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TRANSMITTAL

TO
Deborah Flint, Executive Director
Department of Airports

DATE
08/11/16

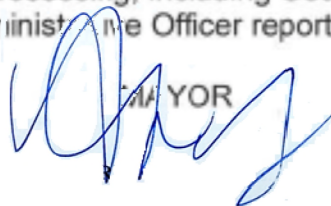
COUNCIL FILE NO.

FROM
The Mayor

COUNCIL DISTRICT
11

**Proposed Terminal Facilities Lease and License Agreement
Between Delta Air Lines, Inc. and the Los Angeles World Airports
Relative to Leased Space, Terminals Relocation, and Renovations
At the Los Angeles International Airport**

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


MAYOR

(Ana Guerrero)

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: August 11, 2016

CAO File No.: 0150-10746-0000

Council File No.:

Council District: 11

To: The Mayor

From: Miguel A. Santana, City Administrative Officer

MAS
RW

Reference: Transmittal from the Department of Airports dated July 18, 2016; referred by the Mayor for report on July 18, 2016

Subject: **PROPOSED TERMINAL FACILITIES LEASE AND LICENSE AGREEMENT BETWEEN DELTA AIR LINES, INC. AND THE LOS ANGELES WORLD AIRPORTS RELATIVE TO LEASED SPACE, TERMINALS RELOCATION, AND RENOVATIONS AT THE LOS ANGELES INTERNATIONAL AIRPORT**

SUMMARY

The Executive Director of the Los Angeles World Airports (LAWA; Department) requests authority to execute a Terminal Facilities Lease and License Agreement (Agreement) with Delta Air Lines, Inc. (Delta; Lessor) for the lease and use of space in Terminals 2 and 3 at the Los Angeles International Airport (LAX). The principle purpose for the proposed Agreement is to provide (1) for the relocation of Delta from its current space in Terminals 5 and 6 to Terminals 2 and 3 no sooner than May 2017 and for the lease of space in Terminals 2 and 3, and (2) a non-exclusive license to use the terminals' common use and public areas. The Delta relocation is subject to the airline's successfully relocating other affected airlines from Terminals 2 and 3 to the vacated Terminals 5 and 6 and to the Tom Bradley International Terminal (TBIT). Delta's current lease for space in Terminals 5 and 6 will conclude on the date that the airline completes its relocation to Terminals 2 and 3 while the new lease will conclude on April 30, 2039, unless terminated earlier as provided for in the Agreement.

The relocation of Delta's operations to Terminals 2 and 3 is contingent upon (1) Delta's development of a relocation plan for the affected airlines (e.g., Air Canada, Alaska Airlines, American Airlines, Hawaiian Airlines, Virgin America, Jet Blue, etc.) that must be approved by LAWA; (2) Delta's preparation of the vacated Terminals 5 and 6 to accommodate the needs of the airlines being relocated; (3) Delta's renovation of Terminals 2 and 3 to address their specific operational needs; and (4) LAWA's successfully negotiating replacement leases, lease amendments, or new agreements with existing and new airlines and terminal occupants. Reassignment of some boarding gates may also accompany the relocations.

The proposed relocation of Delta and approximately 25 other airlines and terminal occupants (e.g., concessions) will, according to the Department, benefit LAX, the traveling public, and other airlines by requiring Delta to make a combination of "non-proprietary" (those benefitting the airport's public and general use areas, including areas benefitting the airlines being relocated) and "proprietary" (those primarily benefitting Delta's operations) improvements in the amount of \$1 billion or more.

The proposed Agreement requires Delta to invest a minimum of \$350 million in renovations to Terminals 2 and 3 and a minimum of \$650 million (total of \$1 billion) in what are termed Definitive Terminal Improvement Plans (DTIP; plans for related improvement projects) to the two terminals, both of which are required to secure the maximum 23-year lease term. While the Agreement provides for a \$1.455 billion cap on LAWA's purchase of Delta's planned and future non-proprietary improvements, a minimum \$1 billion investment is required in order for Delta to obtain the maximum lease term. Required near-term improvements to Terminals 2, 3, 5, and 6 will be purchased by LAWA for an amount not to exceed \$462.6 million using a combination of cash and rent credits. The acquisition costs will be recovered through future terminal rates and charges as per a Rate Agreement negotiated between the Department and Delta.

The proposed lease and accompanying renovations are part of LAWA's ongoing, multi-phase airport improvement plan that has resulted, or will result, in significant renovations to all LAX terminals except Terminal 4.

The Department anticipates receiving, as a consequence of the completion of renovations to Terminals 2 and 3, approximately \$4.9 million in lease revenue the first year and approximately \$1.66 billion over the 10-year period following completion of the improvements.

The proposed Agreement was approved by the Board of Airport Commissioners (Board) on July 20, 2016. For the Agreement to become effective, the City Attorney must approve it as to form. Additionally, approval by the City Council must be obtained since the lease term is for a period longer than five years. The above-referenced aspects of the proposed Lease and License Agreement, and this report, are based upon revised information received from the Department subsequent to the initial request submittal.

BACKGROUND

In 2011, the Board approved an amended Lease and License Agreement under which Delta was required to invest \$148.9 million in Terminal 5 improvements. In 2013, an amendment to the Terminal 5 lease was approved by the Board that gave Delta space in Terminal 6, required improvements by the airline, and obligated LAWA to purchase additional renovations. In 2014, the Board approved an option allowing LAWA to use cash in lieu of rent credits to purchase the renovations. And in July 2015, the Board authorized LAWA's acquisition of additional Delta improvements to Terminals 5 and 6.

The proposed Agreement not only facilitates Delta's move to Terminals 2 and 3, but is required to accommodate the airline's 150 percent increase in passenger daily departures since 2009.

A relocation plan, to be approved by the affected airlines and LAWA, will be developed by Delta (at an approximate cost of \$60 million) to ensure an optimal transition by all parties. In addition to the improvements to the four terminals required for the relocation, Delta will, once the relocation is complete, make the following additional improvements to Terminals 2 and 3 and TBIT (subject to Board approval):

- Renovate Terminal 3 to add more concession space
- Rebuild the "headhouse" (part of a passenger terminal that contains the ticket

counters, waiting rooms, baggage facilities, and restrooms) for Terminals 2 and 3 to accommodate new ticketing facilities and current-technology check-in, improve security check points, and improve the overall guest experience

- Reconstruct ramps, including concrete, fueling infrastructure, and alignment of jet bridges; upgrade aircraft safety features, including state-of-the-art guiding systems
- Develop infrastructure for the planned Automated People Mover, including vertical circulation components for both terminals

Delta's construction of a post-security passenger connector linking Terminals 2 and 3 and the TBIT is an option that may be exercised upon approval by the Board. The above-noted improvements will be acquired by LAWA, subject to Board approval, using a combination of cash and rent credits.

The lease is expected to begin in September 2016, on the first day of the month following Board and Council approval, and conclude no later than April 30, 2039. Earlier termination of the lease is possible under circumstances described in the LAWA Board report of July 20, 2016.

The proposed Lease and License Agreement contains a provision entitled "Minimum Investment Requirement" that requires Delta to invest a minimum of \$350 million in improvements to Terminals 2 and 3. The proposed improvements are categorized as either "non-proprietary" or "proprietary." Non-proprietary improvements are those able to be used by any airline operating from Terminal 2 or 3 and located in what are termed "Airline Areas" and those specifically benefitting "Public Areas." Proprietary improvements will be those primarily benefitting Delta's operations, such as specialty lighting, finishes, or architectural elements.

The Department will purchase the Minimum Investment Requirement non-proprietary improvements in an amount not to exceed \$462.6 million as follows:

- \$134,750,000 in future payments upon completion of renovations to Airline Areas
- \$327,860,000 in future rent credits for Terminal Renovations (82 percent or \$268,845,200) and Airline Relocations (18 percent or \$59,014,800)

In addition to purchasing the non-proprietary improvements to Terminals 2 and 3, there are additional, future terminal improvements that are required of Delta that LAWA is obligated to purchase—up to an Agreement maximum of \$1.455 billion.

In addition to the non-proprietary and proprietary improvements planned for Terminals 2 and 3, Delta will be required to establish agreements with airlines currently operating from the two terminals in order to accommodate their continued operations. As part of that accommodation, Delta may request that up to two TBIT Common-Use gates be converted to Delta Preferential-Use gates if justified by usage. Upon completion of the Midfield Satellite Concourse (estimated completion 2019/20), Delta may request additional TBIT Preferential-Use gates subject to compliance with applicable lease terms.

Alternatives to the Proposed Lease and License Agreement

The Department explains that there are no viable alternatives to executing the proposed lease agreement with Delta Airlines in that (1) approval is a condition of the airline's relocation from

Terminals 5 and 6 to Terminals 2 and 3; (2) deferral of Delta's move to Terminals 2 and 3 would significantly delay realignment of the airport's north terminals and construction of a secure connection between Terminals 1, 2, 3, and TBIT; (3) a delay in Delta's relocation would result in delaying other important passenger-focused improvements; and (4) relocation and terminal improvement plans by airlines other than Delta would be slowed or deferred.

Compliance with City Administrative Requirements

In that the proposed agreement is a property lease, the Department's request is not subject to the provisions of Charter Section 1022, "Use of Independent Contractors."

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.

Leases are not subject to the provisions of the Small Business Enterprise Program (SBE); therefore, the proposed Delta lease is exempt from those provisions. The Lessor must comply with the Living Wage and Service Contractor Worker Retention Ordinances, the Affirmative Action Program, the Child Support Obligations Ordinance, and the provisions of the Contractor Responsibility and First Source Hiring Programs.

Delta has approved insurance, in the terms and amounts required by LAWA, the supporting documents of which are on file with the Department. The Department of Public Works, Office of Contract Compliance, has determined that the Lessor is in compliance with the provisions of the Equal Benefits Ordinance. With respect to the City's Bidder Contributions CEC (City Ethics Commission) Form 55 compliance, Delta is not subject to the provisions in that the airline is not acting in the capacity of a bidder on a City contract, an underwriter, a subcontractor, or a principal.

RECOMMENDATIONS

That the Mayor:

1. Approve the proposed Terminal Facilities Lease and License Agreement between the Los Angeles World Airports (LAWA) and Delta Air Lines, Inc. for the renovation and use of space in the Los Angeles International Airport (LAX) Terminals 2 and 3 for the purpose of continuing, expanding, and improving its passenger services operations at LAX, as well as those of other affected airlines, and relocating various airlines impacted by Delta's relocation to Terminals 5 and 6, subject to compliance with the City's Standard Provisions for Contracting, including the Living Wage and Service Contractor Worker Retention Ordinances, the Affirmative Action Program, Child Support Obligations Ordinance, Contractor Responsibility Program, and First Source Hiring Program, and City Attorney approval as to form;
2. Authorize the Executive Director to execute the Terminal Facilities Lease and License Agreement; and

3. Return the proposed 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 Delta Airlines, Inc. will result in (1) first-year lease revenue to LAWA of \$4.9 million; (2) approximately \$1.66 billion in lease revenue to LAWA over the 10-year period following completion of Delta's Terminals 2 and 3 construction; (3) a minimum of \$1 billion in combined proprietary and non-proprietary renovations made by Delta Air Lines to Terminals 2, 3, and related areas at LAX; and (4) a not-to-exceed amount of \$462.6 million in combined rental credits and cash paid to Delta by LAWA for acquisition of Delta's non-proprietary improvements to Terminals 2 and 3.

As a consequence of the above, LAWA is requesting that the Board of Airport Commissioners appropriate and allocate a not-to-exceed amount of \$462.6 million from the LAX Revenue Fund to WBS (Work Breakdown Structure or "cost center") Element 1.16.17-700 (Terminals 2 and 3 Renovations) and other related WBS Elements, as needed, to purchase from Delta Air Lines certain renovations to Terminals 2 and 3 and others as specified in the Terminal Facilities Lease and License Agreement. This project and the proposed Agreement comply with the Department of Airports adopted Financial Policies. Approval of the 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:10170011