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Date: 6/15/11  
 Submitted in TCT Committee  
 Council File No: 11-0626-51  
 Item No.: 2  
 Deputy: Adam R. Lid

0150-09559-0000

**TRANSMITTAL**

TO Gina Marie Lindsay, Executive Director Department of Airports	DATE	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT	

**Request for Consideration of a Proposed 10-Year Airline Terminal Space Lease and License Agreement Between Alaska Airlines and the Los Angeles World Airports Relative to Leased Space, Terminal Charges, and Planned Construction at the Los Angeles International Airport**

Transmitted for further processing, including Council consideration. See the City Administrative Officer report attached.

MAYOR

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REPORT FROM

## OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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Date: June 10, 2011

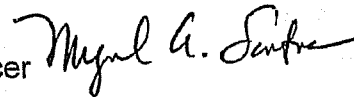
CAO File No.: 0150-09559-0000

Council File No.:

Council District: 11

To: The Mayor

From: Miguel A. Santana, City Administrative Officer



Reference: Transmittal from the Department of Airports dated April 1, 2011; referred by the Mayor for report on April 1, 2011

Subject: **PROPOSED TEN-YEAR AIRLINE TERMINAL SPACE LEASE AND LICENSE AGREEMENT BETWEEN ALASKA AIRLINES AND THE LOS ANGELES WORLD AIRPORTS RELATIVE TO LEASED SPACE, TERMINAL CHARGES, AND PLANNED CONSTRUCTION AT THE LOS ANGELES INTERNATIONAL AIRPORT**

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### SUMMARY

The Executive Director of the Los Angeles World Airports (LAWA; Department) requests authority to execute a ten-year Airline Terminal Space Lease and License Agreement (copy attached) with Alaska Airlines, Inc. (lessor) for the use of 15,990 square feet of space on the Lease Commencement Date, which will increase to 67,410 square feet on the Rent Commencement Date, in Los Angeles International Airport (LAX) Terminal 6. Upon approval of the Terminal Space Lease and License Agreement, LAWA will be able to enter into a related Settlement Agreement that will resolve all outstanding litigation between Alaska Airlines and LAWA for issues involving past terminal charges and a Reimbursement Agreement for reimbursement of Alaska Airlines for design and construction costs for an inline Checked Baggage Inspection System (CBIS) project in Terminal 6. The proposed lease space in and renovations to Terminal 6 will consist of (1) passenger processing areas, including construction of new ticket counters, an expanded passenger screening checkpoint, and construction of a new baggage screening system; and (2) passenger amenities, including construction of a new VIP lounge and renovated passenger waiting areas ("holdrooms").

The proposed lease will allow the lessor to continue, and expand, its passenger services operations at LAX. If approved, the Airline Terminal Space Lease and License Agreement (Space Lease and License Agreement) term could begin as early as the third quarter of 2011 and conclude in 2021. As an initial step in the process, the Space Lease and License Agreement will provide Alaska Airlines with (1) a right of entry to the Terminal 6 areas designated for renovation; and (2) the authority to assume, from LAWA, maintenance of existing building systems that will be affected by the renovations. Execution of the proposed Space Lease and License Agreement will also enable LAWA to reimburse Alaska Airlines for approved expenditures incurred to relocate airlines and other tenants from Terminal 6 to facilitate the renovations.

The following table reflects the primary components of the three inter-related agreements, two of which (the Settlement Agreement and the Reimbursement Agreement) can only be executed upon the Mayor and Council first approving the Airline Terminal Space Lease and License Agreement:

Alaska Airlines LAX Terminal 6 Proposed Lease & License, Settlement, & Reimbursement Agreements		
Agreement	Agreement Components/Characteristics	Term
Airline Terminal Space Lease and License Agreement	Provides for Relocation of Operations from Terminals 2 & 3 to Terminal 6	10 Yrs.
	Provides for Relocation of Various Airlines to Other Portions of the Terminal & to Other Terminals	
	Provides for Significant Construction & Renovations to Terminal 6	
	As a Condition of the Settlement Agreement, Fulfills Certain Terms of and Provides for Dismissal of Said Agreement	
Settlement Agreement	Provides for Repurchase Options and Reimbursement Obligations by LAWA of Construction & Renovations Provides for the Dismissal of the Lawsuit by Alaska Airlines and Establishment of the Terminal 6 Lease	Concurrent with Execution of Terminal Space Lease & License Agreement
Reimbursement Agreement	Provides for the Reimbursement of Alaska Airlines for Approved Project Expenses (e.g., Engineering, Design, Program Management, Licenses, Permits, Insurance, Approvals, Equipment Purchases, Construction, Change Orders, As-Built Drawings, Close-Out, etc.) in Connection With Renovations to Terminal 6. Serves as a "Pass Through" to Allow for TSA Funding to be Provided to Alaska Airlines for Construction of an In-Line Checked Baggage Inspection System (CBIS)	Three Years from Date of Notice to Proceed

### Airline Terminal Space Lease and License Agreement with Alaska Airlines

Alaska Airlines originally occupied space in Terminal 3. However, in order to expand its operations, to enable the processing of international passengers, and to align its objectives for LAX with those of its business partner, Delta Airlines, Alaska Airlines is seeking to relocate its passenger processing operations to Terminal 6. As such, Alaska Airlines has proposed renovations to Terminal 6 with an estimated value of \$271 million, to include new ticket counters, a new VIP lounge, updated passenger waiting areas, an expanded passenger screening checkpoint, and construction of a new inline baggage screening system. In addition, Alaska Airlines will assume the management of various building systems in Terminal 6 while renovations are in progress. At the conclusion of construction, LAWA will purchase certain of the renovations from Alaska Airlines and then lease them back to the airline for a 10-year term with Alaska Airlines receiving preferential use of the holdrooms.

The table below illustrates the financing plan and source of funds for the proposed \$271 million renovation of LAX Terminal 6:

Alaska Airlines LAX Terminal 6 Lease - Financing Plan and Source of Funds			
Projected Financing Plan		Projected Source of Funds	
Uses	Amount	Sources	Amount
Alaska Proprietary Improvements (Club Room, Finishes, etc.)	\$18,600,000	Alaska Airlines Invested Capital	\$18,600,000
Airline Relocations	\$12,700,000		
In-Line CBIS* (includes TSA Reimbursable Portion)	\$62,000,000		
Terminal Building Improvements (Airline share)	\$99,800,000		
Terminal Building Improvements (Non-airline share)	\$77,900,000		
		Alaska Commercial Paper/Long Term Debt	\$156,500,000
		LAWA Cash/PFC** Collections/TSA Reimbursements	\$95,900,000
	\$271,000,000		\$271,000,000
* CBIS - Checked Baggage Inspection System			
**PFC - Passenger Facility Charge			

The last time that significant renovations were undertaken in LAX Terminal 6 was 30 years ago. As a consequence, the terminal and its associated operations and systems are in need of major improvements and upgrades, especially with respect to state-of-the-art baggage screening systems, passenger processing, and passenger amenities. The following represents the major, though not necessarily all, renovations proposed by Alaska Airlines for Terminal 6:

- Design and install a new, shared (with other airlines) inline CBIS and baggage sorting system
- Upgrade passenger holdrooms and provide Federal Inspection Services (for international flights) capability for at least two additional gates that currently have domestic capabilities only
- Install common use systems (e.g., shared baggage check-in equipment, gate boarding equipment, and flight and baggage information displays) to allow any airline to use Alaska Airlines' gates for passenger processing
- Expand the Terminal 6 west ticket counter lobby
- Enlarge the passenger security screening checkpoint
- Create consolidated operations space
- Construct a new VIP passenger lounge
- Conduct initial work in preparation for LAWA's escalator replacement plans for certain areas of the terminal
- Upgrade the building infrastructure required to support the above facility improvements

To accommodate the renovations to Terminal 6 and the post-construction occupancy by Alaska Airlines, the proposed lease specifies the following: (1) LAWA will provide Alaska Airlines with rental credits to cover the expenses related to the relocation of current occupants (airlines and tenants) of Terminal 6; and (2) LAWA will purchase from Alaska Airlines, using a combination of reimbursements and rental credits, certain improvements included as part of the Terminal 6 Airlines Renovations (the credits will be spread equally over the 10-year agreement in the event that LAWA fails to exercise an option to purchase certain of the improvements included in the Terminal 6 Renovations upon completion; the purchase is subject to future approval of the Board of Airport Commissioners). The uniqueness of this arrangement is the fact that the terminal renovations will be financed by Alaska Airlines, then purchased by LAWA, then leased-back to Alaska Airlines.

With the approval of the proposed Terminal Space Lease and License Agreement, LAWA will issue rental credits to Alaska Airlines in an amount not to exceed \$12,682,371 for relocation of airlines and other tenants in Terminal 6 that will reduce future revenues from landing fees and terminal rents. The Department will also be obligated to purchase the Terminal 6 Airline Renovations (the airline's share of the improvements) from Alaska Airlines at the completion of construction. In order to finance the purchase, the Board will be requested to appropriate funds in an amount not to exceed \$161,706,413 from the LAX Revenue Fund to cover costs of Airline Renovations and TSA (Transportation Security Administration) reimbursements for the baggage screening system. The appropriation will include funds to reimburse Alaska Airlines for expenditures incurred for design and construction of the inline CBIS for Terminal 6 in accordance with a reimbursement agreement between LAWA and Alaska Airlines and predicated upon the approval of the Board of Airport Commissioners (Board).

In addition to the above, LAWA will be obligated to issue further Rental Credits to Alaska Airlines if the Department does not exercise its option to purchase the Terminal 6 Renovations (the airlines' share of the improvements). Rental Credits in the amount of \$77,923,234, including interest, would be issued over the 10-year term of the lease in equal installments until the credits have been fully used or LAWA purchases the remaining principal balance of the credits. The lease provisions allow LAWA to recover amounts expended for airline and tenant relocations, the cost of the Terminal 6 Airline Renovations, and other terminal capital investments through the establishment of future rent charges. The funds associated with the Terminal 6 Renovations will be obtained through LAX's equity and/or the Passenger Facility Charge collections. The proposed lease will generate approximately \$4.2 million in first-year revenue for LAWA.

### **Settlement Agreement Between Alaska Airlines and LAWA**

As a consequence of litigation brought by several domestic airlines (known as the "T1/T3 Airlines") against LAWA (termed "LAX III") for what were alleged to be unreasonable and unjustly discriminatory charges implemented by LAWA in 2006/07 to recover costs for (1) increased security and (2) increased maintenance and operating costs at LAX, a U.S. Department of Transportation decision, followed by a 2009 U.S. District Court of Appeals decision, were rendered. In an attempt to resolve the litigation, a Settlement Agreement with one of the parties to the original administrative complaint, Alaska Airlines, is being proposed by LAWA.

As part of the resolution of the LAX III litigation, Alaska will enter into a 10-year lease for space in Terminal 6 to be accompanied by significant renovations, and finance those renovations subject to (1) reimbursement by the Transportation Security Administration—through LAWA—for certain design and construction costs for the inline baggage screening systems; (2) the purchase of certain improvements by LAWA; and (3) the reimbursement by LAWA of certain costs associated with the improvements.

### **Reimbursement Agreement Between Alaska Airlines and LAWA**

Under the terms of the Reimbursement Agreement, Alaska Airlines will oversee and finance the design; engineering; and modification of the Terminal 6 baggage conveyor system, as well as the installation of a TSA-approved in-line baggage inspection system (CBIS), which includes an explosive detection system; and provision of as-built drawings at the conclusion of the project. The approved expenditures (summarized in the table on page 2) for the above items will be reimbursed by LAWA.

### **Leased Space – Alaska Airlines**

On the date the Terminal Space Lease and License Agreement is executed (approximately July 2011), the space leased by Alaska Airlines in Terminal 6 will comprise 15,990 square feet. This date is referred to as the "Lease Commencement Date." Subsequently, on the date when all renovations are completed (approximately July 2012) and Alaska Airlines takes possession of the fully renovated space (referred to as the "Rent Commencement Date") which, in addition to the space needed for its passenger processing, will include space for additional holdrooms and baggage areas, the total leased space will increase to 67,410 square feet. At that time, when Alaska Airlines begins flight operations from Terminal 6, or on April 1, 2012, whichever occurs first, the airline will begin paying rent to LAWA for the 67,410 square foot space. In addition, Alaska Airlines will pay approximately \$4,200,000 in construction rent to compensate LAWA for lost revenue resulting from terminal renovations and the additional space occupied by the airline during construction. Rental costs will be based upon either Alaska Airlines' total leased square footage or on what is known as the Unified Capital Charge (UCC) yet to be approved by the Board of Airport Commissioners. Alaska Airlines has already agreed to be subject to the UCC if it is approved by the Board. Upon completion of the renovations, Alaska Airlines will pay all Maintenance and Operations expenses applicable to areas either occupied or used by the airline.

Execution of the proposed lease with Alaska Airlines will also enable LAWA to provide rental credits of up to \$12,682,371 to help cover expenses related to Alaska Airlines' relocation of eight Terminal 6 airlines and various tenants who will be displaced by the renovations. Those costs may be recovered through future rent charges or the Passenger Facility Charge Collections.

### **LAWA Buy-Back of Terminal 6 Renovations**

Once the approved renovations have been completed by Alaska Airlines—which include installation of the inline baggage handling system, jet bridge renovations, the common use systems, new ticket counters and VIP passengers lounge, updated passenger holdrooms, and an expanded passenger screening checkpoint—LAWA will purchase certain of the improvements for an amount not-to-

exceed \$143,778,833. Beyond that amount, it is estimated that approximately \$17,927,580 will be provided by the Transportation Security Administration to LAWA who will then reimburse Alaska Airlines for approved expenditures for installation of the inline Checked Baggage Inspection System. The Terminal 6 renovations are divided into ten components; each component will be purchased by LAWA as it is completed.

Improvements unique to Alaska Airline's needs, such as specialty lighting, specific finishes, and other architectural elements—estimated to cost approximately \$18,606,322—will be funded by Alaska Airlines and are not subject to reimbursement or buy-back.

### **Alternative to the Proposed Terminal Space Lease and License Agreement**

According to the Department, it is advisable to authorize LAWA to execute the proposed Terminal Space Lease and License Agreement with Alaska Airlines, Inc. in that (1) approval of the lease is a condition of the Settlement Agreement which, if not concluded, could result in continued litigation; and (2) approval of the lease will facilitate both Alaska Airlines' \$271 million in Terminal 6 renovations and the airline's relocation to the terminal which, in turn, will accommodate improved passenger processing.

### **Compliance with City Administrative Requirements**

In that the proposed agreement is a property lease and involves the use of independent contractors, the Department's request is not subject to the provisions of Charter Section 1022.

With respect to CEQA (California Environmental Quality Act) compliance, the issuance of permits, leases, agreements, renewals, or amendments granting use of an existing facility involving no expansion of use at a municipal airport is exempt from the requirements of the CEQA pursuant to Article III, Class 1(18)(c) of the Los Angeles City CEQA Guidelines. Furthermore, the lease with Alaska Airlines, Inc. is exempt from the provisions of the Minority/Women Business Enterprise program pursuant to the Mayor's Executive Directive 2001-26. Alaska Airlines is either in compliance with or LAWA will monitor and ensure compliance with the City's Service Contractor Worker Retention and Living Wage Ordinances, Affirmative Action Program, Child Support Obligations Ordinance, the City's insurance requirements, Contractor Responsibility Program, the Equal Benefits Ordinance, and the First Source Hiring Program for all non-trade airport jobs.

Pursuant to Charter Section 606 and the Los Angeles Administrative Code Section 10.5, the proposed lease, in that it is for a cumulative period longer than five years, must be approved by the Council. Additionally, to become effective, the City Attorney must approve the lease as to form.

### **RECOMMENDATIONS**

That the Mayor:

1. Approve, subject to City Attorney approval as to form, the proposed 10-Year Terminal Space Lease and License Agreement between the Los Angeles World Airports (LAWA) and Alaska Airlines, Inc. for the renovation and use of space in the Los Angeles International Airport (LAX)



Terminal 6, for the purpose of continuing and expanding its passenger services operations at LAX and facilitating the settlement of litigation between Los Angeles World Airports and Alaska Airlines, Inc. over a dispute involving past terminal charges; and

2. Return the proposed Airline Terminal Space Lease and License Agreement to the Department for further processing, including Council consideration.

### **FISCAL IMPACT STATEMENT**

Approval of the proposed Terminal Space Lease and License Agreement with Alaska Airlines, Inc. will result in first-year revenues of approximately \$4.2 million and full cost recovery of approximately \$271 million over a 10-year period as a result of future rent charges to airlines and tenants of Terminal 6 and from Transportation Security Administration grant funding for approved checked baggage inspection systems. Since the Los Angeles World Airports is bound only by the City Debt Management Policies, the City Financial Policies are not applicable. Approval of the proposed Space Lease and License Agreement will have no impact on the City's General Fund.

### **Time Limit for Council Action**

Pursuant to Charter Section 606, "Process for Granting Franchises, Permits, Licenses and Entering Into Leases," and the Los Angeles Administrative Code Section 10.5, "Limitation and Power to Make Contracts," unless the Council takes action disapproving a contract that is longer than five years within 30 days after submission to Council, the contract shall be deemed approved.

*MAS:WDC:10110120*

Attachment

