FINANCE

Options and Analysis of Major Provisions in Airport Concessions Contracts

AAAE

ACT AIRPORT CONSORTIUM ON CUSTOMER TRUST

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Introduction

This paper has been developed in collaboration with the American Association of Airport Executives (AAAE) and was prepared by contributing advisory members of the Airport Consortium on Consumer Trust (ACT) Program's Finance Working Group led by EY, Steer, Kaplan Kirsch & Rockwell, and the Minneapolis-St Paul International Airport. The intention of this paper is to provide a simple, easy-to-follow catalogue of key business terms and provisions in airport concessions contracts, which can be used by airport managers throughout the United States regardless of airport size, location, or organizational structure.

We strive to provide sufficient context and background to help airport decision makers be informed business partners, capable of "asking the right questions" and exploring the best alternatives and contractual structures for their airport. It is critical to note that each airport's position is unique and will inevitably require consideration of historical precedents, local market influences, legal and commercial legacy agreements, consumer preferences, and market demand, to name a few. For this reason, this paper is not intended as a complete guide to preparing any airport manager for a full and final concession agreement negotiation.

It is advisable when pursuing new concession agreements to consider many alternatives and eventually engage in dialogue and market sounding with potential concessionaire partners to identify what contracting terms will yield the best balance of performance and risk allocation for the enterprise. Typically, consulting with a range of advisors, including legal, financial, and industry experts is a necessary and productive process that helps produce the right negotiated agreement for the airport. This paper is meant as a primer for such discussions, including identifying key business drivers of airport concessions and emerging trends in the industry. We have also reflected on more recent changes in the contracting environment since the outset of the COVID-19 pandemic and have sought to highlight preliminary lessons learned throughout this paper, though we note the industry continues to evolve as passenger traffic and health of the industry improves.

Background and Framework

Commercial Strategy & Process

Modern commercial service airports include a wide variety of concessions, ranging from the familiar news, gift, and in-terminal food and beverage providers to rental cars, advertising, and hotels. Most concessions revenues and volumes are driven by passenger traffic; the more passengers using the airport, typically, the greater concessions sales will be. However, there are other important elements of an airport's service characteristics, such as whether it is a hub for an airline, if it is primarily a leisure destination, or if it has substantial international traffic. These factors can significantly affect the types of concessions that are successful. For example, an airport with little or no international traffic is unlikely to sustain a duty-free concession, while a connecting hub may find that passengers spending time between flights are happy to shop at specialty retail offerings. Lastly, because concessions revenues are typically passenger driven, the more passengers using the airport, the greater the variety and number of concessions offerings that can be supported; small hubs or non-hubs may have difficulty sustaining more than a few basic concessions opportunities. We note however, that some smaller destination airports can and do sometimes support an interesting mix of specialty retail and other concessions.

Accordingly, the first and perhaps most important step of an airport operator considering updating its concessions program is to understand the airport's characteristics and consider establishing a program that will both serve and benefit from that airport's unique situation.

The second major step for an airport operator seeking to upgrade or retender its concessions program is to consider the airport operator's internal capacity to operate and oversee a robust concessions program and to review the various business models for concessions programs. These range from the developer model, or fee manager, to direct leasing, and include intermediate options as well. There are lessons to be learned from airports that have executed each of these approaches as well as those which have experimented with novel concessions concepts and business structures. Concessions business models are further discussed later in this section.

Other considerations that the airport operator will need to bear in mind when considering an update to its concessions program include the areas that are available (or can be made available) for concessions, the airport's risk tolerance and the shifting risk tolerance of concessionaires following the COVID-19 pandemic, the financial arrangements with the airlines operating at the airport, and federal airport concessions disadvantaged business enterprise (ACDBE) requirements, as well as local businesses and the opportunities they can provide.

Newer terminal facilities are designed and constructed with a mix of concessions locations included, but older facilities often lack sufficient space or amenities, such as exhaust fans (which may need to be cut through concrete floors or ceilings), storage space, or delivery access. A survey of available space and consideration of whether additional space can be created economically should precede any large concessions revamp.

It is also especially important to understand the financial requirements and ramifications of airline agreements, on revenues from the concessions program. An obvious example is that if new concessions space is to be constructed, the return from concession rentals should be more than sufficient to recover the construction cost and associated debt service. However, if the airport's use and lease agreement provides for sharing of concessions revenues with the airlines, only a portion of concessions revenues may be retained by the airport to cover these expenses. That said, concessions revenues are generally considered to be non-aeronautical revenues in most agreements and can be a prime source of discretionary revenues for an airport operator.

Lastly, airports often seek to reflect their own community through their concessions programs. This also ties to the federal ACDBE requirements applicable to all airports that receive federal airport improvement program (AIP) grants. In short, the ACDBE program is designed to remedy historical inequity by requiring an airport to develop goals for inclusion of disadvantaged small business owners in the airport's concessions program. Several airports have found that the combination of seeking to better develop a sense of place in the concessions program with the focus on minority and other small businesses provides an opportunity to showcase local foods, products, and services. Airports can benefit from carefully considering their user base and working to promote a concessions program that serves the needs of both passengers and local communities. But operating a small business – any business in fact – within the requirements of an airport environment, such as obtaining security clearances, operating during long hours, and sometimes extending for delayed flights and the like, can be a significant challenge. Airports with successful programs often find that aiding new businesses operating at the airport can help overcome those difficulties and bring the anticipated benefits of a more local and diverse set of concessions offerings.

Summary of Different Business Models

Third Party Developer

A Developer approach involves leasing all concessions locations to a specialist firm who will manage the concessions program but does not operate any of the concessions themselves. The developer organizes a competitive procurement process to select the best concessionaires to operate at the airport. Developers will often be responsible for overseeing upfront investment and overhaul of commercial space and therefore these agreements tend to be relatively long term in order to allow time for the developer to amortize investment costs.

The developer model essentially offloads the responsibility for developing and managing a concessions program. A fee is paid to the developer typically as a percentage of the concessions revenue generated. The developer is engaged to provide an enticing mix of different concessions opportunities, mixing local and national food and beverage brands with travel necessities providers, specialty retail and, if warranted, duty free, all while seeking to site the different operations in the best locations within the terminal for that specific offering. As with all retail businesses, location is critical.

Master/Prime Concessionaire

Under a Prime concessionaire approach, the airport leases all or most of the concession space to one or two "Primes." The airport may split the retail and food & beverage concessions across two Primes, or have one company operate both segments, which is known as a Master Concessionaire approach. Prime/Master Concessionaires usually can pay higher percentage rents and agree to higher minimum rents as a result of their economies of scale, though the Prime can at times produce lower total sales. Some airports choose to supplement a Prime approach with Direct Leasing.

Direct Leasing

A Direct Leasing approach involves the airport reaching agreements with vendors on a space-by-space basis or packaging multiple locations into one concession opportunity. This allows for a great degree of competition among concessionaires, as well as the potential for a large amount of variety among vendors. Under Direct Leasing, the airport has the greatest amount of control over its concessions program, but it also requires significant staff resources.

Direct leasing relies on the airport's staff to perform the tasks assigned to the developer or Prime concessionaire in the models described above. The airport develops its own model of an ideal tenant mix, issues requests for proposals, or uses other mechanisms to competitively select the kinds of concessions sought and enters into direct leases with the chosen concessionaires. The advantage of this model is that the airport operator retains the revenue that otherwise would be paid to the developer, but the disadvantage is that this model requires a great deal of both up-front and ongoing oversight by airport staff. Particularly in cases where the airport has a larger, more sophisticated and dedicated concessions staff, this can be a very effective model.

Other Models

Other models tend to be variations on the three preceding ones. Airports with multiple terminals or concourses may enter into agreements with multiple private developers or Prime concessionaires, which control the concessions in a terminal or concourse. As the concessions industry has consolidated, there are several large concessionaires that operate a full range of offerings and can provide substantially all required kinds of options. Another model is for a single concession to operate the majority of the spaces in a terminal or airport, while the airport directly leases with a smaller number of concessionaires, both to ensure local participation and to diversify lease terms so that when the prime's lease terminates, a number of unaffiliated concessions will continue to provide necessary services during the transition.

Factors to Consider When Choosing an Approach

Airport Size

Generally, the larger an airport is, the more flexibility it has in choosing a concessions model. Large airports are more likely to have the staff and passenger volumes to support a Direct Leasing approach. The Developer approach also requires a large passenger volume (5 million or more annual enplanements, generally) to support their business model. The Master/Prime approach tends to be used at smaller airports where passenger volumes make it difficult to support multiple concessions operators, though some larger airports utilize a hybrid model or multiple Prime operators. Airports with aging infrastructure may find additional benefits from the developer model in which the investment for renovating common areas becomes the responsibility of the developer.

Cost

In addition to the staff and management related costs noted above, capital investment is a significant variable across the different business models. Depending on the model, investment in common areas could fall to the airport, or it could be the responsibility of the concessionaire. For example, under the Direct Leasing model, it is in the airport's interest to invest in the common areas (food courts, storage, and support spaces) to improve the attractiveness of concessions locations. Under a Prime or Developer approach, the contracted party will generally be the one investing in the common areas.

Revenue Potential

The Direct Leasing and Developer models tend to generate the most sales, though the Developer takes a cut of sales. Prime/Master Concessionaires are generally able to pay higher rents due to economies of scale, though sales are generally a bit lower than with other approaches. Overall, while the Direct Leasing (due to staffing costs and capital investments) and Developer models (due to fees for the developer) can incur higher costs, on average they generate higher revenues.

Concessionaire Mix and Barriers to Entry

Operating any business within an airport can be challenging. There are operational considerations, such as security screening, centralized storage facilities, and shared common spaces that complicate logistics and increase costs. In addition, new airport concessionaires may find that working with a public airport environment involves specific administrative, legal, and financial obligations that are complex and can create a burden on concessionaires, particularly small businesses. As such, airports should consider which procurement approaches facilitate their target mix of concessionaires and whether they have the ability to help lower barriers to entry for specific subsets of business partners. Some airports are giving increased consideration to undertaking further build out of space, for example, to reduce initial investment requirements on concessionaires. Other actions by airports to lower concessionaire burdens may include adjusted insurance requirements, provision of common shared facilities such as kitchen space, or even dedicated business incubator programs for the smallest concessionaire partners.

Understanding Risk Allocation

The issue of risk tolerance is being revisited at most airports that are undertaking a revision to their concessions program since the onset of the COVID-19 pandemic. The drastic reduction in passengers at most airports – in many cases by 90-95% for several months, with slow recoveries thereafter – had never before been seen in aviation and had not been anticipated in most, if not all, concessions arrangements. In most cases, concessions revenues are driven by the number of passengers, while costs are not as directly correlated. As such, many concessionaires suffered significant losses during the pandemic, even despite efforts by many airports to provide relief in addition to the financial relief provided in the later federal COVID relief acts. As a result, both concessionaires and airports are looking to revise the traditional concessions agreements to address potential future traffic downturns.

Reasonable allocations of risk and reward between airports and concession operators is a central tenant of airport concession agreements. Airport owners procure agreements with concessionaires willing to take certain business risks associated with development, management, and operation of retail and hospitality businesses within an airport environment – risks that these concessionaires, through experience and internally developed skillsets, have become better positioned to manage than typical public agency staff. In return, these businesses can expect to make a reasonable share of profits from their exclusive access to airports' customers, who are generally characterized by higher levels of discretionary income. Maintaining this reasonable balance between risk and reward should produce suitable profits for both the concessionaires and airport owners, while maximizing the quality and availability of retail and hospitality options to the traveling public.

Over time, many assumptions underlying these risk allocations started to be taken for granted or were disregarded altogether – the most notable example being the decoupling of minimum annual guarantee (MAG) payment provisions from risks associated with airport passenger traffic. The onset of the COVID pandemic, with its never-before experienced reduction in passenger volumes, exposed many concession agreements to revenue obligations beyond those practically sustainable by their businesses. Despite airport efforts to provide relief and subsequent federal programs designed to do the same, many concessionaires sustained significant losses or were forced out of business altogether. At the same time, airports were forced to reassess the stability of these revenue sources and the potential of losing one or more concessions operators due to lack of sustained passenger traffic.

The highlighting of these and other potential risks not previously considered is leading to more active discussions about risk allocation between airports and concessionaires when retendering concession contracts. These conversations should be focused on allocating risks to the party best able to manage and absorb them, while also balancing the rewards associated with taking these risks. This approach should be applied when considering many of the concession agreement provisions discussed in this paper.

Emerging Trends

Emerging Trends in Concessions Contracting

The catalogue of contract provisions which follows in this paper identifies many of the recent changes in contracting approach. Generally, these trends appear aimed at providing airports and concessionaires more options and flexibility as to how to approach periods of significant financial distress. However, in some cases these trends may reallocate material risks more fundamentally and permanently.

One such example is the fundamental reconsideration of use of the minimum annual guarantee structure since the onset of COVID. We have seen the recent introduction of a shift to a per-passenger revenue guarantee in some commercial contracts, which was not common before COVID. This is a noteworthy shift which completely removes total passenger volume risk from the concessionaire, a risk that some concessionaires may have only recognized the significance of after COVID began impacting their operations. While traffic recovery is well underway, it is likely that both airports and concessionaires will now reconsider the potential variability of this demand driver for some time.

Other trends are less fundamental but nonetheless important. These include the rise of new financing approaches in which airports can proactively create new pathways for concessionaires within their airport, and in so doing, can often help nurture ACDBE and local participation goals. This trend was likely accelerated more by the pandemic than as a direct result of it but remains one of the key shifts in concessions policies over the past several years. In other cases, airports are exploring taking a more active role in management of their concessions programs, either through consideration of a self-management structure or through a licensing partnership which operates more like other major event spaces.

Airports are also increasingly looking to diversify their toolkit for how to address concessionaire challenges. These include revisiting agreement provisions that could otherwise force a draconian default upon a concessionaire, even when it may not be in the airport's best interest. Another such example is the introduction of additional flexibility for "below the line" fees which may be explicitly utilized for employee compensation and welfare. This has been utilized in response to the initial health and safety risks associated with staffing during the pandemic and represents a shift in response to the overall labor shortages faced by many within the airport environment during the subsequent period.

Finally, airports and concessionaires are increasingly facing the need for new conversations about the use of technology within the airport and the accompanying data generated by digital operations. Use of these data sets has recognized short term benefits, but also importantly, the potential value and opportunity that is of interest to all parties involved in the passenger's airport experience. However, there are just as many legal, ethical, and commercial questions about how and why technology and customer data are being utilized as there are potential new applications. These questions are a developing area of concessions agreements and are expected to evolve as new approaches emerge and are tested in the market.

Some airport management teams and concessionaires were able to work through adjusted concessions agreements that sought to create a combination of operational and financial flexibility in order to preserve passenger services. In some cases, airports are now seeking to incorporate these flexible approaches into renewed concessions agreements. These provisions typically require consultation with and approval by the airport but can include more flexibility in operating hours (especially where the concessionaire controls multiple locations) and in inventory, including both retail offerings and menus of food and beverage outlets. Thus, the typical requirements which drive up fixed costs: operating at all times in which there is flight activity, or providing the same wide range of food and beverage offerings or retail options in all circumstances, as well as to pay a rigid MAG, can be altered. In some cases, a mechanism can be included to scale percentage rent to reflect fixed costs, so that at very low passenger volumes, percentage rent is minimal or forgiven and subsequently increases as passenger traffic returns (potentially above prior ceilings upon recovery of traffic so as to help recover the airport's losses). In our experience, airports will benefit from planning for future stress conditions, including significant traffic downturns, by creating such frameworks for adjusting agreements through such a balanced and multifaceted approach.

Examples of Emerging Trends in Concessions Operations

Ghost Kitchens

Raleigh-Durham International Airport launched a ghost kitchen in Terminal 2, allowing customers to order at a kiosk or online from nine restaurant concepts that share a kitchen. The customer may then pick up the order at a locker or have it delivered to the gate, which is in itself a growing trend. The concept of an airport ghost kitchen is appealing for the efficiency it offers with regards to staff and space – a concessionaire can have nine restaurants with a single kitchen and staff. Another benefit of ghost kitchens is the flexibility of location – with no front of house section, these concepts do not require the same volume of prime real estate as other concessions concepts. On top of that, the kitchen portion of a restaurant usually accounts for 70% of the cost, meaning a ghost kitchen provides significant cost savings compared to a traditional restaurant concept. These ghost kitchens may also offer lower barriers to entry for small operators.

Vending Machines

There is movement away from the traditional vending machines offering products from large multinational food and beverage conglomerates to smart machines carrying more specific products. These modern vending machines are sometimes referred to as "mobile retail." One example is the PopShop vending machine installed at John Glenn Columbus International Airport, which carries brands and products from the Columbus area. Another is the Automated Pizza Kitchen from Basil Street, a vending machine that heats up a flash frozen pizza, which recently made its airport debut at San Antonio International Airport. Even more traditional airport retailers such as Hudson have started supplementing their physical storefronts with vending machines stocked with a variety of products and brands, including Apple, Sony, Lego, Brookstone, and more. With a relatively tiny footprint, 24-hour availability, and no staffing costs at a time when staffing shortages abound, these machines may see continued growth at airports.

Immersive Shopping Experiences

Immersive shopping experiences akin to showrooms or booths one might find at a music festival can provide a novel experience for travelers while also increasing customer engagement for brands. A recent example of this is Chanel's No. 5 Spaceship experience at London Heathrow, where customers could purchase fragrances as well as the brand's limited-edition advent calendar. On top of offering a purchasing experience, the pop-up included a game where shoppers could find hidden stickers to win prizes from Chanel. Another example is the House of Suntory pop-up at Singapore Changi Airport, which showcased a variety of Suntory's luxury whiskies to shoppers. These experiences double as point-of-sale and brand awareness levers.

Just Walk Out

Hudson, using Amazon's *Just Walk Out* technology, launched their first Hudson Nonstop store at Dallas Love Field Airport in 2021. Since then, Hudson has opened similar stores at Chicago Midway International Airport and Nashville International Airport. In a similar fashion to Amazon Go stores, customers can enter the space by swiping a credit card, pick up whatever items interest them, and exit the space without needing to checkout. These stores have obvious appeal for all parties – the consumer does not have to wait in line and has access to the store at all hours, while the concessionaire can cut down on labor costs without the checkout line and is thus better insulated from the financial and operational impacts of a tight labor market.

Creative Use of Space

Outdoor space is emerging as a highly sought-after airport space. Concessionaires and other service providers (notably lounge operators) see such space as providing a differentiated offer that improves customer experience. Outdoor space can also help reinforce the "sense of place" that airports and concession program operators are seeking by providing landscape views and exposure to local weather and climate conditions. In other cases, airports and concessionaires are partnering to integrate concession and hold room space. This can allow opportunities for limited space to be dual purposed for revenue growth and passenger function, but the management of the space needs to be well planned.

Gaming Lounges and Entertainment

Because most concessions space is allocated to retail and food & beverage businesses, entertainment options tend to be an afterthought. Though several Asian airports, including Singapore Changi, Incheon, and Hong Kong airports have a movie theater as part of their portfolios, several factors make similar buildouts at U.S. airports difficult, not least of all the space requirements. However, a better fitting entertainment experience – video game lounges - is already stateside. With locations at Los Angeles International Airport and Dallas-Fort Worth International Airport, and locations on the way at Charlotte Douglas International Airport and Houston Hobby Airport, Gameway are providing a way for travelers to kill time by playing the latest popular titles such as Fortnite, FIFA, NBA2K, Madden, Call of Duty, and more. The potential for gaming lounges at airports is interesting, with flexibility around timing (someone can choose to play a few rounds of a game for a half hour or sit at a console for most of a three-hour layover), a varied customer demographic from solo travelers to families with kids, and rising popularity of Virtual Reality gaming.

Catalogue of Key Contract Provisions

Minimum Annual Guarantee (MAG)

What is it?	A MAG reflects a minimum amount a concessionaire will pay the airport in concession rent in any given year. This is defined in the contract and is applicable for each year of the contract. Typically, MAG is paid in equal, monthly installments.
What is the airport's goal? What is the concessionaire's goal?	MAGs have historically provided airports with two things: 1. A baseline revenue which can be relied upon; 2. A smoothed revenue curve, as concessionaires would pay no less than a flat monthly MAG throughout the year, regardless of traffic variance. MAGs also may induce concessionaire behavior aligned with airport goals: 1. An incentive to reach certain sales targets; 2. An implication of expected sales thresholds that may dissuade bidders who evaluate the concession opportunity differently. Concessionaires typically viewed MAGs as a way to increase the competitiveness of their proposal, particularly in markets where expected traffic growth reduced the perceived risk to concessionaires.
What were the typical approaches pre-COVID?	1. **Setting the MAG:** concessionaire MAGs typically include two parts: a. A first-year guarantee, in dollars; b. An escalation of the MAG from Year Two to end of term. This is often based on a share of the previous year's actual concession rent (for example, 85% of actual) and typically includes a floor set at the Year One MAG. 2. **Structuring a MAG:** traditionally MAGs have been set as a total annual value. 3. **Bidding Tool:** Concessionaires often used a higher MAG to seek better locations or to win the bid.
What are the typical approaches post-COVID?	During COVID, many concessionaires failed to meet their guarantees. This raised questions as the value of the MAG provision for airports if it was not providing the revenue protection envisioned. Post-COVID approaches have included: 1. **Setting the MAG:** Some concessionaires are proposing no MAG in Year One. Many airports have eliminated open bidding for Year One MAGs, opting to either define a specific MAG or have no Year One MAG. 2. **Structuring the MAG:** Some concessionaires have moved towards a per-passenger MAG to eliminate their exposure to traffic risk and only take on performance risk. The floor of Year One MAG is sometimes no longer applicable.
What are the key tradeoffs between approaches?	While airports can benefit from high MAGs associated with aggressive concessionaire bids, there is the risk of concessionaires overbidding and asking for relief from the commitment, or even defaulting. Per-passenger MAGs shift all traffic risk to the airport. While this may make sense, airports should consider how this impacts concessionaires risk profile and whether other risk allocations should be restructured as well.

Key impacts to other contract provisions	♦ Owner vs concessionaire financing ♦ Refresh of space requirements ♦ Default/relief options
Other considerations/impacts on different airports	Airports with larger and more diversified revenue capacity may have less need for the MAG commitment than a smaller market who would benefit from an additional fixed contractual obligation. However, markets with higher traffic risk will also have MAGs more heavily discounted by concessionaires, particularly post-COVID. In principle, eliminating MAGs should reduce risk for concessionaires and facilitate higher percentage rents for the owners.

Street Pricing

What is it?	Street Pricing is a policy established by airport leadership that defines a ceiling on the price a concessionaire may charge in relation to the price of similar goods elsewhere (i.e., “on the street”) in the market area. Such a policy typically prescribes the method and frequency with which Street Pricing is determined, as well as the procedure for dealing with complaints and violations.
What is the airport’s goal? What is the concessionaire’s goal?	Street Pricing has historically provided airports with two things: 1. The public perception that the customer is not going to be a victim of price gauging at the airport, despite the post-security situation of being a “captive market.” 2. A reference policy should there be accusations or complaints regarding high prices within the airport. Concessionaires generally oppose Street Pricing. Capital and operating costs for in-terminal locations far exceed those of streetside comparators, so it can be difficult to generate enough sales to turn a profit while there is an external cap on prices. The difference between strict Street Pricing and Street +10% Pricing, for example, can be the difference between loss and profit.
What were the typical approaches pre-COVID?	♦ Street Pricing ♦ Street Pricing plus a percentage (usually 10% or 15%) ♦ No such policy
What are the typical approaches post-COVID?	During COVID, some concessionaires asked for modifications or suspensions of Street Pricing policies. Post-COVID approaches have included: 1. **Redefining the market area for comparators.** Some Street Pricing policies may set the benchmark area near the airport or downtown, while better comparators may be in sports or entertainment venues. 2. **“Wellness charges” or other below-the-line charges.** As discussed in a separate section of this paper. 3. **Revisiting whether Street Pricing is still in line with the airport management’s goals and objectives.** At some airports, Street Pricing had been imposed when in-terminal concession programs were basic. Over the past generation or so, many customers have demonstrated their demand for high-quality offerings (which cost more), and the value proposition of concessions is now greater.
What are the key tradeoffs between approaches?	No Street Pricing can lead to greater sales and therefore greater revenue for the airport. Nevertheless, the leadership of many US airports have opted for a Street Pricing policy to protect consumers and manage the airport’s public image.
Key impacts to other contract provisions	♦ Concession Rent (e.g., greater of Minimum Annual Guarantees and percentage rent) ♦ “Wellness charges” or other below-the-line charges ♦ Construction costs
Other considerations/impacts on different airports	Public and political perception is a legitimate concern in environments in which price gouging is possible. Enforcement can be difficult and time-consuming.

Owner vs. Concessionaire Financing of Improvements and Refurbishments

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<tr><td>What is it?</td><td>Airport concession agreements often include a requirement for the concessionaire to provide for build-out of their concessions space, including furniture, fixtures, and equipment (FF&E) as well as some level of defined reinvestment to “refresh” the space near the midpoint of the term of the agreement. These capital costs come with the following considerations:
1. Must be supportable by the concessions’ commercial opportunity;
2. The concessionaire must have sufficient financial resources to support its investment, either through its corporate balance sheet, relationships with financial lending institutions or established credit ratings; and
3. The concession agreement must have sufficient term to allow for the amortization of investment consistent with repayment of the financing.</td></tr>
<tr><td>What is the airport’s goal?

What is the concessionaire’s goal?</td><td>Airports and concessionaires should also consider the following as part of structuring an airport concessions program:
1. Obtaining financing can often be a hurdle to ACDBE or small business participation in an airport’s concession program.
2. Involvement of third party lenders often comes with certain rights to secure repayment of their loans, which can add administration or reduce flexibility for the airport owner in making changes to a concession agreement.
3. Longer-term concession agreements needed to support required levels of investment reduces the airport owner’s flexibility to make changes to its facilities or concessions program as the aviation business evolves.
4. Under investment can lead to lower passenger spend while over investment places financial pressure on the concessionaire, increasing their vulnerability to passenger volume volatility and other business risks.</td></tr>
<tr><td>What were the typical approaches pre-COVID?</td><td>Airports have historically imbedded requirements for the concessionaire to finance fit-out, FF&E, and mid-term refurbishment (often as a percentage of initial fit out investment) within the concession agreement.</td></tr>
<tr><td>What are the typical approaches post-COVID?</td><td>Greater awareness of concessionaires’ exposure to airport passenger traffic risk may dampen concessionaire or lender appetite to take on financing of fit-out, FF&E and mid-term refurbishments. Airport owners may consider offering financing to increase participation of smaller businesses that could be “crowded out.”</td></tr>
<tr><td>What are the key tradeoffs between approaches?</td><td>Airports will look to balance proper levels of investment in its program, achieve goals for ACDBE/small business participation, and maintain flexibility in airport administration and facilities control. As such, airports may consider:
♦ Traditional concessionaire financed investment
    ○ Maintains the best balance of business risk and level of investment
    ○ Contractual obligations for ACDBE participation remain, but may not produce the same level of direct involvement in “local” concepts</td></tr>
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	○ Agreements will still require longer terms to amortize and repay investment ♦ Airport provided concessions financing ○ Transfers greater level of financing risk to airport (eliminating direct obligations to lenders outside of concession agreement with airport) and requires airport involvement in determining appropriate levels of investment to be financed ○ Increases opportunity for involvement of ACDBE and small/local concepts in concession portfolio with better access to low-cost capital, albeit with greater administrative requirements and credit risk for the airport ○ Potential for greater flexibility in agreement term and facility control ♦ Creation of a special purpose entity (SPE) to finance concessions investment ○ Potential to manage and diversify airport financing risk through a "pooled" risk approach to achieve lower cost of financing, but maintain higher availability to ACDBE and small/local venders ○ Greater costs and requirements on airport/SPE to determine maximum level of financeable investment and administer the program
Key impacts to other contract provisions	♦ ACDBE Program ♦ Risk Allocation ♦ Length of Agreement Term
Other considerations/impacts on different airports	The options discussed above may be considered on a stand-alone basis or as part of a portfolio approach. However, these options represent a spectrum of risks that may not be appropriate or manageable for every airport, so each airport should consider the trade-offs in risks and benefits within approaches to individual agreements and their program.

ACDBEs

What is it?	Airports receiving federal grants are required to maintain an Airport Concession Disadvantaged Business Enterprise (ACDBE) program consistent with 49 CFR Part 23. The main objectives of the ACDBE program are consistent with other federal DBE programs: ♦ To ensure non-discrimination in the award and administration of opportunities for concessions by airports; ♦ To create a level playing field on which ACDBEs can compete fairly for opportunities for concessions; ♦ To help remove barriers to the participation of ACDBEs in opportunities for concessions; and, ♦ To help remedy historic inequality and under inclusion of DBEs in airport concessions programs.
What is the airport's goal? What is the concessionaire's goal?	As a basic premise, Airports must maintain an ACDBE program under Part 23 (Participation of Disadvantaged Business Enterprise in Airport Concessions) as a condition of receiving federal grants. Businesses entering into concession agreements with airport operators will generally assist the airport owner in meeting its federal participation and reporting requirements as a condition of their concessions agreements.
What were the typical approaches pre-COVID?	Airports typically manage their ACDBE programs directly or with the assistance of prime contractors through terms and conditions included in their concession agreements.
What are the typical approaches post-COVID?	No changes in these approaches have been developed in the post-COVID environment related specifically to ACDBE programs. However, airports are increasingly seeking to develop concessions programs reflecting local brands, culture, and tastes. Purveyors of these local brands are typically smaller in scale and lack the financial resources of those representing national brands, and often fit the eligibility requirements of ACDBE programs. Proposed changes to the ACDBE program will increase personal net worth limits, require airports to undertake small business programs and take other steps. Since COVID, airports have learned that they must review joint venture agreements and ensure that any benefits provided to concessionaires reach all partners and to review the equitable impacts of any relief efforts.
What are the key tradeoffs between approaches?	Airport goals of developing a "sense of place" through their concessions programs using local concepts has great synergies with the ACDBE program, and in many cases, meets other local goals for equity and small business development. However, the significant administrative and cost burdens associated with operating commercial businesses in an airport environment (labor availability, security requirements, inventory, and supplier logistics, etc.) greatly dimmish the attractiveness of these opportunities to the very entities the airports are looking to do business with. Attracting these businesses may require changes to either contractual or commercial aspects of airports' traditional concessions programs.
Key impacts to other contract provisions	To further small, local, and ACDBE participation in airport concessions, airports may consider providing additional resources or incentives to these potential

	venders, either directly or through concession agreements with national concessionaires doing business with ACDBEs under their prime contract.
Other considerations/impacts on different airports	Airports may also consider different approaches to financing of concessions improvements and refurbishments (discussed earlier in this whitepaper). While certain approaches may improve access to capital and lower vender financing costs, it may also change risk allocations contained in traditional concession agreements, creating greater risk for airport operators. The potential for increased risks should be considered by each airport relative its financial constraints and policy goals. Note ACDBE regulations prohibit any local preference in selection of concessions.

Length of Agreement Term

What is it?	The duration of a concession agreement. It is common for there to be an extension option for additional years.
What is the airport's goal? What is the concessionaire's goal?	Concessionaires generally value term over any other key provision. It represents a predictable, long-term "backlog" of future revenues; ultimately and cumulatively it is a statement to the market indicating how much the firm is worth. Outside of what is prescribed in a concession agreement, a concessionaire may offer to make additional capital investment in its locations in exchange for an extension of term and longer terms can allow concessionaires time to recoup either initial upfront investment or high initial MAGs. Airport managers often use Term as a "carrot" to help get the concessions program it desires. During a public solicitation process, longer Term can attract a wider set of bidders and thus foster competition that benefits the airport. During a private negotiation with an incumbent, an extension of Term can align proprietor and tenant goals in preparation for, e.g., a redevelopment of terminal facilities.
What were the typical approaches pre-COVID?	Terms range widely and most commonly are between five and twenty years. Their length depends on a variety of factors, such as: ♦ Quality of opportunity/locations; ♦ Expected capital investment (which correlates with concession category); ♦ Coincidence/phasing of terminal development plans; ♦ Coincidence/phasing of other concession agreements. Term extensions are commonly embedded in a concession agreement, to incentivize good performance and allow flexibility for the airport operator. Most extensions range between one and five years.
What are the typical approaches post-COVID?	Since COVID effectuated "lost time" within Term, many airports offered extensions of term. A common extension period for COVID has been two additional years though no comprehensive survey has yet been taken.
What are the key tradeoffs between approaches?	With longer terms an airport can project with greater certainty future revenues further into the future. Also, the offer of longer term in a solicitation is likely to attract greater interest from concessionaires and could induce a more competitive set of proposals. On the other hand, shorter terms can give the airport operator more control and flexibility.
Key impacts to other contract provisions	♦ Concession Rent (e.g., greater of Minimum Annual Guarantees and percentage rent) ♦ Construction costs & mid-term refurbishment
Other considerations/impacts on different airports	Coincidence with major terminal (re-)development plans Any exclusive (i.e., only concession of that type) "long-term" agreement (i.e., longer than five years) must receive prior approval of the FAA Regional Civil Rights Office.

Options in the Event of Default

What is it?	Concessions agreements typically include a list of events that constitute default. Typically, these include failure to make payment when due, bankruptcy of the tenant, and failure to comply with other contractual obligations after notice and an opportunity to cure the default. The payment default provision typically results in negotiation of whether notice must first be given by the airport and, if so, if there is a cure period.
What is the airport's goal? What is the concessionaire's goal?	Airports should consider what failures by a concessions tenant are truly material to the airport and then tailor the timing of the event of default, and subsequent remedies, accordingly. Concessionaires want to avoid clauses that allow for default or allow for greater flexibility to remedy in the event of a breach of terms.
What were the typical approaches pre-COVID?	Remedies for an event of default have traditionally been limited and rely primarily on termination of the agreement. While this can be the ideal remedy for a tenant that is not likely to come into compliance, it can often be too draconian for the situation and can have impacts on concessionaires' financing options.
What are the typical approaches post-COVID?	Airports increasingly are turning to the use of liquidated damages (LDs) for the first few violations of lease provisions. Imposition of a liquidated damage provision both provides some compensation to the airport for violations but, more importantly, it highlights the failure of the concessionaire to comply with its lease terms and often focuses the concessionaire's management on remedying the lapse. Liquidated damages typically increase as the number of subsequent violations. Other remedies include allowing the airport to act on behalf and at the expense of the tenant, such as obtaining insurance coverage for the tenant, and billing the cost back or providing a specific service, but that remedy often requires an outlay of funds that may not always be feasible or recoverable.
What are the key tradeoffs between approaches?	It is important to align remedies with defaults. Termination is often drastic in comparison. LDs are being used more often to better align remedies.
Key impacts to other contract provisions	♦ Minimum Annual Guarantee ♦ Licensing and Branding ♦ Insurance, Legal Compliance and ACDBE requirements
Other considerations/impacts on different airports	It should be noted that while bankruptcy or insolvency of the tenant is almost always listed as an event of default, the federal bankruptcy code does not permit the enforcement of such so-called "ipso facto" clauses, and, thus, they will not be given effect. That is one of the reasons why most counsel strongly recommend that the security deposit be a letter of credit or bond – an asset of a third party instead of the tenant – which can be accessed in the event of a tenant bankruptcy. Drawing on such a security deposit to cure a tenant default also provides an actionable intermediate sanction short of termination.

Licensing and Branding

What is it?	Increasingly, the right to use a specific brand name is critical to the success of a concession. Some large concessionaires have entered into agreements with major brands that allow them to franchise that brand at airports and other locations around the country or the world. In other cases, the concessionaire obtains limited, local rights to use the brand name.
What is the airport's goal? What is the concessionaire's goal?	Airports are looking for recognizable, well-regarded brands as well as brands with local connections that provide a sense of place. Licensing can facilitate the introduction of such brands into an airport space operated by an experienced airport concessionaire. Concessionaires are similarly looking for the best brand opportunities that will entice and attract customers while retaining flexibility and control over their independent airport operations.
What were the typical approaches pre-COVID?	Among the considerations of importance to airports are the concessionaire's rights to use such branding and the concessionaire's consistency with the brand's practices. With respect to the former, the concession agreement should contain representations and warranties by the concessionaire that it has the legal right to use the specified brands at the airport location(s) specified, with a concomitant right to default the concessionaire if such representations are false. National brands are often quite insistent that the right to use their brand is accompanied by the obligation to meet the brand's standards.
What are the typical approaches post-COVID?	COVID has not led to material changes in airport licensing approaches, but airports are more frequently facing a less-discussed issue in which national concessionaires will often license the right to use a local business's name and logo to help provide the local look and feel that airports seek, but not undertake the obligation to provide substantially the same product.
What are the key tradeoffs between approaches?	There have been numerous instances where the concessionaire provides a product that does not resemble that of the licensed brand. For example, a local coffee shop may license its brand and logo, but find that the concessionaire is providing standard, undifferentiated coffee, which can result in frustration to local consumers expecting a familiar experience as well as potential bad marketing for the original brand. Airports may wish to ensure contractually that, if a national or regional concessionaire is licensing the name and logo of a local favorite, the product delivered by the concessionaire is also consistent with that of the local brand. This can include consulting with the licensed brand regularly, "secret shopper" visits to evaluate the product and other investigative mans to assure quality control.
Key impacts to other contract provisions	♦ ACDBE ♦ Options in the event of default ♦ Construction costs ♦ Indemnity against IP infringement ♦ Representations and warranties

Other considerations/impacts on different airports	Another alternative is to actively involve the local business in the airport location, which can result in multiple benefits, including increased quality, increased local participation and, potentially, assisting in achieving ACDBE goals. Some concessionaires will include mentorship programs to help provide outreach opportunities connecting their airport operations with local small businesses.

Data Management

What is it?	Concessionaires develop a great deal of data from their operations, some of which could be beneficial to the airport operator. Absent a contractual provision, however, concessionaires will typically take the position that any data generated through their business operations are property of the concessionaire (or franchisee) and will not be shared with the airport or others.
What is the airport's goal? What is the concessionaire's goal?	Before an airport seeks the right to obtain data from its concessionaires or to use customer data, the airport should work through the many issues that are raised by collecting and maintaining this data. Some of these issues are addressed in a separate AAAE ACT paper on digital and technology integration in airport revenue. Addressing data protection and the proposed uses of the data collected prior to any such collection should be the airport's goal. Information provided at a point of sale can include personally identifiable information (PII) that is protected under federal and state laws as well as under international laws. The holder of such information has certain non-delegable obligations to safeguard the data and, in the event of a breach, may be liable to the person whose data has been compromised in damages. Thus, the concessionaires will often either refuse to share such data or place substantial limitations and requirements around its collection and use by another party.
What were the typical approaches pre-COVID?	Recently, there has been a great deal of public discussion regarding the potential benefits of gathering this data for a number of uses, but there are also risks that airports should be aware of before contractually requiring that concessionaires share their data with the airport. From an operational standpoint, allowing an airport operator to access and process the data gathered by its concessionaires can be a powerful tool. Regular customers can be rewarded and a more powerful relationship between the airport and its passengers, or a three-way benefit among the concessionaire, airport and passenger, established.
What are the typical approaches post-COVID?	Making sure the concessionaire's data can be integrated with other datasets collected by the airport (e.g., FIDS), in order to better predict peak periods or add flavor to KPI. The rise of additional technology enablers such as mobile ordering, omnichannel marketing, smart menus, personalized pushed ads (utilizing AI) and others.
What are the key tradeoffs between approaches?	More data can lead to increased need for data storage and overall IT infrastructure and support. This has real costs for airports.
Key impacts to other contract provisions	♦ Street Pricing ♦ Indemnity and insurance (including cyber coverage)
Other considerations/impacts on different airports	Many consumers no longer expect that "their" data is theirs to hold in privacy and to deal with as they see fit, but others believe that they have a right to control who holds and uses their data. Failure to meet their expectations and unexpected or unrelated use of their data, for example though a sale to a third party, can be perceived as a breach of trust and undercut the very customer relationship that many airports are seeking to develop.

Wellness Charges

What is it?	Wellness or benefits charges are surcharges which allow concessionaires to charge an additional fee on top of the agreed airport pricing policy. Such fees are increasingly common as airports and concessionaires face staffing challenges, pressures for higher minimum wage and benefit commitments, and impacts from COVID.
What is the airport's goal? What is the concessionaire's goal?	Airports can find wellness charges preferable to price increases and they provide a mechanism for concessionaires to generate revenue for specific reasons, typically related to staffing. This is in part due to market conditions and union efforts which have pushed up labor costs, and in some cases, is due to evolving policy frameworks that have increased minimum wage regulations, particularly in special environments such as airports. Concessionaires are in favor of added flexibility to increase revenue that wellness charges allow. However, these charges are generally between 2-5%, and therefore, don't have the same impact that modifications to Street Pricing policy could.
What were the typical approaches pre-COVID?	Such policies were rare prior to COVID.
What are the typical approaches post-COVID?	During COVID, some airports utilized wellness charges as a compromise to calls to suspend Street Pricing rules. Post-COVID approaches have included: 1. Allowing a charge that contributes to employee benefits (e.g., San Francisco International Airport has a 2% Employee Health Benefits Fee) 2. Allowing a benefits charge, with conditions (ex. Oakland International Airport allows a 3% benefits surcharge with the option of increasing to 5% if the concessionaire includes a "Value Meal" [$10 max and must include entrée and drink] and "Deal of the Week" [$15 max and must include entrée and drink])
What are the key tradeoffs between approaches?	Theoretically, adding in below the line surcharges allows for less scrutiny around higher prices, however, there is potential for friction with consumers who feel misled by these surcharges. Increasing the Street Pricing percentage may have the potential to generate greater sales but also increases the "price shock factor". While the charges appear appropriate for managing short term and transitory disruptions to operations, they may not be well suited for permanent incorporation into concessionaire pricing and airports may need to consider limitations on use.
Key impacts to other contract provisions	♦ Street Pricing ♦ Percentage rent (reduced compared to increases in prices)
Other considerations/impacts on different airports	Public and political perception.

Summary and Conclusions

As outlined in the sections above, airports pursuing new or renewed concessions agreements need to consider a variety of key provisions which will impact concession operations, customer experience, airport finances, and management flexibility throughout the term of the agreement. The process of updating a concessions program must begin with an airport's assessment of their commercial approach, including whether to pursue a developer model, Prime concessionaire model, direct leasing, or some combination of the above. However, regardless of the commercial structure, airport management will still need to think through a number of key provisions and consider not only their independent importance but also the inter-dependence between provisions.

This review of key contract provisions also highlights the specific and acute challenges COVID posed to concessionaires during the dramatic and unprecedented collapse of passenger air travel in 2020. Since then, concessionaires and airports have faced heighted questions about how to create better allocation of risks between owners and operators given the variability of key business drivers, including most importantly of all, passenger traffic. What has been observed thus far is that many contracting structures have endured in more or less the same structure as was employed pre-COVID. However, there are some notable new perspectives, including a reconsideration of minimum annual guarantees, revisiting legal remedies for non-compliance or default, and developing additional mechanisms to adjust pricing and operations in response to unforeseen dynamics such as the pandemic's impacts on workforce safety and availability.

One key question which remains unanswered is whether some of these changes will prove only transitory or whether there will be an enduring change in approach. As noted in this paper, some of the recent adjustments, such as more flexible responses to concessionaires' financial distress, appear to be positive long-term developments which increase airport management's flexibility, while other recent changes, such as the imposition of "wellness charges," are aimed to address specific operational risks and appear to be better suited to address short-term market conditions than as a long term policy shift. However, allowing for the re-introduction of such temporary provisions within concessionaire agreements may be a long-lasting change.

Ultimately, airport managers need to consider their own unique concessions environment and the needs of their specific customer base, including both passengers and employees. Providing an excellent concessions experience can be achieved through a variety of commercial approaches and can be structured in ways that balance risk and financial return between all parties involved, including the airport itself. Finding the right balance of that risk allocation requires a deliberative process which considers each of the contract provisions outlined in this paper as well as other factors of importance to the airport and private concessions partners. Working across the airport's full management team and collaborating with external commercial, legal, and financial advisors is typically the best approach to define goals for a successful concessions refresh and to ultimately ensure that a thoughtfully considered concessions structure is executed with the best suited partners. Additional information and resources about concessions management can be found through AAAE as well as authors of this paper.

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The Finance Working Group has been actively supported by a range of airports and industry partners.

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