City Council Regular Meeting: July 14, 2015

Agenda Item: 8-C

To: Mayor and City Council

From: Martin Pastucha, Director of Public Works/Airport Director

Marsha Jones Moutrie, City Attorney

Subject: Airport Leases With Ruskin Theater, Atlantic Aviation, Krueger Aviation, Gunnell Properties, American Flyers, Spitfire Grill, Typhoon, And Miscellaneous Tenants And Update On Airport Issues

Recommended Action

Staff recommends that City Council authorize the City Manager to negotiate and execute new Santa Monica Airport (Airport) leases with aviation and non-aviation tenants at market rates and on terms consistent with the guidance provided by Council at its meeting of March 24, 2015.

Executive Summary

All Airport leases expired on June 30, 2015. This expiration date was selected by the City to ensure that the City's contractual obligations to the federal government under the 1984 Settlement Agreement and the City's contractual obligations to Airport tenants would expire at the same time. The City took this approach to maximize its options for possible future uses of the land currently utilized for Airport purposes once the City's contractual obligations to operate the Airport had expired.

This straightforward approach has been complicated by two legal claims. First, in recent years the Federal Aviation Administration (FAA) has claimed that the 1948 Instrument of Transfer obligates the City to use the parcel covered by that instrument as an Airport in perpetuity. Second, aviation interests have claimed that the City's federal grant obligations do not expire until 2023 and require the City to continue to operate the entire Airport until 2023.

The City is currently litigating these claims in federal court and in an administrative proceeding before the FAA. It is uncertain when each will end and most likely neither will conclude for another 2-3 years. Until these legal issues are resolved, it appears inevitable that the FAA and aviation interests will do all they can to prevent the City from effectuating any decision the Council may make to remove all or part of the land from airport use.

Faced with these legal and practical realities, the City, as Airport owner and operator, is continuing to operate the Airport responsibly and lawfully, while taking all measures possible to reduce adverse impacts on local health, safety and welfare, including adverse financial impacts upon the City. To ensure that the Airport is self-supporting and not a drain on the City's general fund while the City's authority is being clarified, staff recommends the following leases with Airport tenants on terms listed in this summary and explained in this report.

Consistent with the guidance Council provided on March 24, 2015, all proposed leases would be at market rate. This will significantly enhance Airport revenues, assist in protecting the General Fund from subsidizing the Airport, and allow for continued repayment of the loans previously made to subsidize Airport operations. In short, it will ensure that residents do not bear the costs of the Airport's operation. Also consistent with Council's guidance, the leases on the Western Parcel would be month-to-month.

Perhaps most important to the community, the City's future options for using the rest of the land would be protected by a term in the leases allowing the City to terminate early if its authority to control use of the land is established sooner than the expiration date of June 30, 2018.

Therefore, staff recommends the following leases:

1. Ruskin Theater (3-year term at $3,595.27 per month).
2. Atlantic Aviation of Santa Monica (3-year term at $54,889.93 per month and 40% of the net rental revenue from subleasing).
3. Krueger Aviation Inc. (month-to-month at $4,920 per month and 50% of the net rental revenue from subleasing) (western parcel).
4. Gunnell Properties LLC (3-year term at $91,170.80 per month and 12% of gross revenue above the amount of the City’s base rent).
5. Ameriflyers of California dba American Flyers (month-to-month at $11,229.58 and 50% of the net rental revenue from subleasing) (western parcel).
6. Campclar Corporation dba Spitfire Grill (3-year term at $8,474.40 per month or 6% of gross receipts, whichever is greater).
7. Typhoon Restaurant Inc. (3-year term at $6,060.00 per month or 6% of gross receipts, whichever is greater).
8. Various month-to-month lease agreements for single space of either land or portions of buildings for artists, aviators and others.

While the proposed lease terms would be consistent with past Council direction and past leasing decisions, would protect the City's future options, and would ensure that residents would not bear the cost of Airport operations, staff recognizes that other priorities may take precedence. Council's priorities may be taking all steps to maximize flexibility and expressing its commitment to local control. If so, staff recommends one year leases, rather than month-to-month tenancies. One year leases would provide for some business continuity and thereby facilitate responsible Airport management during the time that it takes to resolve issues relating to the City's control of its land. Month-to-month leases, on the other hand, are likely to draw more serious legal challenges and are less likely to achieve fair market lease rates. While month-to-month lease terms may send a strong symbolic message, it lessens the City's leverage to advance the community's long-term interests. Council may also need more information before making leasing decisions. If so, consideration of all or certain leases could be temporarily deferred.

Background

The City has reached an important juncture in the history of the Santa Monica Airport. All Airport leases and the 1984 Settlement Agreement with the federal government have expired.

The City timed these expirations to coincide based on its long-standing, publicly declared, and continuing belief that its legal obligations to operate the Airport arose solely from the terms of the 1984 Agreement and federal grant assurances (which the City believes have already expired by their own terms). With those obligations expired, the City has believed in good faith that, beginning on July 1st 2015, it would have the full legal authority to control the use of its land now occupied by the Airport. And, for many years, the federal government agreed. Indeed, the FAA previously stated in a formal determination that use of the land now occupied by the Airport would be a local land use matter after 2015. However, as 2015 approached, the FAA changed its position. Now, the agency claims that the Instrument of Transfer (Instrument) obligates the City to operate the land covered by that Instrument as an Airport in perpetuity and under several restrictions. And, the aviation community claims that the grant obligations, which cover the entirety of the Airport, do not expire until 2023.

The City adamantly disputes these claims and believes that, as of July 1, 2015, it has the legal authority to determine the future use of the land now occupied by the Airport.

In 2013, the City hired an internationally respected litigation firm, Morrison and Foerster, to file suit and resolve the question of the City's authority to control use of its land. At present, the 9th Circuit Court of Appeal is reviewing the district court judge's decision granting the FAA's motion to dismiss. The appeal is fully briefed, and the parties are awaiting oral argument, which is not yet scheduled.

The grant expiration date is the subject of a Part 16 proceeding filed by aviation interests and now pending before the FAA. The City Attorney's Office is handling the case. It is fully briefed, and the FAA's initial determination is overdue. Once issued, it will be subject to administrative and judicial review, which means that the case may move through three steps of agency review and then into federal court.

Thus, the legal battle about the FAA's claims that it controls use of the land forever and about the significance of July 1st continues; and staff anticipates that it will likely take another two to three years.

Since Council's last consideration of Airport leases, staff has continued to monitor developments at the federal level. The FAA is moving ahead with its Metroplex project. The Environmental Assessment has been released and both City staff and community members have attended sessions hosted by the FAA as part of the public review process. Of primary importance to residents of both Santa Monica and Los Angeles is the fact that, if implemented, the proposed heading on takeoff would eliminate the current need for coordination of departures from the Airport and Los Angeles International. This change would, in turn, reduce run up time and attendant emissions at both airports. The FAA's proposed new heading would apparently route instrument flights directly to the coast with a turn to the northwest seaward prior to the shoreline, thus routing aircraft over both Venice and Santa Monica. In another development, the federal government has announced that emission standards will be promulgated. This would lessen the health hazards of aircraft emissions, but it would presumably take years to implement.

Discussion

Meanwhile, as the City's legal disputes drag on and federal regulators inch forward, the Airport's adverse impacts continue to burden surrounding neighborhoods. Aircraft noise continues to degrade residents' peaceful enjoyment of their homes. Air pollution and runway safety risks create constant worry. So, Airport neighbors demand action.

Local leaders have continued to respond. On May 12, 2015, Council directed staff to take all measures possible to mitigate impacts, including presenting to Council any and all options for local action to reduce aircraft emissions in the coming months. And Congressional Representatives Ted Lieu and Karen Bass have joined Airport neighbors in calling for closure of the Airport. The Representatives have also arranged an opportunity for City and community representatives to express their views and concerns to the FAA's Associate Administrator for Airports in Washington on July 8th. (However, he has taken the position that he cannot discuss their concerns and can only listen because of the pendency of the Part 16 proceeding.) Additionally, City staff has taken the initial steps to implement Council's direction to convert part of the non-aviation land into recreational usage. The FY 15-16 budget includes funding for a feasibility analysis, early concept plan, and community outreach related to converting the land currently used for tie downs to 12 acres of recreational space. So, significant efforts relating to the Airport's present impacts and the future use of the land occupied by the Airport are ongoing.

Many City residents and Airport neighbors believe that these efforts are not nearly enough. Some urge the City to simply shut down Airport operations now. Of course, if history is any guide, Council action to close all or part of the Airport would be immediately opposed in court by both the federal government and the aviation community. And, based on past experience, if such action were attempted in advance of a judicial decision about the City's authority to close the Airport, a federal court would certainly likely issue an injunction maintaining the status quo. The federal courts have been very receptive to such requests in the past. Thus, in order to fulfill its responsibilities and ensure that the Airport remains self-supporting while issues relating to the City's control over the land are resolved, Airport staff has been working on lease negotiations with help from its new leasing consultant and legal staff. Proposed terms have been negotiated subject to Council approval.

The seven proposed leases represent a mixture of uses. Four are primarily for aviation services though all would likely include non-aviation subtenancies. Three are for non-aviation uses: two restaurants and a theater. The miscellaneous leases, for very small leaseholds, would include cultural and aviation uses.

Consistent with Council's direction, all of the leases proposed for Council consideration are at market rate. If approved as proposed, they would approximately double the amount of rent received by the City for these parcels as shown on Attachment A, which shows both past and proposed rents. Consistent with Council's guidance, the leases recommended for the two properties on the Western Parcel are both month-to-month. The others would be for terms of years ending no later than June 30, 2018. However, all of the leases would contain provisions reserving the City's right to regain possession of the leasehold if its right control use of the Airport land is established prior to June 30, 2018. Thus, entering into the leases as recommended would not prevent the City from changing the use of the Airport land if the City's authority is established and the Council decides upon a change of use.

Residents living near the Airport have urged that the Council should not grant three year leases and should only lease Airport property for aviation uses on a month-to-month basis. Staff continues to recommend longer term leases for all tenants. Both practical and legal aspects of the current situation strongly suggest that, if the Council were to decide to devote its land to a different use, it would take at least three years to complete the legal disputes and undertake initial planning work. Moreover, affording disparate leasing opportunities to aviation and non-aviation tenants is likely to draw more legal challenges. And, as noted above, the City's options can be safeguarded with early termination clauses.

As to fiscal impacts, the proposed three year lease terms will allow for some business continuity and stability for the current businesses which will retain current tenants within their current spaces with minimal vacancies. Also, when vacancies arise, the three year term will allow the City to quickly fill those vacancies because the flexibility of offering a longer term. This will assure the viability of the Airport Fund during this transition. A one year term might allow some stability, but staff believes that a month-to-month term will not. Additionally, the three year lease allows for master tenants (whole building tenants) to maintain their whole facility and absorb all or a large portion of the maintenance costs associated with their facility. Under a one year lease the costs will be shared by the City and on a month-to-month lease term those costs would be the responsibility of the City.

The three year term also allows for a better negotiating position in implementing environmental requirements for tenants' ground equipment. Asking current tenants to replace their current fleet with alternative powered vehicles for their business is a costly proposition. A three year lease provides for that requirement.

Additionally, a three year lease term provides consistency with other leases currently approved by Council. On June 9, 2015, at the Council meeting, Council approved a three year term for VWGofA, Milstein Adelman LLP, and Museum of Flying. Providing a different term for aviation tenants might be problematic.

<u>**Specifics of the proposed leases are as follows:**</u>

Ruskin Theater (3000 Airport Avenue, Suite A)

Ruskin Theater is a 49 seat local community theater and acting school for children and adults, which has operated at its present location since 2001. The leasehold consists of approximately 2,663 square feet of administrative offices and theater space. Staff recommends a three year term, not to extend beyond June 30, 2018, at the rate of $3,595.27 per month. Rents would be adjusted annually to reflect the Los Angeles Consumer Price Index increase with a 2% minimum and a 5% maximum increase per year.

Atlantic Aviation (2828 Donald Douglas Loop North)

Atlantic Aviation (Atlantic) is a fixed-base operator (FBO), providing aeronautical support services such as fueling, hangar rental, tie-down and aircraft parking, aircraft maintenance to jet and turboprop aircraft. The proposed lease with Atlantic Aviation would be for three years and would include 11,634 square feet of office space and 64,337 square feet of aircraft hangars at a monthly base rent of $54,889.93. Rents would be adjusted annually to reflect increases in the Los Angeles Consumer Price Index with annual adjustments of no less than 2% and no more than 5%. The City would also receive 40% of the net rental revenue from subleasing above the base rental rate, which equates to approximately $80,000 per year, and would receive fuel flowage fees initially set at the rate of $0.11 per gallon for every gallon of fuel delivered, which equates to approximately $270,000 per year. Additionally, Atlantic Aviation would be responsible for all maintenance on the leasehold, including all pavement maintenance. It would also operate the fueling facilities previously operated by Gunnell and would dispense only Biofuel and unleaded avgas when they become viable and commercially available and to use alternative-fuel support vehicles on its leasehold after one year.

Krueger Aviation (2701 Airport Avenue)

Krueger Aviation (Krueger) is primarily in the business of aircraft sales, aircraft maintenance and subleasing to aviation and non-aviation subtenants. Under the proposed agreement, Krueger would lease the building and maintenance hangar on a month-to-month basis. All other land occupied under the prior lease (about 1.4 acres) has been released back to the City. Krueger's proposed lease would include 3,400 square feet of office space, 7,200 square feet of an aircraft maintenance hangar, and tarmac for a total of 24,733 square feet of land at a monthly rate of $4,920. The lease would require that 50% of the net rental revenue from subleasing above the base rental rate which results in an additional payment of approximately $24,000 per year.

Gunnell Properties (3100 Donald Douglas Loop North)

Gunnell Properties LP (Gunnell) previously held a land lease with the City and developed facilities on that leased property with the proviso that the land and any improvements reverting back to the City upon lease expiration. One such facility is an underground fuel farm, consisting of four fuel tanks used for storage and dispensing of fuels used by aircraft and fleet surface vehicles. Due to the lease expiration, ownership of the fuel farm would be transferred to the City, and Atlantic Aviation would operate it. Overall, the Gunnell lease would encompass a total of 465,880 square feet of land, including 17,915 square feet of office space and 143,374 square feet of hangar space. The proposed lease would be for a term not to exceed June 30, 2018, at a monthly rate of $91,170.80. Rents would be adjusted annually to reflect increases in the Los Angeles Consumer Price Index with annual adjustments of no less than 2% and no more than 5%. Additionally, the City would receive 12% of Gunnell's gross revenue above the amount of the City's base rent, resulting in potential additional revenue of $348,600 per year.

Spitfire Grill (3300 Airport Avenue)

The proposed three-year lease with Campclar Corporation dba Spitfire Grill (Spitfire) is for a full service restaurant that would include a total of 4,782 square feet of interior space for the restaurant, kitchen, conference room, and administrative offices as well as 1,062 square feet of exterior space used for outdoor dining. Monthly rent would be $8,474.40 or 6% of gross receipts calculated monthly from sales of all food, beverages, concessions, gift shop, and site/special event rental income, whichever is greater. This equates to approximately $8,000 in annual additional revenue (based on 2014 revenue). The rent would be adjusted annually to reflect increases in the Los Angeles Consumer Price Index with annual adjustments of no less than 2% and no more than 5%.

Typhoon Restaurant

The proposed lease with Typhoon Restaurant, Inc. (Typhoon) is for a full service restaurant including a total of 4,040 square feet of space for the restaurant, kitchen, and an administrative office. Typhoon has been located at 3221 Donald Douglas Loop South since 1990. The proposed lease would be for a term not to exceed June 30, 2018, with a monthly rental rate of $6,060.00 or 6% of gross receipts calculated monthly from sales of all food, beverages, concessions, gift shop, and site/special event rental income, whichever amount is greater. Rents would be adjusted annually to reflect increases in the Los Angeles Consumer Price Index with annual adjustments of no less than 2% and no more than 5%. Additionally, the City would authorize an amount not to exceed $75,000 of rent abatement allocated throughout the term of the lease as a tenant improvement credit. This would allow the Typhoon to perform some needed renovation intended to help increase their gross revenue which would, in turn, increase rent received by the City.

American Flyers (2501 Airport Avenue)

Ameriflyers of California, Inc. dba American Flyers has agreed to a new month-to-month lease at a monthly rent of $11,229.58 for 3,600 square feet of office space and 35,907 square feet of hangar space, for a total of 131,690 square feet. The land includes five tie-down spaces for the use of the lessee's own aircraft and taxi lanes for the movement of aircraft in front of hangars. Under their previous lease American Flyers utilized approximately 6.4 acres. Under the proposed agreement American Flyers would lease approximately 3 acres of land from the City, a decrease of approximately 3.4 acres in the size of the leasehold. The City thus would have 3.4 acres of land available for other uses. Rents would be adjusted annually to reflect increases in the Los Angeles Consumer Price Index with annual adjustments of no less than 2% and no more than 5%. Additionally, the City would receive 50% of the net rental revenue from subleasing resulting in an additional payment of approximately $36,000 per year and would remit payment of fuel flowage fees, initially set at the rate of $0.11 per gallon (approximately $15,000 per year based on 2014 figures).

Various Month-to-Month Leases

Staff also recommends month-to-month lease agreements with 77 tenants for single spaces of either land or portions of buildings. Tenants would include artists, architects, contractors, film/TV producers, writers, non-profits. Some of these leases would also be for aviation maintenance, storage, hangars, car dealership parking, and contractor parking. Annual projected revenue from these types of leases at full occupancy will be $1,720,677.84. The term of these agreements would be month-to-month not to extend beyond June 30, 2018. Rents would be at market rates. Rates would escalate between 2% and 5% annually and will include the lease provisions approved by Council at its March 24, 2015, meeting.

<u>Alternatives</u>

Council may prefer shorter term leases in order to maximize flexibility and/or express its commitment to maximizing local control. If so, staff recommends one year leases for all tenants, rather than month-to-month. The one year term would afford more stability for all Airport tenants and better preserve the Airport's fiscal self-sufficiency. It is difficult to predict the fiscal consequences of shorter-term leases and particularly difficult to predict the fiscal consequences and operational impacts of granting only month-to-month leases. Staff assumes that some tenants will leave the Airport and that new tenants may be hesitant to rent on a solely month-to-month basis.

Alternatively, Council may prefer to defer all or certain leasing decisions until it has more information. For instance, Council may prefer to await and consider information about any results of the meeting with Congress members and the FAA in Washington before granting lease approvals. If so, consideration of all leases or certain leases could be temporarily deferred.

Next Steps

In addition to moving forward with leases in accordance with Council's directions, staff will continue to closely monitor developments and utilize any opportunities that arise to address adverse Airport impacts, while the community awaits resolution of questions relating to its authority. A recent court decision may be an example of such an opportunity. In NBAA v. Town of East Hampton, (E.D.N.Y. CV 02246-JS-ARL), aviation interests sued to invalidate noise restrictions adopted by defendant town, which, like Santa Monica, owned and operated an airport and had a long history of airport-related disputes. The town's airport was subject to a prior settlement agreement between the plaintiffs and the FAA; the town was not a party. That settlement agreement appeared to shorten the duration of some of the town's grant obligations, including the obligation prohibiting economic discrimination. After the agreement was made, a Congressman asked the FAA about the impact of the settlement agreement on the town's ability to establish restrictions. The FAA responded with a rather unofficial writing stating that, after the new assurance expiration date, the FAA would not initiate proceedings to enforce grant conditions unless the town accepted new grants.

After advising the FAA of its intended action, the town adopted two new curfews and a prohibition against "noisy aircraft" using the airport more than once in a given time period. Aviation interests filed suit, claiming, among other things, that the local laws were preempted by the restrictions imposed by the Airport Noise Capacity Act ("ANCA"). Aviation interests also sued the FAA claiming that it lacked authority to enter into the settlement agreement that purported to shorten the term of the Grant Assurances. The aviation interests sought consolidation of the two suits and a preliminary injunction halting enforcement of the town's new laws. For purposes of the preliminary injunction, the court held that the town's laws setting curfews were not preempted by ANCA and (based on the specific facts before the court) were reasonable, non-arbitrary, and non-discriminatory and therefore constitutional exercises of the town's rights as airport proprietor. The court did enjoin the town's ordinance that would have restricted the frequency of operation of "Noisy Aircraft" during the vacation season in The Hamptons.

This decision is the first favorable decision regarding airport proprietor's rights in some time and may be very significant for that reason. However, it is important to note that this is a preliminary decision of a lower court in a different jurisdiction, and the FAA did not appear in court to oppose the town's restrictions. Moreover, the settlement agreement with the FAA shortening the grant obligations is very unusual; and it is being challenged in a separate case brought by aviation interests against the FAA. (The FAA's initial response in that case is due July 8th, but the FAA may seek an extension.) Therefore, both the ultimate outcome of the East Hampton case and its precedential value to other airport proprietors remain to be seen. Nonetheless, it suggests noteworthy possibilities and will certainly be useful to the City. Legal staff will continue to monitor it closely and advise Council of any opportunities it suggests for addressing noise and environmental impacts of the Airport.

Financial Impacts and Budget Actions

The recommended leases with Ruskin Theater, Atlantic Aviation, Krueger Aviation, Gunnell Properties, American Flyers, Spitfire Grill, Typhoon Restaurant, and various single space leases will generate $3,561,027.80 (base monthly rent x 11 months) of annual base rent revenue during FY2015-16 and an additional $496,600 of projected percentage of rent revenue. The proposed leases associated with a three year term constitute, during FY2015-16, $1,809,691 in annual base rent revenue and an additional $436,600 projected percentage of rent revenue. Revenues from these leases are allocated in accounts 33431.402120, 33431.402130, and 33431.402110. Revenue increases associated with the new lease agreements are included in the FY 2015-16 budget.

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Attachment: Past vs. Proposed Rent Comparisons

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