Item D

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Ad Hoc Committee on Airport Competitiveness
Issue Document

Airline Lease Agreements

1. Issue Description:

Current rates and charges, and the operational structure for the Airport are set forth in the Scheduled Airline Operating Agreement and Terminal Building Lease (aka airline lease agreements). The agreements took effect on December 1, 2007 and are valid for 5 years, with one 5-year renewal period, subject to the mutual agreement of the City and the airlines. The current lease will expire on November 30, 2012.

The airline lease agreements cover all aspects of the Airport-airline operational and financial relationship. For example, under the agreements, most terminal facilities are leased on a shared use or preferential use basis. The agreements establish the methodology for calculating airline rates and charges. Landing fees are calculated using a residual airfield cost center method (the airlines absorb any extra costs and keep any extra revenues), while terminal rents are calculated using a compensatory methodology (the Airport absorbs any extra costs and keeps any extra revenues). To help maintain rates at the projected cost per enplaned passenger ("CPE"), a rate stabilization fund was established. The agreements provide for revenue sharing between the Airport and the signatory airlines after certain requirements are met.

Airline approval of all projects in Phase I of the Terminal Area Improvement Program ("TAIP") was incorporated in the agreements. Phase II of TAIP projects are also approved by the airlines through the agreements, as long as specific activity triggers are met before the City initiates design or construction of these projects. The agreement establishes a process for consultation and moving forward with projects not pre-approved in either phase of the TAIP. The agreements also incorporate compliance with the City's Curfew Ordinance, including the voluntary agreement of each airline to continue to ensure that airline corporate and flight scheduling personnel are aware of the Curfew Ordinance and the airline's commitment to curfew compliance. The agreements also contain the airlines' *voluntary* commitment to schedule and conduct *all* takeoffs and landings at the Airport between the hours of 6:30 a.m. and 11:30 p.m.

2. Key Issue Elements:

The agreements reflect the core relationships between the Airport and the airlines. The operating portion of the airline lease agreements have a strong and direct impact on the airline operating environment at SJC. The rates and charges portion of the agreements have a strong and direct impact on the airlines' CPE and thus the Airport's competitiveness to retain current air service and attract new service. As the current agreements expire, there are major operational and financial issues that need to be reviewed. For example, should the current agreements simply be extended and the terms left in place? If the five-year option is not pursued, what term should the new agreement cover (short-term or long-term)?Are there issues or terms related to the rates and charges methodology and/or revenue sharing that need to be reviewed and addressed? If so, how can those issues be corrected and keep the Airport's CPE competitive? Are there operating issues that need to be addressed?

Staff wishes to share a broad overview of the issues related to the new agreements and then provide the Committee with an opportunity to offer its comment on what it believes should be considered high priority issues for the next agreement.

3. Estimated budget savings or cost impacts on the Airport:

Though it is not possible at this time to say what the specific financial impacts of the next agreement will be, the airline lease agreements will undoubtedly have a strong impact on the financial position of both the Airport and the airlines. The current lease agreement generated approximately $46.7 million in operating revenues in FY 09-10 – 42% of all Airport operating revenues in FY 09-10. In addition, there are directly aligned relationships among the Airport-airline financial relationship, the Airport-airline operating relationship and SJC's competitiveness to retain current air service and attract new air service.

4. Council action required?

Yes. Though the specific timeline has not yet been developed, this item will be coming to the City Council for approval in 2012.

5. Implementation Schedule/Timetable:

New agreements must be in place by December 1, 2012. Though the content of the agreement will impact competitiveness, the implementation schedule should not directly or significantly impact competitiveness if the agreements are completed as scheduled.