Item E

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Ad Hoc Committee on Airport Competitiveness
Issue Document

Concessions Viability

1. Issue Description:

The advertising concession and the food & beverage and retail concessions were awarded through an RFP process which occurred prior to the recession and corresponding drop in enplanements. To secure an agreement with the Airport during better economic times, all winning concessionaires submitted proposals with aggressive minimum annual guarantees (MAGs). However, with the turndown in the economy, the Airport concessionaires are now struggling to generate adequate revenue to cover the MAGs that they are contractually obligated to pay the Airport. The concessionaires are all experiencing losses at their SJC operations – some at significant levels.

2. Key Issue Elements:

Maintaining the viability of the concession agreements will require an increase in sales, a reduction in costs, or a combination of both. To the extent the concessionaires are not able to meet their MAG obligations, the Airport will need to adjust its budgetary expenditures to compensate for the reduction in revenue. That adjustment would most likely be in the form of further staff reductions. Having reduced Airport staff from 400 FTE in 2008 to about 200 FTE today, the Airport is at or close to its minimum staffing requirements. Further staff reductions would reduce the Airport's competitiveness by reducing the quality of its services. Accordingly, both the Airport and concessionaires have a strong mutual interest in a successful concessions program at SJC. With that mutual interest in mind, as outlined below, the Airport is working with all of the master concessionaires in a number of ways to improve the viability of their programs at SJC.

Advertising Concession

Clear Channel has a $4.2 million MAG which has already been reduced by $350,000 by eliminating advertising sites agreed upon by both the Airport and Clear Channel. In addition to the MAG reduction, the Airport has taken the following steps to assist Clear Channel:

- Provided additional advertising sites with no corresponding increase in MAG;
- Eliminated the minimum capital investment requirement for additional sites;
- Removed the $376,000 mid-term capital investment requirement;
- Approved new advertising sites that typically would not meet the Airport's stringent standards;

- Agreed to combine the capital investment requirement categories, saving Clear Channel $296,000.

Even with these cost reductions and new sales opportunities, Clear Channel is only generating a fraction of the sales needed to break even. At their current $0.42 sales per enplanement, it would take 15 million passenger enplanements a year before Clear Channel would begin paying the Airport more than its MAG obligation. Clear Channel says it is losing in excess of $2 million annually at SJC.

Food & Beverage and Retail Concessions

The four concession agreements have a combined MAG obligation of $8.5 million a year and all are operating at a loss. The concessionaires have asked for MAG relief, store closures, reduced hours of operation and relief from the Airport's policy that prices not be more than 10% over comparable street locations.

The Airport has been working with the concessionaires to increase sales and reduce operating costs. Minimum hours of operation were recently adjusted and the majority of concession locations now have reduced hours without compromising passenger service needs. A new pricing policy has been drafted that has incorporated suggestions from the concessionaires, the City Auditor and policies of other airports, including those in the Bay Area. Although the Airport is not willing to deviate from its pricing requirement of street price plus 10%, staff is exercising more flexibility by requiring fewer street comparisons.

Sales per enplanement at SJC are slightly higher than the national average for similar sized airports. However, enplanements are significantly lower than the concessionaires projected and overall sales are not meeting expectations with sales per square foot only 68% of the national average. Finally, the Airport is working closely with the concessionaires to implement new marketing campaigns to increase the visibility of their concessions to passengers.

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

As noted above, should concessionaires not meet their MAG obligations, the Airport risks losing the associated MAG revenue and faces the prospect of additional reductions of a staff that has been reduced by 50% in the past two years to the detriment of service to passengers and tenants.

4. Council action required?

Council action will be required to amend the Clear Channel agreement to consolidate the capital investment categories. Council action will also be required to approve the new pricing policy to be incorporated into the food & beverage and retail concession agreements.

5. Implementation Schedule/Timetable:

The pricing policy is expected to be finalized with the concessionaires and brought to Council in June 2011. Amendments to the Clear Channel agreement and the food & beverage and retail agreements are expected to be executed in the 1st quarter of fiscal year 2011/2012.