnership between the Airport and its carriers, staff recommends the use of \$2.17 million currently allocated to the Rate Stabilization Fund to reduce 2008-2009 Terminal Rental Rates. An amendment to the Airline-Airport Lease and Operating Agreements is required to make this one-time adjustment to the terms and conditions of the Agreements. Although the cargo airlines do not pay terminal rents and will therefore not be impacted by the proposed use of the Rate Stabilization Fund to reduce 2008-2009 Terminal Rental Rates, the Airline-Airport Cargo Operating Agreements include the same revenue sharing and Rate Stabilization Fund provisions as the Agreements with the passenger airlines. Therefore, amendments to the Cargo Agreements are also required.

In the event that unanimous concurrence and execution of the amendments are not received by the airlines currently operating at the Airport, the 2008-2009 Terminal Rental Rates will not be reduced and the Rate Stabilization Fund will remain at \$9 million.

ANALYSIS

Mineta San José International Airport's conservative budget management and fiscal policies resulted in greater than anticipated ending fund balances in 2006-2007 and 2007-2008. These savings, along with moderate financial projections, strategic debt financing, and effective cost management, allowed the Airport to reduce airline rates for 2008-2009 from the originally projected cost per enplaned passenger (CPE*) of \$10.20 to \$9.02. In the budget adopted by the City Council on June 24, 2008, the Airport also was able to fully replenish the Airline Rate Stabilization Fund with the addition of \$4.34 million, bringing the reserve level to its full \$9 million as called for under the Airline Agreements.

As part of the Airport's ongoing analysis of the aviation economic climate, as well as the Airport's own financial situation, staff has reviewed the AAAC request to amend the Rate Stabilization Fund provisions in the Airline-Airport Lease and Operating Agreements on a one-time basis to further reduce projected 2008-2009 terminal rents below the projected terminal

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rents included in the Adopted 2008-2009 Airport budget, retroactive to July 1, 2008. Staff recommends reducing the Airport's 2008-2009 contribution to the Rate Stabilization Fund by half as shown in the table below.

	Fund	Projected CPE*	Average Rent
2007-2008 Rate Stabilization Fund	\$4,656,978		
Replenishment of Rate Stabilization Fund	<u>+\$4,343,022</u>		
2008-2009 Adopted Rate Stabilization Fund	<u>\$9,000,000</u>	\$9.02	\$206.76/sq. ft.
Recommended Adjustment	<u>-\$2,171,511</u>		
Adjusted 2008-2009 Rate Stabilization Fund	\$6,828,489	\$8.61	\$193.14/sq. ft.

* CPE is an index, not an actual charge, that reflects the overall ratio of cost of landing fees and terminal rents to the number of passengers boarding at the Airport.

There are several benefits from this recommendation:

- SJC passenger carriers will be able to pay lower rates and reduce operating costs at the Airport at a time when they are struggling with high fuel costs, service reductions, and financial losses.
- The Airport will be able to maintain a healthy \$6.8 million Rate Stabilization Fund allowing prudent management of future risks, and it continues the commitment in the Airline Agreements to fully replenish the Rate Stabilization Fund in the future as funds are available.
- The Airport will continue to be cost-competitive among Bay Area airports and can strengthen its already positive partnership with its carriers in a highly competitive environment.
- Travelers and the community will benefit from the mutual commitment of the airlines and the Airport to retain and attract local air service as much as possible while the aviation industry reduces capacity throughout the nation.

Staff will return to the City Council this fall with additional recommendations to meet the challenges resulting from the current volatility of the aviation industry and the anticipated reductions in revenue compared to the 2008-2009 Adopted Budget. The Airport will assess summer activity levels and forecasted carrier schedule changes, and year-end financial information will be available to help update revenue estimates and determine any revised expenditure plans in order to adjust to new conditions since the original budget was submitted and approved.

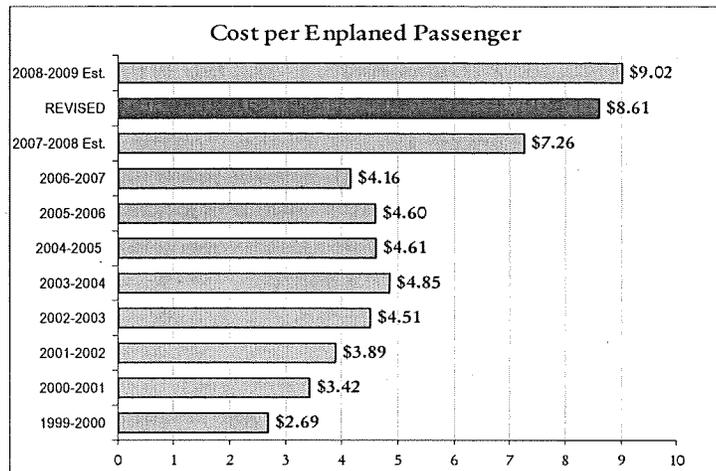
OUTCOME

City Council approval of this recommendation will authorize the City Manager to amend the Airline Agreements on a one-time basis to reduce projected 2008-2009 airline terminal rental rates at the Airport to provide relief to air carriers, retroactive to July 1, 2008. No other changes will be made to the terms of the Agreements. The Director of Aviation will report back to the

Council in fall 2008 with additional information and recommendations to meet the fiscal and budgetary impacts of the changing aviation industry environment.

EVALUATION AND FOLLOW-UP

The Airport's cost per enplaned passenger is regularly reported as part of the Transportation and Aviation Services CSA Business Plan Performance Measures. The chart to the right provides a history of the CPE at SJC. It is important to point out that the measure is influenced both by the cost of operating and re-constructing the Airport, as well as the number of passengers using the Airport in a given year.



PUBLIC OUTREACH

- Criterion 1: Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website posting)**
- Criterion 2: Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and website posting)**
- Criterion 3: Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a community group that requires special outreach. **(Required: E-mail, website posting, community meetings, notice in appropriate newspapers)**

A copy of this report has been provided to the SJC Airport Airline Affairs Committee. This report and recommendations will be posted on the City Council agenda website for the meeting of August 19, 2008.

COORDINATION

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

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COST IMPLICATIONS

There are no additional costs to this recommendation. The recommendation, however, will reduce the anticipated 2008-2009 Rate Stabilization Fund by \$2,171,511, and it will allow for a projected reduction to the 2008-2009 Airline cost per enplaned passenger from \$9.02 to \$8.61. Landing fees would remain flat at \$2.24 per 1,000 pounds landed weight, and average terminal rental rates will be reduced from \$206.76 to \$193.14 per square foot.

BUDGET REFERENCE (IF APPLICABLE)

None

CEQA

Resolutions No. 67380 and 71451, PP 08-142



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Director of Aviation

For more information or answers to questions, please contact William F. Sherry, Director of Aviation, at (408) 501-7669 or Terri Gomes Deputy Director for Airport Finance and Administration, at (408) 501-7638.

