San Francisco International Airport

MEMORANDUM

February 6, 2017

TO: Members, Capital Planning Committee

FROM: Kevin Kone, Managing Director - Finance

SUBJECT: Capital Planning Committee Meeting, February 6, 2017 – Airport hotel project bond authorization and related supplemental appropriation.

Executive Summary

- On October 19, 2015, the Capital Planning Committee (the "CPC") recommended approval of two items related to the on-Airport hotel (the "Hotel") project: (1) a resolution of the Board of Supervisors (the "Board") approving the Airport Commission's issuance of bonds to finance the Hotel, and (2) the related supplemental appropriation ordinance. On December 1, 2015, the Board acted on these matters, adopting Resolution No. 433-15 and passing Ordinance No. 220-15.
- Since the fall of 2015, the Bay Area has experienced a significant increase in construction costs, which has hampered the Airport's goal of delivering the Hotel within the existing project budget without significantly reducing the number of guest rooms. Due to this construction cost escalation, as well as increases in the amount of Hotel space dedicated to revenue-generating meeting facilities and food and beverage outlets, the project budget has increased by $30 million.
- In light of this budget increase, the Airport now requests that the CPC consider and recommend approval of two Hotel-related items: (1) a resolution (the "Bond Resolution") of the Board approving the Airport Commission's issuance of up to $35 million principal amount of additional Airport revenue bonds, bringing the total approved amount to $278 million, and $35 million principal amount of additional hotel special facility bonds, bringing the total approved amount to $260 million; and (2) the related supplemental appropriation. The additional bond proceeds would be used for project costs and associated financing costs.
- The Airport, in consultation with its hospitality consultant and financial advisors, expects the Hotel to produce positive financial results at its higher project budget, in part because the hospitality consultant's updated projections show a higher average daily room rate for the Hotel relative to that projected in 2015. By maintaining the original program with 351 guest rooms, the Airport expects to derive higher Hotel "net profits" (i.e., total hotel revenues less total hotel operating expenses, required reserve deposits, and debt service costs) than a smaller Hotel that is within the existing project budget. Once occupancy has stabilized, total revenues are estimated to be approximately $12 million per year higher for the 351-room Hotel than for the smaller, 289-room Hotel. Moreover, by maintaining the

original program, the Hotel will be able to provide more rooms to accommodate the Airport's growing number of passengers.
- This item is expected to be presented to the Airport Commission on March 7, 2017. Consequently, the Airport is requesting that the CPC's recommendation be made contingent upon the subsequent adoption of a resolution consistent with this item by the Airport Commission.

Background

The Hotel's cash-flow must be kept separate from that of the Airport, so that the Hotel operator can pay Hotel expenses directly from Hotel revenues. To establish this separate treatment of Hotel revenues, in 2015 the Airport Commission designated the Hotel as a "special facility" under the Airport's 1991 Master Bond Resolution. To finance the Hotel at the lowest available cost while maintaining its special facility status, the Commission plans to issue two types of bonds:

- Tax-exempt Airport Capital Plan Bonds (i.e., general airport revenue bonds), which would be sold to investors; and
- Tax-exempt Hotel Special Facility Bonds, which would be purchased by the Commission with proceeds of the Airport Capital Plan Bonds.

Due primarily to: 1) significant construction cost escalation, particularly in the areas of electrical, mechanical, glazing and interior finishes; and 2) increases in the amount of space allocated for revenue-generating facilities (e.g., meeting facilities and food and beverage outlets), the Hotel project's estimated cost has increased by $30 million since the fall of 2015. This represents a 14.3 percent increase in the construction budget. In comparison, an independent cost management firm estimates that San Francisco construction costs have increased by 17.3 percent in the past year.[1]

The Airport and its financial advisors have determined that the increase in the project budget would result in a $35 million increase in the authorization required for both Airport Capital Plan Bonds and Hotel Special Facility Bonds, reflecting the increase in project cost and associated financing costs. The changes in the Airport's proposed Hotel financing plan are summarized below.

[1] Rider Levett Bucknall, "USA Report, Quarterly Construction Cost Report," October 2016.

Costs Payable from Airport Capital Plan Bonds	October 2015		February 2017 Revision
Hotel AirTrain station construction costs		$ 15,000,000	$15,000,000
Costs of issuance		3,000,000	3,000,000
Purchase of Hotel Special Facility Bonds		225,000,000	260,000,000
Project Costs Payable from Hotel Special Facility Bonds			
Hotel construction costs (including repayment of commercial paper principal and reimbursement of operating funds)	$210,000,000		$240,000,000
Capitalized Interest, Commercial Paper Interest	20,000,000		25,000,000
Less: contribution from Hotel operator	(5,000,000)		(5,000,000)
Total Hotel Special Facility Bonds:	$225,000,000		260,000,000
Total Airport Capital Plan Bonds:		$243,000,000	278,000,000

Based on extensive analysis by the Airport's hospitality consultant (Jones Lang LaSalle) and financial advisors, the Airport expects the Hotel to be financially feasible with the revised budget, generating annual revenues sufficient to pay operating expenses and increased debt service costs.

The proposed Bond Resolution would:

- Approve the Airport Commission's issuance of up to $35 million principal amount of additional Hotel special facility bonds, bringing the total approved amount to $260 million, to finance Hotel and related costs (or to refinance Commercial Paper and/or operating funds issued for Hotel costs), and fund a capitalized interest account. As currently authorized, the Hotel special facility bonds will have a maturity of 40 years and bear interest at a fixed rate to be determined at the time of issuance.

- Approve the Airport Commission's issuance of up to $35 million principal amount of additional Airport Capital Plan Bonds, bringing the total approved amount to $278 million, to finance the purchase of the Hotel special facility bonds by the Commission, along with financing the Hotel AirTrain station (and/or refinance Commercial Paper issued for the station), and associated costs of issuance. There is no change in the maximum bond maturity of 40 years, or in the interest rate limitations set forth in Resolution No. 50-11 of the Board of Supervisors. The Airport Capital Plan Bonds will be sold prior to June 30, 2020, and may be issued as Variable Rate Bonds.

The Airport is also requesting approval of the supplemental appropriation of the additional Airport revenue bond proceeds and Hotel special facility bond proceeds, and $60,000 in additional Airport operating funds that will support CSA auditing services).

Request to the Board of Supervisors

The Airport Commission will request that the Board of Supervisors adopt the Bond Resolution approving the increase in Airport revenue bonds and Hotel special facility bonds, and make a supplemental appropriation of the additional bond proceeds.

If you have any questions or need additional information on this proposal, please let me know.

Kevin Kone
Managing Director - Finance