State of New York
Office of the State Comptroller
Division of Management Audit

PORT AUTHORITY OF NEW YORK AND NEW JERSEY

ADMINISTRATION OF AIRPORT AND BUS TERMINAL CONCESSION CONTRACTS

REPORT 95-S-98

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit

Report 95-S-98

Mr. Lewis M. Eisenberg
Chairman
Port Authority of New York and New Jersey
One World Trade Center
New York, NY 10048

Dear Mr. Eisenberg:

The following is our report on the administration of the Port Authority's airport and bus terminal concession contracts for the period January 1, 1992 through December 31, 1995.

This audit was done according to the State Comptroller's authority as set forth in Section 7071 of the Unconsolidated Laws of New York. We list major contributors to this report in Appendix A.

Office of the State Comptroller
Division of Management Audit

July 28, 1997

Executive Summary

Port Authority Of New York And New Jersey Administration Of Airport And Bus Terminal Concession Contracts

The Port Authority of New York and New Jersey (Authority) was created in 1921 to operate passenger terminals and transportation facilities within a 25-mile radius of the Statue of Liberty. The Authority's Aviation Department (Aviation) operates three major metropolitan-area airports: John F. Kennedy International (Kennedy), Newark International (Newark), and Fiorello LaGuardia (LaGuardia). Authority officials are responsible for awarding and monitoring concession operations at all passenger terminals that are not managed by the lessee airlines. Concession sales at all airport facilities totaled $239 million during calendar year 1995 ($10 million more than 1994) for the sale of food and other items including newspapers, toiletries, luggage, and clothing. The Authority's share of these revenues was about $28 million.

The Authority's Bridges, Tunnels and Terminals Department (Department) operates the Authority's bus terminal and other transportation facilities. During our audit period, the Department administered 43 concession contracts at the bus terminal providing the Authority with annual revenues of about $4 million.

Our audit addressed the following questions regarding the Authority's administration of airport and bus terminal concession contracts:

- Is the Authority's concession contract award process open and competitive?

- Are concession operations administered to maximize Authority revenue and to provide an acceptable level of customer service?

Audit Observations and Conclusions

Our audit found that Authority officials do not always manage an open and competitive concession contract award process. We also found that, despite the addition of several new commercial tenants, they have not filled a considerable amount of vacant concession space in the bus terminal; nor do they adequately monitor contractor performance and compliance with concession contract terms. We estimated that these deficiencies have resulted in millions of dollars in lost revenue.

At Newark airport, 8 vendors managed all of the 18 concession areas operating there during the audit period. Five of these vendors, who were managing 14 of the 18 concessions, have each operated at Newark for more than 20 consecutive years. They account for 25 (69 percent) of the 36 spaces available for lease in the airport. During the audit period, 11 of the 18 contracts reached their respective termination dates. However, competitive bids were solicited for just two of these contracts. The other nine contracts were renewed with the incumbent vendors as a result of direct negotiation or automatic renewals. (See pp. 5-6)

At Kennedy, we reviewed 12 of the 21 concession leases in effect during the audit period and found that only eight came up for renewal during this period. Of these eight, only three were awarded as a result of competitive bidding. The other five were renewed automatically or via direct negotiation. (See p. 6)

At the bus terminal, where formal bidding procedures have not been developed or adopted, only one of the nine concession contract files we reviewed showed any evidence that Department officials had attempted to solicit competitive bids for concession space. Instead, concession contracts were renewed continuously without question, including one vendor who, at times, had owed the Authority approximately $59,000 in back rent. (See pp. 6-8)

We found that the Newark and Kennedy airport facilities made efficient use of their available concession space. However, the bus terminal had a considerable amount of vacant concession space. In fact, during our fieldwork, we observed 25 percent of this terminal's available concession space (35,417 square feet) was not being used to generate concession revenue for periods ranging from several months in one case, and up to 15 years in another. Based on the prevailing market rental rates at this facility during the corresponding periods of vacancy, we estimate the Authority could have earned as much as an additional $3.7 million in concession revenue had these vacant spaces been rented. (See pp. 9-11)

The Authority's Internal Audit Unit periodically reviews concession contractor books and records to ensure that the Authority receives its proper share of concession revenue. However, there is no evidence that any other aspects of contractor performance (e.g., hours of operation; services/products provided; pricing, etc.) are monitored by Authority officials. Our own observations of contractor practices found that some concessions were not open for business during all required hours, while others were selling their commodities for prices exceeding those approved by Authority officials, and exceeding those charged by retail chains in the surrounding areas. Such practices can lead to lost revenue and consumer dissatisfaction. (See pp. 13-16)

Comments of Authority Officials

Authority officials indicated that the decisions to not competitively bid selected concession contracts or to hold available concession space off the market were made with good reason. They also believe that our draft report did not present a balanced picture of the Authority's efforts to improve the retail environment at its facilities. We have addressed their concerns in this final report.

Contents

Introduction

Background

The Port Authority of New York and New Jersey (Authority) was created in 1921 to operate passenger terminals and transportation facilities within a 25-mile radius of the Statue of Liberty. The Authority is governed by a 12-member Board of Commissioners (Board). The Governors of New York and New Jersey each appoint six members to the Board, which in turn elects one of its members to serve as Chairman. The Board also appoints an Executive Director, who is responsible for the daily management of the Authority's 39 facilities.

The Authority's Aviation Department (Aviation) operates its three major metropolitan-area airports: John F. Kennedy International (Kennedy), Newark International (Newark), and Fiorello LaGuardia (LaGuardia). Concession sales at these facilities totaled $239 million during calendar year 1995 ($10 million more than 1994) for the sale of food and other items including newspapers, toiletries, luggage, and clothing. The Authority's share of these revenues was about $28 million, a slight increase over the revenue received in 1994.

Authority officials are responsible for the direct management, including concessions, of all passenger terminals not managed by the lessee airlines. For example, at Newark Airport terminals A and B, the Authority contracts directly with all concessionaires, while at terminal C, a major airline contracts directly with concessionaires subject to the Authority's approval. Similarly, at Kennedy, the Authority is responsible for contracting with, and monitoring, concessionaires at the airport's International Arrivals Building, while Kennedy's other eight terminals are managed by private airlines.

In 1989, as part of an overall renovation of LaGuardia Airport, the Authority hired several consultants to study the retail business at its Central Terminal Building (Terminal). The goal of the study was to identify ways for LaGuardia to optimize concession revenues, improve customer service, enhance the airport's overall image, and assess the benefits of privatizing concession operations. As a result of this study, a multi-year contract was awarded in 1994 to a developer/management company for renovating the Terminal, contracting with concessionaires during the renovation, and managing the concession operations thereafter.

The Authority's Bridges, Tunnels and Terminals Department (Department), formerly known as the Interstate Transportation Department, is responsible

for surface transportation, planning, and policy analysis. It operates the Authority's bus terminal and other transportation facilities, including the Holland and Lincoln tunnels. More than 50 million passengers a year use the bus terminal, where approximately 6,800 buses arrive and depart on a typical weekday. During our audit period, the Department administered 43 concession contracts at the bus terminal providing the Authority with annual revenues of about $4 million.

Audit Scope, Objectives and Methodology

We audited the Authority's administration of airport and bus terminal concession contracts for the period January 1, 1992 through December 31, 1995. Our audit objectives were to determine whether contract awards for these concessions are open and competitive, and whether the Authority administers its concession contract operations to maximize revenue and ensure that facility users are provided with an acceptable level of customer service. To accomplish these objectives, we reviewed applicable laws and regulations, interviewed appropriate Port Authority officials and staff, and reviewed relevant records at Authority offices in the World Trade Center, the airports and the bus terminal. We also performed physical observations at airport and bus terminal concession facilities.

Our review of LaGuardia's concession contracts was limited to an overview of the contract award process used to hire the newly-appointed independent management company. We determined that Authority officials had considered relevant factors, such as contractor experience and financial issues, in their decision to privatize.

We did our audit according to generally accepted government auditing standards. Such standards require that we plan and do our audit to adequately assess those Authority operations which are included in our audit scope. Further, these standards require that we understand the Authority's internal control structure and compliance with those laws, rules and regulations that are relevant to the Authority's operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, finite audit resources are

used to identify where and how improvements can be made. Thus, little audit effort is devoted to reviewing operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas that need improvement and does not address activities that may be functioning properly.

Comments of Authority Officials

A draft copy of this report was provided to Authority officials for their review and comment. Their comments are included in selected sections of the report and are presented in their entirety as Appendix B.

Within 90 days after final release of this report, we request that the Chairman of the Port Authority of New York and New Jersey report to the Governor, the State Comptroller, and leaders of the Legislature and fiscal committees of the State of New York, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Concession Contract Award Process

Considering the number of persons frequenting the Authority's airport and bus terminal facilities, and the limited number of concession spaces available, it is reasonable to assume that these facilities would be quite attractive to prospective concessionaires. The Authority is not required by law to use competitive bidding for obtaining concessionaires. However, as a general rule, it's good business practice to follow an open and competitive contract award process at all Authority facilities to ensure that as many vendors as possible have the opportunity to compete for the spaces, that high-quality services with the greatest revenue return to the Authority are obtained, and that the appearance of favoritism is avoided. Such a process requires soliciting bids in sufficient time for contractors to submit a response, and holding public bid openings that will allow all bidders to attend and be assured that the contract award process is fair and equitable. Exception to this practice may occur, however, explanation and justification for these exceptions should be documented to protect the Authority from complaints and perceptions of unfair business practices.

The Aviation Department staff reportedly follow "Aviation Department Guidelines for Determining Method and Criteria for Award of Airport Terminal Concessions" when awarding concession contracts. These guidelines list qualitative and quantitative criteria that staff are expected to consider before they renew concession contracts with concessionaires. The criteria include:

Customer Service (the number of customer complaints received against the concessionaire);

Financial Performance (concessionaire sales and revenue trends, timeliness of past rental payments and financial reporting); and

Merchandising/Marketing (concessionaire creativity in advertising and maintenance of attractive shopping facilities).

According to the guidelines, the Authority's "overall goal is to develop a healthy combination of competitive proposals and renewals of concessionaires who have demonstrated the desired commitment to service and financial performance." However, the guidelines neither address methods of identifying the best prospective vendors without prior Authority experience, nor recommend specific contract renegotiation time intervals.

We found that Aviation's concession contracts are not always awarded openly and competitively. For example, at Newark, just 8 vendors managed all of the 18 concession areas operating there during the audit period. Five of these vendors, who were managing 14 of the 18 concessions, have each operated at Newark for more than 20 consecutive years. They account for 25 (69 percent) of the 36 spaces available for lease in the airport.

During the audit period, 11 of the 18 contracts reached their respective termination dates. However, competitive bids were solicited for just two of these contracts. The other nine contracts were renewed with the incumbent vendors as a result of either direct negotiation or automatic renewal.

In five of the nine cases, Newark officials told us they believed it was in the airport's best interest to negotiate directly with the existing concessionaires. For example, two of the concessions renewed (duty-free shop and newsstand) were operated by minority-owned business enterprises. Because Newark officials were satisfied with the past performance of these vendors, and one of the Authority's purchasing objectives is to include minority-owned businesses in the contract award process, they decided not to put the contract out to bid. However, we saw no evidence that Newark officials had attempted to develop a pool of minority-owned business enterprises that offer these or similar products. Had they done so, they could have continued to contract with minority-owned concessions and obtained the benefits of competitive bidding.

At Kennedy, we reviewed 12 of the 21 concession leases in effect during the audit period and found that only eight of them came up for renewal during the period. Of these eight, only three were awarded as a result of competitive bidding. The other five were renewed via direct negotiation or automatic renewal.

According to Authority officials, concessionaires are allowed to amortize their capital investments over the period of their leases. In certain instances, they are allowed to invest more than they can realistically recoup during the contract period in view of projected sales. In such cases, if their contracts are not renewed, the Authority is liable for the amount of money unamortized at the end of the contract period. For example, we found that in 1991, the Authority had renewed one of its food service concessions two years before the lease was due to expire. Since the concessionaire had invested $1,030,000 of unamortized capital expenditures at its airport facility, the Authority would have been contractually obligated to reimburse the concessionaire for its "unamortized investment loss" if the Authority did not renew the concessionaire's lease. Such arrangements limit the Authority's options at lease renewal.

At the bus terminal, where formal bidding procedures have not been developed or adopted, only one of the nine concession contract files we reviewed showed any evidence that Department officials had attempted to solicit competitive bids for concession space. Instead, concession contracts were renewed continuously without question, including one vendor who, at times, had owed the Authority approximately $59,000 in back rent. As a prerequisite to renewal of these contracts, the vendor paid the overdue rent.

As a result of these deficiencies, potential contractors who may have been able to enhance Authority revenue as well as customer service, were not given the opportunity to do so.

Aviation and Department management offered a number of explanations and comments on their concession contract operations both during our field work and in response to our draft report. For example, bus terminal officials told us they are not required to follow any established concession administration procedures. Authority officials also noted that the Bus Terminal currently has a broader mix of quality retail shops than at any time in the recent past. This mix has resulted in significantly increased retail sales for concessions. They further believe that most retailers nearby the Terminal will not respond to a bid solicitation. Newark officials disclaimed any responsibility for current long-term concessionaires and cited them as the result of prior administration's management. Kennedy officials told us that plans to make major renovations at the International Arrivals Building, which never came to fruition, resulted in management's hesitation to bid competitively for concessionaires while renovations were pending.

Furthermore, Authority officials indicated that at times, it was more cost efficient to renew the lease of a current tenant to avoid possible temporary revenue lapses between outgoing and incoming vendors due to concession area renovations. They also noted that in 1992 they hired a retail leasing professional to help them develop a "Bus Terminal Retail Master Plan." Pursuant to the plan, instead of formal competitive bidding, qualified retailers are identified and pursued. The plan suggests the Authority pursue an attractive product mix and offers examples of potential retailers by product category (e.g., fast foods and newstands). For example, in the fast food category the consultant offers such names as McDonald's, TCBY, and Taco Bell.

The competitive bidding process should entail adequate planning and occur in sufficient time prior to lease expiration to avoid temporary revenue lapses between tenants. We acknowledge the improvements in the Bus Terminal's mix of retail shops and the corresponding increased retail sales. Authority officials state, ". . . retail leasing professionals have advised Bus Terminal

staff that an appropriate level of quality and mix of tenants cannot be produced through competitive bidding . . ." However, we do not suggest the level of quality expected or the mix of tenants be part of the competitive process. Officials should first establish the desired mix of tenants, and the quality standards to be achieved. Once that is done, then competitive bidding can be used to select the vendors.

In addition, although Bus Terminal retail sales have almost doubled between 1990 and 1995, the Authority's share of concession revenue increased by only 15 percent. We believe a more consistent policy for awarding and renewing concession contracts would maximize concession revenue to the Authority.

Recommendations

1. Make greater use of formal open competitive bidding procedures to maximize returns from Authority concession contract operations.

2. Document the reasons where competitive bidding is not an option or the preferred method.

3. Assess all current concession contracts to determine whether contract terms such as capital investment components are reasonable, in line with industry standards, and likely to provide the Authority with a reasonable share of revenue. Use the results of this assessment when negotiating contract renewals.

Vacant Concession Space

To the extent possible, all available concession space at airport and bus terminal facilities should be utilized to maximize Authority revenue and to provide sufficient services to facility users. We found that the Newark and Kennedy airport facilities made efficient use of their available concession space, and we commend Authority officials for their efforts at these facilities. The officials have renovated space, added new stores, and taken creative approaches in matching retailers with available space. We also observed noticeable improvements to space utilization at the Bus Terminal's concession area when compared to the early 1990s, as retail sales at the Bus Terminal reportedly grew from $27 million in 1990 to nearly $46 million in 1995, and several prominent retailers began leasing space in the Bus Terminal.

However, despite these improvements in Bus Terminal operations, the Bus Terminal still has a considerable amount of vacant concession space. In fact, during our observations, 25 percent of this terminal's available concession space (35,417 square feet) was not being used to generate concession revenue for periods ranging from several months in one case, and up to 15 years in another. Based on the prevailing market rental rates at this facility during the corresponding periods of vacancy, we estimate the Authority could have earned as much as an additional $3.7 million in concession revenue had these vacant spaces been rented.

EXAMPLES OF REVENUE OPPORTUNITIES

BUS TERMINAL VACANT CONCESSION SPACE AS OF SEPTEMBER 30, 1995

Example	Available Sq. Ft.	Sq. Ft. Rental Value*	Years Vacant	Estimated Lost Rental Revenue
1	900	$19	14.67	$250,873
2	1,470	19	12.67	353,873
3	6,800	9	10.67	653,004
4	4,587	35	2.58	414,206
5	4,800	38	5.67	1,034,208

* Per most recent actual rents collected for these spaces.

Bus Terminal officials told us that concession space vacancies exist because of their long-standing plan to use some spaces for central ticketing and to combine others into larger areas for future rental. They also stated that anytime a decision is made to hold (concession) space off of the market, a detailed analysis is performed evaluating the opportunity cost of holding the space off of the market versus the cost of lease buyouts upon early termination. However, examples of these detailed analyses, prior to 1996, were not provided to the audit team, nor did they have a schedule for implementation of their plan to use space for central ticketing. They also told us that they believed the unattractive locations of their vacant space made it difficult for them to find tenants. Therefore, they disagree with our estimates of the lost revenue opportunities illustrated above. They believe our estimates are unsupportable since much or the space was not leasable without substantial capital investment to improve the visibility and accessibility of the space. Yet our own observations found that several of these locations were heavily trafficked, and that neighboring concessions, such as the deli, received a continuous flow of customers.

The concession space in question has been vacant for a long time and bus terminal officials have been asking for higher than market rents. We asked two independent property appraisers, as well as several vendors in the terminal's immediate vicinity, to quote a reasonable commercial rent for an 8th Avenue location. Each indicated that an annual rate of $50 per square foot was reasonable. However, we noted that since these spaces became vacant, bus terminal officials were asking from $60 to $85 per square foot for several of their vacancies, or $10 to $35 per square foot above the quoted figures. When we brought this issue to the attention of bus terminal officials, they noted that in some cases they were achieving the higher rates. They also indicated that rent depends on several factors including store size, location, and products sold. They further note that since rental rates are directly correlated to established sales levels, rental revenue will continue to increase as new leases and renewals reflect the increase in sales.

We agree, in general, with the rent-driving factors noted by Authority officials. It is for these very reasons that their current asking rates need to be revisited and reassessed. We also believe that Department officials have not marketed their available space adequately. For example, the bus terminal building houses a U.S. Post Office branch on the second floor. There is no marquis or other public notice of this branch location visible to persons walking in or around the terminal building. In fact, our random survey of 100 terminal users found that 77 of them were not aware of this branch location. It is reasonable to assume that widespread knowledge of this branch location would increase the number of persons entering terminal premises, thus increasing the number of potential concession customers.

Recommendations

4. Continue efforts to maximize space utilization and strategically plan renovations to minimize loss of potential concession revenue.

5. Reassess the reasonableness and competitiveness of the commercial rental rates bus terminal officials are currently asking.

Monitoring Concession Operations

Concession contract operations should be monitored to ensure that the Authority receives its proper share of concession revenue and that concessions provide sufficient and adequate services to users of Authority facilities. The Authority's Internal Audit Unit periodically audits concession contractor books and records to ensure that the Authority receives its proper share of concession revenue. However, there is no evidence that any other aspects of contractor performance (e.g., hours of operation, services/products provided, pricing, etc.) are monitored by Authority officials.

Our own observations of contractor practices found that some concessions were not open for business during all required hours, while others were selling their commodities for prices exceeding those approved by Authority officials. Such practices can lead to lost revenue and consumer dissatisfaction.

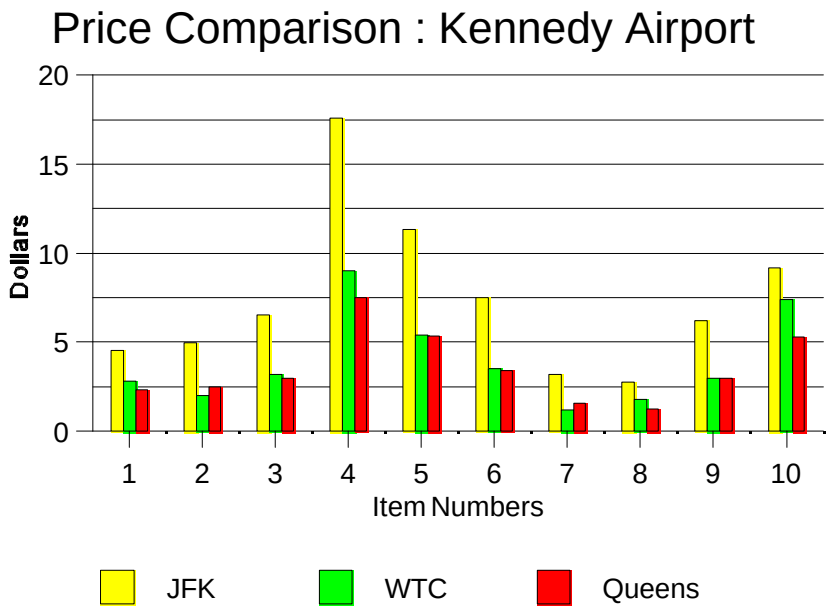
According to the concession contract files we reviewed, concessionaires are to be open 24 hours a day, 7 days a week, unless a revised schedule of operation is agreed to in writing by Authority officials. We were told that this requirement is based on the premise that airport and bus terminal facilities are never closed and the needs of their customers must be accommodated around the clock.

We visited Kennedy Airport concessionaire locations on four separate occasions both before and after the normal business day of 9 a.m. to 5 p.m., to determine whether concessions were accommodating early-morning and late-evening passengers. On each occasion, we found that at least two concessions were closed, contrary to Authority policy and contractual agreements. In fact, on one of these occasions, eight concessionaires were closed, despite the fact that airplanes were still arriving and departing. Closed concessions included the newsstand, music store, and trading shop.

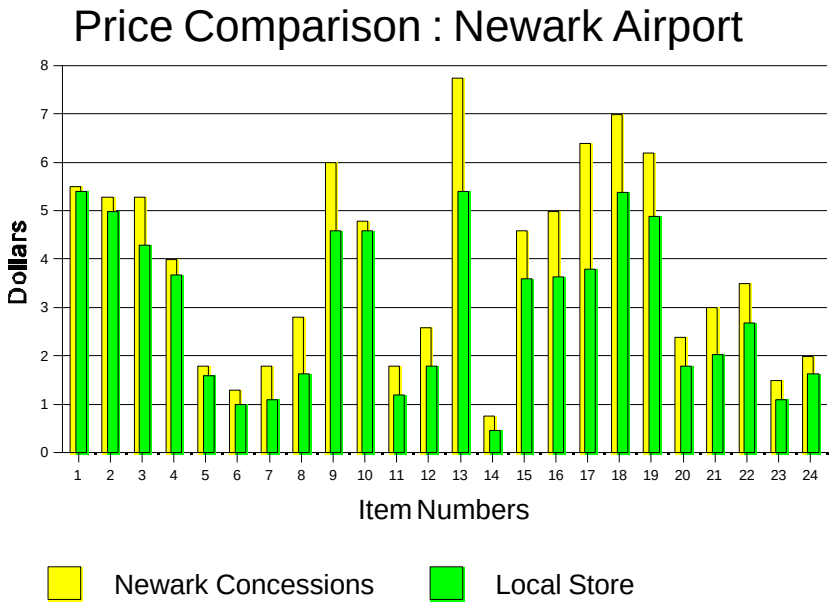
Our random observations at Newark and the bus terminal found concessionaires to be operating during early morning and evening hours on each occasion.

According to Airport officials, vendors are required to implement competitive pricing practices commensurate with the prices charged in the neighboring communities and/or similar retail operations. To test compliance with this contractual provision, we compared the prices of ten items sold at one of Kennedy's gift shops with prices charged for identical products at a retail outlet in the World Trade Center (another Authority-managed facility) and

a local Queens outlet for a national drug store chain. As the following chart illustrates, the prices for the items sold at Kennedy were an average of 88 percent higher than the prices charged at the World Trade Center, and an average of 103 percent higher than those charged at the local retail outlet. We performed a similar comparison at Newark Airport, comparing the prices of 24 items sold by airport concessionaires to the prices charged at a large retailer located in the City of Newark. The prices for items



sold by airport concessionaires exceeded those charged by the local retailers by an average of 29 percent.



Kennedy officials told us they were aware of the price differentials at airport concessionaires and were working to make them more competitive. However, Newark officials suggested that our comparison of prices was not fair because we compared airport concessionaires to a national chain that offers retail discounts. We are not suggesting that airport concessions must charge the same prices as large national chains. However, our comparison shows substantial price differentials for many items, thus demonstrating that there are opportunities to create a more competitive pricing environment.

Authority officials agreed that they have not formally monitored concession contractor performance or compliance with non-financial contract terms. However, they claim to have recently established audit units that will do so on a formal basis.

Recommendation

6. Establish formal procedures for monitoring contractor performance, including revenue reporting, hours of operation and pricing, and take corrective action with concessionaires which do not comply with contract requirements.

Major Contributors to This Report

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January 28, 1997

Mr. David R. Hancox
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Re: Office of the New York State Comptroller -- Draft Report on the Administration of Airport and Bus Terminal Concession Contracts, dated November 22, 1996

Dear Mr. Hancox:

We have received the referenced draft report forwarded to Mr. Lewis M. Eisenberg, Chairman of The Port Authority of New York and New Jersey, by your letter dated November 22, 1996. Our immediate observation is that the report does not present a balanced picture of the Port Authority's efforts to improve the retail environment at its facilities. For example, the report fails to mention the substantial and important changes which have been implemented over the past five years at the Port Authority Bus Terminal (Bus Terminal) to create a vigorous and healthy retail environment. Furthermore, the report also fails to focus on the creative approaches that we have used to implement new concession opportunities at our airport facilities.

By all accounts, the Bus Terminal has a broader mix of quality retail shops, provides a more secure environment for its patrons and is drawing more non-bus passengers to its concession space than at any time in the recent past. The fact is that retail sales at the Bus Terminal have grown from $27 million in 1990 to nearly $46 million in 1995. Bus Terminal revenues from retail operations have increased from $3.4 million to $3.9 million over the same period and are estimated to total $4.1 million for 1996. Since rental rates are directly correlated to established sales levels, revenue will continue to increase as new leases and renewals reflect the dramatic increase in sales.

Appendix B

Concession sales at the Port Authority's three major airports totaled $239 million in 1995 -- an increase of $10 million over total concession sales recorded for the previous year. Strong concession sales at our airports is due to several reasons including physical improvements, such as new stores and renovations of concession space in several terminals, and higher levels of passenger traffic. For example, the quality and quantity of concession offerings in the Central Terminal Building (CTB) at LaGuardia Airport have significantly improved since Marketplace LaGuardia Limited Partnership's (MLLP's) arrival in September 1994. The newly redeveloped West End Mall area of the CTB has three new food and beverage stores and four new retail outlets. The four new retail stores include Warner Brothers, Sweet Factory, Hudson News and Sunglass Hut. MLLP's plan for the Center Section calls for eight different retail offerings including books, cosmetics, optical services, jewelry, clothing and accessories. MLLP's ability to attract name-brand tenants has not compromised its ability to negotiate favorable rent terms and conditions. In fact, some of the new agreements have more favorable terms than the older agreements. MLLP has also succeeded in attracting tenants not normally found at airports (Warner Brothers' first airport location other than Orlando, Florida and Wendy's second airport location nationwide).

The Port Authority has also instituted a Kiosk Program at John F. Kennedy's International Arrivals Building (IAB) in which retail revenue is equally shared with the airlines. The program, with little cost to the PA and airlines, commenced in 1995 with a few kiosks placed in the departure areas of the IAB. By 1996, it had expanded to a total of fourteen kiosks, which generated new retail sales of approximately $3.5 million and total revenue of approximately $600,000. Tie Rack, with one kiosk in the West and East Wings leads retail sales with approximately $800,000 per year. It should be noted that the operations of the IAB will be turned over to a private developer/operator who will provide new retail concepts for food, beverage and consumer service businesses that will access national, regional and local markets.

Our comments with respect to the specific recommendations follow:

Recommendation #1 **Establish formal open competitive bidding procedures for all Authority concession contract operations. Ensure that Authority staff responsible for awarding concession contracts understand these procedures.**

We do not believe that competitive bidding is the best strategy for selecting concessionaires in all cases. When competitive bidding has made sense from a business and operational perspective, it has been used to select concession contractors. For example, Marketplace LaGuardia Limited Partnership (MLLP), the concession operator at LaGuardia Airport, was selected as the result of a formal

competitive bidding process. However, it is our policy to make exceptions to the competitive bidding process based on the performance of the current contractor, assuring adequate Disadvantaged Business Enterprises (DBE) opportunities and the testing of new retail concepts. If a vendor is performing in an acceptable, mutually profitable manner and maintaining the premises in first-class condition, we continue to believe that it is appropriate to grant a lease extension.

It would be impractical to implement formal competitive bidding procedures at the Bus Terminal. Most retailers particularly those located in the Central Business District where competing businesses are nearby simply will not respond to a request for a competitive bid. Furthermore, retail leasing professionals have advised Bus Terminal staff that an appropriate level of quality and mix of tenants cannot be produced through competitive bidding and such a practice would ultimately result in lower customer satisfaction, lower sales and lower rental revenue.

Instead of formal competitive bidding, qualified retailers are identified and pursued by leasing staff, who use as a guide the Bus Terminal Retail Master Plan that was developed in conjunction with Halcyon Real Estate Advisors/Ernst & Young in 1992. As is consistent with the industry, the use of brokers assures us that retail space is openly marketed and that we have an opportunity to consider the best and widest array of prospects that the "market" has to offer. Bus Terminal leasing staff have relationships with over 60 brokers who specialize in leasing retail space. They actively market the facility to these brokers, who often "control" national and regional retail tenants (i.e., a retailer selects sites in a given locale exclusively through a specific broker, and refers all landlord solicitations to that broker, who rarely, if ever responds to requests for bids).

Because of the reinvigorated retail environment at the Bus Terminal, staff are now able to negotiate leases under competitive conditions (i.e., several offers are received for the same space) for prime sites as they become vacant. Examples of leases that have been negotiated under competitive conditions include Cosmetics Plus, Mrs. Fields' Cookies, Radio Shack, International Shoppes (Hallmark), Sak's Florist, Ports of Call, Broadway Sneaker, and McAnn's Pub.

Recommendation #2 **"Document the reasons for any decision that competitive bidding is not an option."**

In those areas where competitive bidding procedures are appropriate, we have instructed staff to document the reasons for non-compliance.

Recommendation #3 **Assess all current concession contracts to determine whether contract terms such as capital investment components are reasonable, in line with industry**

standards, and likely to provide the Authority with a reasonable share of revenue. Utilize the findings when negotiating contract renewals.

During the initial lease negotiations, we thoroughly review all proposed contract terms, including "capital investment" requirements (normally referred to in the industry as tenant improvements), to ensure that they are reasonable and consistent with market conditions. As part of our lease renewal evaluation process, we conduct an analysis of the tenant's current and past financial condition, sales performance, and arrearage history. This analysis also includes a review of the lease renewal terms on a net present value basis and Equal Constant Rent (ECR) per square foot basis. This information, along with other factors, including tenant quality and mix, is used to determine if a lease renewal is in the best interest of the Port Authority and its customers. It should be noted that in many instances, it is significantly more expensive to replace rather than renew a tenant. Not only is the revenue stream interrupted while the space is being released and built out for the new tenant, but also, a full commission is payable on a new Bus Terminal lease whereas the Port Authority generally does not pay commissions on renewals.

Recommendation #4 **Implement an aggressive concession space rental program with the objective of maximizing space utilization, concession revenue, and vendor competition.**

The best indicator of our aggressive efforts and progress in leasing vacant space at the Bus Terminal is our track record over the past four years. The vacancy rate at the end of 1996 was 22 percent -- lower than at any time during the audit period. As a result of the initiatives and strategies outlined in the Retail Master Plan, the Bus Terminal now attracts high-caliber national and regional retailers. During the audit period, leases were executed with Au Bon Pain, Timothy's Coffees, Sweet Factory, California Burrito, Ditsch Pretzel, Hudson News, Deli Plus, Sunglass Hut, and NatWest Bank (ATM). Since November 1995, leases have been signed with Radio Shack, Mrs. Fields' Cookies, Cosmetics Plus, Villa Pizza, General Nutrition Center and H & R Block. These new leases have resulted in $10 million of leasehold investment by our tenants.

The leasing of space formerly occupied by Walgreen's is an excellent example of how staff aggressively moved to fill vacant space with quality tenants. Five months after Walgreen's had vacated its space, agreement on lease terms was reached with three prominent retailers - Cosmetics Plus, Radio Shack and International Shoppes (Hallmark) - to fill the space. By anyone's standards, this was impressive. Staff will continue to aggressively market vacant space at the Bus Terminal; however, there will always be some vacant space because all space is not created equal. It is a fact of life that some of the retail space is located in undesirable areas. Nonetheless, Bus

Terminal retail leasing staff have shown excellent results in developing creative, revenue-generating uses for hard-to-lease space -- e.g., H & R Block.

One point made in the audit, that the Bus Terminal retail space -- if 100% leased -- could have generated an additional $3.7 million in revenue over the past 15 years, is not supportable since much of the space will not be leasable at any rate without substantial capital investment by the Port Authority to improve the visibility and accessibility of the space. As rental rates in the Bus Terminal improve, it may be possible in the future to justify such expenditures.

In certain instances, space has been held off the market in the short term in order to provide flexibility for long-term planning and improvements. Such was the case with the space noted in the audit as held off the market because of a plan to revise central ticketing. As a policy, each of our leases contains a 30-day cancellation clause, which provides for reimbursement of the unamortized cost of the lessee's improvements. This provision ensures that the transportation facility maintains flexibility to make alterations that are in the best interest of its patrons while giving retailers comfort that the large investments they make in the leaseholds will be repaid should it become necessary to exercise the provision. Anytime a decision is made to hold space off of the market, a detailed analysis is performed which evaluates the opportunity cost of holding the space off of the market versus the cost of lease buyouts upon early termination. Because of the prohibitive cost associated with buying tenants out of newly leased space, it was determined by staff to be a prudent business decision to hold space off the market until a final decision was made about central ticketing. Ultimately, a decision was made to not implement the plan to revise central ticketing and the subject space is now being actively marketed.

Recommendation #5 **Reassess the reasonableness and competitiveness of the commercial rental rates bus terminal officials are currently asking.**

Asking rent depends on several factors, including store size, location within the building, amount of store frontage, tenant sales performance, the type of product to be sold, profit margin, and tenant investment. In retail leasing, food, kiosks, newsstands, and small retail locations typically command higher rents per square foot than larger stores and recreational establishments. The asking rents for all locations are negotiable and all reasonable offers from qualified tenants are considered. It should be noted that we are achieving $60 to $85 per square foot rentals. Timothy's Coffee, Kelly Direct, Sweet Factory, Sunglass Hut, Zaro's, and Hudson News are all paying in excess of $100 per square foot. For larger space and secondary locations, we are receiving offers of $60 to $85 per square foot. For low-traffic areas and commercial spaces, the rental rates are less.

Recommendation #6 **Establish formal procedures for monitoring contractor performance, including revenue reporting, hours of operation, pricing and customer satisfaction.**

The Port Authority has assigned staff to monitor the retail operations at its facilities. For example, at Kennedy International Airport a separate division monitors concession operations at the airline-operated terminals and the International Arrivals Building (IAB). The Concession Management Plan, which was developed for airport facilities in 1995, addresses specific topics, such as pricing and store operations. It should be noted that formal procedures for monitoring tenant compliance with lease terms have been established at our airport and Bus Terminal facilities.

Recommendation #7 **Take corrective action if concessionaires are not complying with contract requirements.**

As part of our concession management strategy, corrective actions have been, and will continue to be, taken to ensure tenant compliance with lease terms. With respect to the finding that some airport concession prices substantially exceeded the prices charged by local retailers for similar items, we have requested all concessionaires to provide us with a listing of their current prices. Based on a survey of off-airport locations, we will provide each retail operator with a list of acceptable prices which is consistent with our pricing policy. Port Authority staff will periodically monitor concession operations to enforce its pricing policies.

We appreciate the efforts of your staff to identify ways in which the Port Authority can improve its management of concession contracts. However, a major shortcoming of this report is that it fails to adequately recognize the many successful initiatives that have been undertaken by the Port Authority to improve the retail environment at its facilities. It is our expectation that the final report will present a more balanced picture.

Sincerely,

Charles F. McClafferty
Chief Financial Officer

cc: Hon. L. M. Eisenberg, Chairman
The Port Authority of NY & NJ

Mr. G. J. Marlin, Executive Director
The Port Authority of NY & NJ

Ms. P. A. Woodworth, Director
NYS, Division of the Budget