



*Los Angeles
World Airports*

February 14, 2013

The Honorable City Council
of the City of Los Angeles
City Hall – Room 395
Los Angeles, CA 90012

LAX

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Gina Marie Lindsey
Executive Director

Reference: CF 13-0171

This is to hereby transmit for your information the Mayor approved City Administrative Officer's report regarding the lease with Southwest Airlines Company covering premises located in Terminal 1 at Los Angeles International Airport.

Sincerely,

Mark S. Adams
Chief, Government Affairs Division
Los Angeles World Airports

Attachments



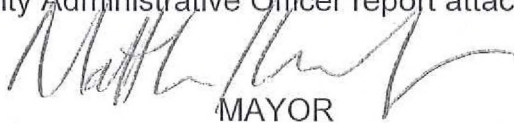
0150-00939-0115

TRANSMITTAL

TO Gina Marie Lindsey, Executive Director Department of Airports	DATE FEB 11 2013	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT 11	

Proposed Ten-Year Airline Terminal Facilities Lease and License Agreement Between Southwest Airlines Company and the Los Angeles World Airports Relative to Leased Space, Terminal Charges, and Planned Renovations at the Los Angeles International Airport, Terminal 1

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


MAYOR

MAS:WDC: 101300871

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: February 6, 2013

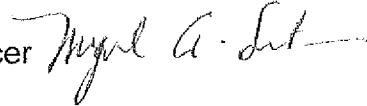
CAO File No.: 0150-00939-0115

Council File No.:

Council District: 11

To: The Mayor

From: Miguel A. Santana, City Administrative Officer



Reference: Transmittal from the Department of Airports dated January 7, 2013; referred by the Mayor for report on January 11, 2013

Subject: **PROPOSED TEN-YEAR AIRLINE TERMINAL FACILITIES LEASE AND LICENSE AGREEMENT BETWEEN SOUTHWEST AIRLINES COMPANY AND THE LOS ANGELES WORLD AIRPORTS RELATIVE TO LEASED SPACE, TERMINAL CHARGES, AND PLANNED RENOVATIONS AT THE LOS ANGELES INTERNATIONAL AIRPORT, TERMINAL 1**

SUMMARY

The Executive Director of the Los Angeles World Airports (LAWA; Department) requests authority to execute a ten-year Airline Terminal Facilities Lease and License Agreement with Southwest Airlines Company (Southwest Airlines; lessor) for the use of 116,270 square feet of space on the Lease Commencement Date, in Los Angeles International Airport (LAX) Terminal 1. With the approval of the Terminal Facilities Lease and License Agreement, LAWA will be able to enter into a related Settlement Agreement that will resolve all outstanding litigation between Southwest Airlines and LAWA for issues involving disputed terminal charges. The proposed lease space in and renovations to Terminal 1 will include (1) improving the passenger security screening checkpoint; (2) relocating US Airways to Terminal 3 to facilitate Terminal 1 improvements; (3) designing and implementing a new in-line Checked Baggage Inspection System (CBIS) and baggage sorting system; (4) upgrading 12 passenger "holdrooms" and associated building infrastructure; (5) refurbishing the arrival and baggage claim area; (6) replacing passenger boarding bridges; (7) renovating airline support office space; and (8) replacing sections of aircraft parking area paving and associated fuel hydrant pit locations. The renovation costs will be paid by Southwest Airlines; however, some improvements will be reimbursed through rental credits while others will be purchased outright by LAWA. The proposed lease is expected to begin in February 2013 and conclude on June 30, 2024.

During the first year of the lease, approximately \$9,523,000 in revenue to LAWA will be generated with subsequent years' revenue to be determined by rental rates approved by the Board of Airport Commissioners (Board). Once the Terminal 1 renovations are completed, including those to the CBIS and passenger loading bridges (also referred to as passenger walkways or jet bridges), LAWA will purchase the improvements from, and lease them back to, Southwest Airlines. Improvements unique to Southwest Airlines' needs ("Proprietary Improvements"), such as specialty lighting, specific finishes,

and other architectural elements—estimated to cost approximately \$16,147,000—will be funded by Southwest Airlines and are not subject to reimbursement or buy-back.

Included in the proposed lease is the preferential use by Southwest Airlines of 12 gates in Terminal 1 (LAWA is retaining two common-use gates for future airlines' needs). Additionally, preferential gate use scheduling for both preferential-use and common-use gates will be extended to Southwest Airlines at the discretion of the Department. The above-referenced aspects of the proposed lease, and this report, incorporate revised information received from the Department subsequent to the initial request submittal.

The following table reflects the primary components of the proposed Terminal Facilities Lease and License Agreement:

Southwest Airlines LAX Terminal 1 Lease - Primary Components			
Description	Detail	Financing	Comments
Lease Term	3/13 - 6/30/14		10-Years
Estimated Rental Space	116,270 Sq Feet		
First-Year LAWA Revenue	\$9,523,000		
Southwest Airlines' Investment in T-1		\$400,155,000	
		\$14,657,000	Part of \$384,008,000 in "Non-Proprietary Improvements." Amount is for relocating US Airways from T-1 to T-3 to enable T-1 renovations. Costs are subject to rental credits reimbursement by LAWA
Breakdown of T-1 Investment*		\$222,422,000	Part of \$384,008,000 in "Non-Proprietary Improvements." Improvements to "airline areas," areas that are usable by any airline operating in T-1. Improvements to be purchased by LAWA after completion. Approximately \$29.6 million in anticipated TSA funding will be used to offset design & construction costs for new in-line CBIS
		\$146,929,000	Part of \$384,008,000 in "Non-Proprietary Improvements." Improvements to "public areas," areas not specific to any airline. Costs are subject to rental credits reimbursement by LAWA unless LAWA decides to purchase improvements
		\$16,147,000	"Proprietary Improvements" unique to Southwest Airlines' operational needs (e.g., specialty lighting, finishes, architectural elements). Cost are not subject to rental credit reimbursement by LAWA

*See Rpt. Attachments 1 - A through D

The LAX Terminal 1 was built in the mid-1980s, and there have been no major renovations since that time. 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, passenger amenities, and building systems (e.g., mechanical, electrical, and plumbing). The following lists the major, though not necessarily all, renovations proposed to be completed by Southwest Airlines for Terminal 1 (see Attachments 1- A through D for details):

- Renovate arrivals level on west side of ticketing building, including installation of new baggage claim devices; replace mechanical, electrical, and plumbing systems, as well as building finishes
- Renovate departure and mezzanine levels on west side of ticketing building, including new ticket counters; replace mechanical, electrical, and plumbing systems, as well as building finishes. Install new security screening checkpoint on mezzanine level
- Renovate east side of arrivals level of ticketing building to enable installation of new in-line baggage screening system
- Renovate departure and mezzanine levels on east side of ticketing building, including new ticket counters; replace mechanical, electrical, and plumbing systems, as well as building finishes. Install new security checkpoint on departure level
- Renovate concourse, including replacement and/or upgrading of mechanical, electrical, and plumbing systems. Reconfigure layout to provide coordinated approach to holdrooms and concessions. Reconfigure support space on lower level to accommodate relocated functions resulting from security and ticketing improvements
- Install terminal-wide premise distribution and paging system
- Reconfigure aircraft parking (including new apron paving, striping, and fuel hydrant pit relocations) to accommodate new, larger aircraft parking gates. Replace all passenger loading bridges, pre-conditioned air, and potable water equipment. Upgrade battery chargers for electric ground support equipment
- Install secure connector between Terminals 1 and 2
- Construct canopy over departures curb between Terminals 1 and 2

Proposed Funding for Terminal 1 Renovations

To facilitate the renovations to Terminal 1 and the post-construction occupancy by Southwest Airlines, the proposed lease specifies the following: (1) LAWA will provide Southwest Airlines with rental credits to cover expenses related to the relocation of US Airways from Terminal 1 to Terminal 3 (approximately \$14,657,000); (2) LAWA will provide rental credits to Southwest Airlines for improvements to the "public areas" (approximately \$146,929,000) spread equally over the 10-year term of the lease, including annualized accrued interest at four percent on the outstanding principal unless the improvements are purchased by LAWA; and (3) upon completion of the renovations, LAWA will purchase Southwest Airlines improvements (approximately \$222,422,000) made to the "airline areas," those areas used by any airline operating out of Terminal 1. Anticipated Transportation Security Administration (TSA) funding in the amount of \$29.6 million will be used by LAWA to offset the improvements cost to the airline areas. Proprietary Improvements made by Southwest Airlines that

uniquely benefit the airline will not be subject to reimbursement by LAWA or rental credits. The benefit of this arrangement is that the terminal renovations will be financed by Southwest Airlines, then purchased by LAWA (with the exception of the Proprietary Improvements), then leased back to Southwest Airlines thereby minimizing the up-front capital investment by LAWA. To enable the Department to purchase the improvements made to the "airline areas," an allocation of \$222,422,000 will be requested from the LAX Revenue Fund to WBS (Work Breakdown Structure) Element 1.13.11-700 (Terminal 1 Renovations).

The funds associated with the Terminal 1 renovations will be obtained through LAX's terminal rental rate base and, if available (and only for some portions), the Passenger Facility Charge collections. The proposed lease will generate approximately \$9,523,000 in first-year revenue for LAWA.

BACKGROUND

Proposed Settlement Agreement with Southwest Airlines

As a result 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, was rendered. In an attempt to resolve the litigation, a Settlement Agreement with one of the parties to the original administrative complaint, Southwest Airlines, is being proposed by LAWA as part of the proposed action. The Settlement Agreement was executed by the Department and Southwest Airlines on January 14, 2013.

As part of the resolution of the LAX III litigation, Southwest Airlines will enter into a 10-year lease for space in Terminal 1 to be accompanied by significant renovations, and finance those renovations subject to (1) reimbursement by the TSA—through LAWA—for design and construction costs for the in-line baggage screening systems; (2) the purchase of certain improvements by LAWA; and (3) the issuance of rental credits for costs attributable to relocating US Airways from Terminal 1 to 3 and Terminal 1 renovations.

TSA Partial Reimbursement of Security-Related Costs

To help airports cope with the added security costs necessitated by the September 11, 2001 terrorist attacks, the TSA has been providing partial reimbursement to LAWA of expenditures (e.g., design, engineering, construction, and management) for in-line Checked Baggage Inspection Systems and baggage sorting systems at LAX and Los Angeles/Ontario International Airport (LA/ONT). To date, the Department has received \$253,930,357 in TSA reimbursements for initial security projects at the LAX Tom Bradley International Terminal and Terminal 3 and for LA/ONT. Subsequent funding in the amount of \$200 million has been approved by the TSA for security projects at LAX involving Terminals 1, 2, 4, 6, 7, and 8 for which \$23,912,730 has been received to date. Consequently, of the \$456,467,000 committed by TSA for LAWA security-related projects, \$277,843,087 has been received.

Leased Space – Southwest Airlines

On the date the Terminal Facilities Lease and License Agreement is executed (known as the "Lease Commencement Date," which is approximately February 2013), the space leased by Southwest Airlines in Terminal 1 will comprise 116,270 square feet. Required changes to the originally-proposed square footage, if more than 2,000 square feet but less than ten percent of the overall project, will be subject to Board approval. Changes in excess of ten percent of the overall project will require City Council approval. The proposed lease contains an early termination option. During the first 180 days, Southwest Airlines may decline to construct the \$400,155,000 in Terminal Renovations as discussed above. In that case, the 10-year lease term would be reduced to three years to reflect the fact that the original lease term is predicated on Southwest Airlines completing the Terminal 1 renovations.

Airline rental rates for the leased space in Terminal 1 are established by the Rate Agreement executed by LAWA and Southwest Airlines on December 26, 2012, subject to periodic changes as specified.

Alternative to the Proposed Terminal Facilities Lease and License Agreement

Per the Department, it is advisable to authorize LAWA to execute the proposed Terminal Facilities Lease and License Agreement with Southwest Airlines 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 Southwest Airlines' investment in Terminal 1 renovations and implementation of the new in-line Checked Baggage Inspection Systems which, in turn, will improve security at LAX and 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.

In terms of 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 Southwest Airlines is exempt from the provisions of the Minority/Women Business Enterprise program pursuant to the Mayor's Executive Directive 2001-26. Southwest Airlines is either in compliance with or LAWA will monitor and ensure compliance with the Affirmative Action Program and Child Support Obligations Ordinance. Southwest Airlines is not subject to the provisions of the Living Wage/Service Contractor Worker Retention Ordinances, Contractor Responsibility Program, Equal Benefits Ordinance, First Source Hiring Program, and the Bidder Contributions CEC (City Ethics Commission) Form 55.

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 Facilities Lease and License Agreement between the Los Angeles World Airports (LAWA) and Southwest Airlines Co., for the renovation and use of space in the Los Angeles International Airport (LAX) Terminal 1, 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 Southwest Airlines over a dispute involving past terminal charges; and
2. Return the proposed Airline Terminal Facilities Lease and License Agreement to the Department for further processing, including Council consideration.

FISCAL IMPACT STATEMENT

Approval of the proposed Terminal Facilities Lease and License Agreement with Southwest Airlines Co., will result in (1) first-year rental revenues to LAWA of \$9,523,000; (2) approximately \$400,155,000 in renovations made by Southwest Airlines to Terminal 1 at LAX, \$16,147,000 of which will be proprietary renovations to be paid by the airline; and (3) up to \$384,008,000 in rental credits or acquisition costs paid to Southwest Airlines by LAWA. In addition, reimbursements to LAWA of approximately \$29,600,000 are anticipated from the Transportation Security Administration for costs associated with implementing new checked baggage inspection systems in Terminal 1. While the renovation costs will be paid by Southwest Airlines, some improvements (as noted above) will be reimbursed through rental credits while others will be purchased outright by LAWA. As a consequence of the above, LAWA is requesting that the Board of Airport Commissioners allocate a not-to-exceed amount of \$222,422,000 from the LAX Revenue Fund to WBS (Work Breakdown Structure or "cost center") Element 1.13.11-700 (Terminal 1 Renovations) as needed to reimburse Southwest Airlines and/or provide rental credits for Terminal 1 renovations. This project, the proposed Terminal Facilities Lease and License Agreement, and the related Settlement Agreement comply with the Department of Airports adopted Financial Policies. Approval of the Terminal Facilities Lease and License Agreement and the Settlement 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:10130087

Attachments

ATTACHMENT 1 - A

Schedule 1 - Attachment A Summary of Proposed Terminal 1 Renovations

Scope Component	Description
1. Relocations	The relocation of US Airways to Terminal 3, including the relocation of other parties in Terminal 3 as necessary.
2. West Ticketing – Arrivals Level	The renovation of the arrivals level on the west side of the ticketing building, including installation of new baggage claim devices, replacement of MEP systems and building finishes.
3. West Ticketing – Departure and Mezzanine Levels	The renovation of the departure and mezzanine levels on the west side of the ticketing building, including new ticket counters, replacement of MEP systems and building finishes. Also includes a new security screening checkpoint on the mezzanine level.
4. Inline Checked Baggage Inspection System and Facilities	The installation of a new inline baggage screening system. Also includes the renovation of the east side of the arrivals level of the ticketing building to enable the installation of the inline baggage system.
5. East Ticketing – Departure and Mezzanine Levels	The renovation of the departure and mezzanine levels on the east side of the ticketing building, including new ticket counters, replacement of MEP systems and building finishes. Also includes a new security screening checkpoint on the departure level.
6. Concourse	Renovate the entire concourse, replacing and upgrading MEP systems. Reconfigure the layout to provide a coordinated approach to holdrooms and concessions. Reconfigure support space on the lower level to accommodate relocated functions as the result of the ticketing and security checkpoint work.
7. Information Technology	Installation of a terminal wide premise distribution system and paging system.
8. Gate Systems	Reconfiguration of the aircraft parking to accommodate full B737-800W parking at 13 gates, including new apron paving, striping and fuel hydrant pit relocations. Replacement of all passenger loading bridges, 400Hz, pre-conditioned air and potable water equipment. Upgrade the battery chargers for GSE.
9. Terminal 2 Connector	Installation of a secure connector between Terminals 1 and 2.

ATTACHMENT 1 - A

Schedule 1 - Attachment A

Summary of Proposed Terminal 1 Renovations

Scope Component	Description
10. Curbside Canopy	Construction of a canopy over the departures curb between Terminals 1 and 2.
TOTAL PROJECTED COST	\$400,155,000

ATTACHMENT 1 - B

Schedule 1 – Attachment A T1 Airline Renovations

In general, Airline Renovations are improvements that are:

- (a) Usable by any airline operating in Terminal 1.
- (b) To the parts of the building classified as “airline.”
- (c) In cases of base building infrastructure, the portion of the improvement allocated to Airline is based on the ratio of Airline to Public space in Terminal 1.

The specific components are listed below.

Scope Component	Description
1. West Ticketing – Arrivals Level	The renovation of the arrivals level on the west side of the ticketing building, including installation of new baggage claim devices, replacement of MEP systems and building finishes.
2. West Ticketing – Departure and Mezzanine Levels	The renovation of the departure and mezzanine levels on the west side of the ticketing building, including new ticket counters, replacement of MEP systems and building finishes. Also includes a new security screening checkpoint on the mezzanine level.
3. Inline Checked Baggage Inspection System and Facilities	The installation of a new inline baggage screening system. Also includes the renovation of the east side of the arrivals level of the ticketing building to enable the installation of the inline baggage system.
4. East Ticketing – Departure and Mezzanine Levels	The renovation of the departure and mezzanine levels on the east side of the ticketing building, including new ticket counters, replacement of MEP systems and building finishes. Also includes a new security screening checkpoint on the departure level.
5. Concourse	Renovate the entire concourse, replacing and upgrading MEP systems. Reconfigure the layout to provide a coordinated approach to holdrooms and concessions. Reconfigure support space on the lower level to accommodate relocated functions as the result of the ticketing and security checkpoint work.
6. Information Technology	Installation of a terminal wide premise distribution system and paging system.

ATTACHMENT 1 - B

Schedule 1 – Attachment A
T1 Airline Renovations

Scope Component	Description
7. Gate Systems	Reconfiguration of the aircraft parking to accommodate full B737-800W parking at 13 gates, including new apron paving, striping and fuel hydrant pit relocations. Replacement of all passenger loading bridges, 400Hz, pre-conditioned air and potable water equipment. Upgrade the battery chargers for GSE.
TOTAL PROJECTED COST	\$222,422,000

ATTACHMENT 1 - C

Schedule 1 – Attachment A T1 Terminal Renovations

In general, Terminal Renovations are the improvements that are:

- (a) Expansion of the overall building footprint and envelope.
- (b) To the public areas of the building.
- (c) In cases of base building infrastructure, the portion of the improvement allocated to the Terminal is based on the ratio of Airline to Public space in Terminal 1.

The specific components are listed below.

Scope Component	Description
1. West Ticketing – Arrivals Level	The renovation of the arrivals level on the west side of the ticketing building, including installation of new baggage claim devices, replacement of MEP systems and building finishes.
2. West Ticketing – Departure and Mezzanine Levels	The renovation of the departure and mezzanine levels on the west side of the ticketing building, including new ticket counters, replacement of MEP systems and building finishes. Also includes a new security screening checkpoint on the mezzanine level.
3. Inline Baggage System and Facilities	The installation of a new inline baggage screening system. Also includes the renovation of the east side of the arrivals level of the ticketing building to enable the installation of the inline baggage system.
4. East Ticketing – Departure and Mezzanine Levels	The renovation of the departure and mezzanine levels on the east side of the ticketing building, including new ticket counters, replacement of MEP systems and building finishes. Also includes a new security screening checkpoint on the departure level.
5. Concourse	Renovate the entire concourse, replacing and upgrading MEP systems. Reconfigure the layout to provide a coordinated approach to holdrooms and concessions. Reconfigure support space on the lower level to accommodate relocated functions as the result of the ticketing and security checkpoint work.
6. Information Technology	Installation of a terminal wide premise distribution system and paging system.
7. Terminal 2 Connector	Installation of a secure connector between Terminals 1 and 2.

ATTACHMENT 1 - C

Schedule 1 – Attachment A
T1 Terminal Renovations

Scope Component	Description
8. Curbside Canopy	Construction of a canopy over the departures curb between Terminals 1 and 2.
TOTAL PROJECTED COST	\$146,929,000

ATTACHMENT 1 - D

Schedule 1 -- Attachment A
Southwest Renovations

In general, the Southwest Renovations are the improvements that are:

- (a) Branded.
- (b) Unique to SOUTHWEST's specific operational needs, such that it is not reasonable to assume that another airline could use the improvement without modification.
- (c) Specialty lighting, finishes and other architectural elements specifically selected by SOUTHWEST.
- (d) Interior construction of all exclusive lease spaces.

Specifically, the Southwest Renovations include, but are not limited to:

Scope Component	Description
1. West Ticketing – Arrivals Level	Interior build out of a new Southwest Airlines baggage service office. All branded signage and displays. Relocation of Southwest baggage service operations.
2. West Ticketing – Departure and Mezzanine Levels	New ticket counter and curbside millwork, signage and equipment. Interior build out of new Southwest Airlines demised premises. All branded signage and displays. Relocation of Southwest ticketing operations.
3. East Ticketing – Departure and Mezzanine Levels	Interior build out of new Southwest Airlines demised premises. All branded signage and displays. Relocation of Southwest operations.
4. Concourse	New gate millwork and equipment. Interior build out of new Southwest Airlines demised premises. All branded signage and displays. Relocation of Southwest operations.
5. Gate Systems	Upgrade the battery chargers for Southwest electric GSE. Revised gate striping.
TOTAL PROJECTED COST	\$16,147,000