

COUNTY OF MILWAUKEE
Inter-Office Communication

Date: February 3, 2009

To: Supervisor Gerry Broderick, Chairman, Committee on Parks, Energy and Environment
Sue Black, Director, Department of Parks, Recreation and Culture

From: Douglas C. Jenkins, Deputy Director of Audits

Subject: Request to Change Coast Restaurant from a Year-Round Walk-In Restaurant to a "Reservation Only" Facility [File No. 07-175(a)(a)]

At its meeting on January 27, 2009 the Committee on Parks, Energy and Environment considered a request from the Parks Director to allow the Zilli Hospitality Group permission to change the Coast Restaurant from a year-round walk-in restaurant to a "reservation only" facility. The request was for permission to make the change, with rental, utility and commission payments to remain as currently provided for in the existing lease.

The Committee referred the matter to the Department of Audit and Corporation Counsel to review the terms of the existing lease for a report back on the appropriateness of the lease terms as applied to a "reservation only" facility.

Subsequent to the referral, Zilli Hospitality Group submitted a revised proposal (see attached) that would retain walk-in restaurant service, but with a reduced schedule. Under the revised proposal, walk-in restaurant service would be provided throughout the year for specified hours on six holidays/special days, and for unspecified evening hours Tuesdays through Fridays. Remaining Saturdays through Mondays would be open for "reservation only" bookings. In addition, Zilli Hospitality Group has proposed opening the restaurant 20 times throughout the year for non-profit organizations and community groups, with free access to rooms, coffee, soda, water and audiovisual equipment. Food and bar would be available to such groups for a fee. The proposal also includes, at no cost to the County:

- Removal of a small private dining room and replacing the area with a semi-permanent wood dance floor.
- Removal of 20 feet of a rounded wall, with a new ceiling and floor to match the existing interior.

Additional enhancements are proposed for the interior of the facility, such as fresh paint, re-staining of all doors, and lighting effects that mimic water movement and natural blue uplighting.

Although not specifically addressed in the attached revised proposal, Zilli Hospitality Group has confirmed that the revised proposal is made with the understanding that all rental, utility and commission payments would remain as currently provided for in the existing lease.

Background

At the O'Donnell Park lakefront site, the Parks Department has lease and management agreements with Zilli Hospitality Group (d/b/a Grandview Management, Inc. and Ellen's Prestige Catering) to operate the *Coast Restaurant*. The two parties also have similar, but separate, leases to book and cater events at the *Miller Room* in the Miller Pavilion and at the *Harbor Lights Room* at the adjacent Downtown Transit Center.

Troubled History

The Miller Brewing Company Pavilion, sitting atop a 1,250-car parking garage at the O'Donnell Park location, was completed in 1992. For nearly three years, Milwaukee County actively sought, without success, a suitable tenant to establish and operate a restaurant at the O'Donnell Park site.

On September 29, 1995, an entrepreneur entered into a ten-year lease agreement with the County to rent a portion of the Miller Brewing Company Pavilion for the purpose of operating a *Pavilion Restaurant*. The lease included an option for the lessee to extend the term for two consecutive five-year periods, effectively committing the County to a 20-year lease term. The rental payments were based on an annual base rent amount plus a share of certain facility and restaurant revenues based on annual gross sales.

File documentation indicates this public-private partnership did not proceed smoothly. In November 1995, an application by the lessee to obtain a City of Milwaukee liquor license was withdrawn after a recommendation by the City of Milwaukee Police Department against the application, noting a criminal background of the restaurant's general manager. There were ongoing financial disputes between the County and the lessee and litigation appeared imminent. Due to lack of profitability, the *Pavilion Restaurant* closed in December 1999. Shortly thereafter, the lessee entered a management contract with two individuals to renovate the facility and in April 2000, service resumed in a restaurant known as *Nola's on the Lake*. However, the County continued to experience difficulties with the prime leaseholder. On July 12, 2002, correspondence from the former Parks Director notified the lessee of a "failure to maintain and repair improvements, trade fixtures, equipment and mechanical systems" as required by the lease agreement. The letter outlined several specific violations, including failure to replace ceramic tile and grout in the kitchen

The same correspondence also mentioned the lessee's intent to assign the lease to an established local restaurateur, but cautioned the lessee that the above-mentioned violations had to be corrected prior to the assignment.

In July 2002, the County Board adopted a resolution [File No. 02-347] that permitted the planned reassignment of the restaurant at O'Donnell Park. However, disputes between the lessee and the prospective assignee ensued, and by August 2002, the deal was cancelled.

Soon thereafter, Parks was notified that a separate vendor had begun negotiations with the lessee for possible assumption of the lease. This vendor already held a separate lease agreement with the County for the exclusive rights to provide catering services to parties that booked use of the *Harbor Lights Room* at the downtown Transit Center adjacent to the O'Donnell Park site. This existing vendor expressed interest in making over the restaurant's image, menu, decor and facilities and, in the course of the make over, agreed to make the repairs specified in the July 12, 2002 correspondence from the former Parks Director.

The County Board approved the lease reassignment on September 26, 2002, and on October 16, 2002, an Assignment and Assumption of Commercial Lease was entered into by and between the former lessee and Grandview Management, Inc. The document transferred all of the rights, title and interest in the Lease Agreement to Grandview for the remainder of the term of the lease.

Key Lease Provisions

The lease agreement contains the following key contract provisions:

- **Lease Term.** The initial lease period was for ten years beginning November 1, 1995, with options for Grandview to renew for two consecutive five-year periods. The first five-year option was exercised by Grandview. The second five-year renewal option is available to Grandview when the current extension expires November 1, 2010.
- **Base Rent.** Base rent was initially \$5 per square foot (7,045 sq ft = \$35,225 per year) for the first ten years. The rate increased to \$7.50 per square foot (\$7.50 x 7,045 = \$52,838 per year) for the 11th through 20th years, with an annual escalator tied to the Consumer Price Index.
- **Premium Rent.** Beginning with the 6th year of the lease, the annual rent was comprised of the base rent plus a premium 'profit sharing' rent of 1.5% of gross sales from restaurant activities in excess of \$2,499,999 from restaurant, rental and catering activities performed within the premises. For the 11th through 20th years of the lease, the premium rate increased to 3%. Premium payments are to be made before April 30 of each year, based on the calendar year revenue calculations prepared by the lessee's independent accounting firm.
- **Parking.** The lease, as subsequently amended, calls for the County to make available to lessee, at all times during the term of the lease, up to 25 unreserved and four reserved parking spaces for use by lessee's employees at a flat rate of \$2.50 per car, per day. On an annual basis, the County may increase that rate up to a maximum of 25 cents per car.
- **Insurance.** The lease requires the lessee to submit certificates of insurance annually for the duration of the agreement. The County shall be named as additional insured. The County shall approve the certificate of insurance on the commencement date of the lease and each such anniversary date for the duration of the agreement.
- **Utilities.** The lease calls for the County to pay all utility charges and to bill the lessee monthly based on actual use.

Ramifications of Revised Proposal to Change Business Model

As a public-private partnership, there is a shared interest by both parties to cooperatively forge an environment that provides the best chance for a successful venture, under either business model. As documented in the background section of this report, Milwaukee County has experienced great difficulty in attracting a successful business partner for the O'Donnell Park site. Grandview has established a solid record of capital investment, professional business operation, and effective promotion and marketing of the three venues (*Miller Room, Harbor Lights Room and Coast Restaurant*) at the site.

Grandview, as a for-profit business enterprise, has indicated it cannot sustain a year-round walk-in restaurant at O'Donnell Park on a profitable basis, particularly in the current economic environment. Understanding from past experience that the County only benefits when a profitable, professional business partner is successfully operating at the O'Donnell Park site, the key County issues concerning this lease are:

- Will the County retain the minimum rental payments contained in the existing lease agreement?

- Will the County receive its established share of revenue generated from operations in the form of commissions as defined in the existing lease?

Public demand for the venue is key. The County will retain the minimum rental payments from the *Coast Restaurant* venue if, and only if, special event bookings under the new business model generate sufficient revenues to cover the approximately \$55,000 minimum rental payment. Grandview's request to convert to the new business model under the existing lease provisions indicates the business' confidence that bookings will be sufficient to meet the minimum rental payment demands.

The generation of County commissions, while also dependent upon the demand for bookings, could be affected by the manner in which potential revenue streams are addressed under the lease. It is unlikely the *Coast Restaurant* venue would generate the \$2.5 million in gross sales necessary to invoke the 3% County commission in 2009, regardless of the business model pursued by Grandview. (As a matter of reference, Grandview's independent accounting firm reported gross sales of just over \$2 million for 2007, the latest available data.)

Issues that Could Benefit from Clarification

The Office of Corporation Counsel has indicated that, unlike the original proposal by Zilli Hospitality Group (Grandview), the revised proposal to modify its business model at *Coast Restaurant* from a year-round walk-in restaurant to a combination reduced schedule walk-in and "reservations only" venue does not require formal County Board approval. Rather, the change can be addressed administratively by the Parks Director, utilizing a Memorandum of Understanding with Grandview to clarify language in the existing lease. As such, it presents an opportunity for the Parks Director to review the existing lease provisions to determine if there are additional issues that could benefit from greater clarification by mutual agreement.

Revenue Streams Subject to Milwaukee County Commissions

In an audit of Parks Facilities Leases issued in April 2006, concerns were raised with some of the provisions of a Letter of Agreement between Grandview and the Parks Department that clarified and modified certain details of the lease agreements in force. One item noted in the audit report as lacking was inclusion of food and beverage sales for outside venues at the *Harbor Lights Room* (North and South Garden Space) when calculating Milwaukee County commissions. At that time, Grandview was excluding food and beverage sales at the Garden Space bookings from calculation of the County's 21% commission rate under that lease. Audit recommendations were made to address this concern, as well as others, including obtaining County Board approval of the Letter of Agreement.

In April 2007, Grandview and the Parks Department developed a Memorandum of Understanding (MOU) to address this and other lease clarifications. One of the stated purposes of the MOU was to address conflicts between the terms of the various leases held between Grandview and the Parks Department. The County Board approved the MOU, which apply to all three leases described in this report, as well as a lease for exclusive food and beverage catering services at the Mitchell Park Domes. However, the provisions contained in the *Miller Room* and *Harbor Lights Room* leases, the revenue streams for which the County's commission rates are applied may be too narrowly defined.

In each lease except the *Coast Restaurant* lease, commissions due Milwaukee County are based on a percentage of gross food and beverage sales. As previously noted, in the *Coast Restaurant* lease, commissions are based on gross sales from restaurant activities, rental and catering activities. Upon reviewing the April 2007 MOU, there is concern regarding the following provision:

Definition of food and beverages

The definition of food and beverages upon which commissions are to be paid will apply solely to "food" and "beverages" as is currently the case. Pass-through rentals of furniture, tableware, and other non-food products will remain exempt from commission payments.

Based on the language of the MOU and information provided by Grandview's accounting firm, it appears Grandview may intend to exclude certain items (e.g., rentals) from gross sales at the *Coast Restaurant* venue, upon which County commissions are calculated. Since gross sales from all sources have not approached the \$2.5 million threshold since 2003, it is not clear how the April 2007 MOU language cited above impacts *Coast Restaurant* commissions.

According to the Parks Contract Administrator, Grandview management has indicated that, as a service to clients, Grandview "passes through" purchases or rentals of certain items on behalf of clients, with no mark-up or profit generated. According to Grandview, it passes through such costs, without mark-up, whether clients use their own vendors or choose to use a preferred vendor of Grandview's choosing. In this way, Grandview maintains greater control over the quality and logistical aspects of the events.

While the MOU does not further define pass-through items, the lease for catering events at the Mitchell Park Domes contains the following list of pass-throughs:

"...Caterer shall pay to the County 8% commission of all food and beverage sales less sales tax and exclusive of pass through items including china, linen, floral arrangements, entertainment, lighting, other related rentals, and staff labor."

The above list of "pass-throughs" appear to be a fairly exhaustive list of potential revenue streams that represent potential profits for Grandview, as well as potential commissions for Milwaukee County. On the other hand, if Grandview provides these items to clients for cost, with no additional mark-up, it should maintain and produce, upon request, explicit records, including receipts and invoices, to document the "pass-through" nature of the costs.

If experience under the new business model and other circumstances warrant consideration of including some of the items currently identified as "pass-throughs" as additional revenue streams, the County may wish to consider including such items in the calculation of commissions due.

Finally, if the year-round Tuesday through Friday evening service contained in the modified proposal submitted by the Zilli Hospitality Group entails traditional restaurant hours, it appears to represent continuation of a fairly extensive walk-in restaurant operation. This is a significant departure from its original proposal. The expected hours of operation should be specified. Prior to expiration of the current lease period on November 1, 2010, should walk-in restaurant hours be eliminated or substantially reduced further, the County Board may wish to explore with Corporation Counsel the possibility of revisiting the five-year option provision of the *Coast Restaurant* lease.

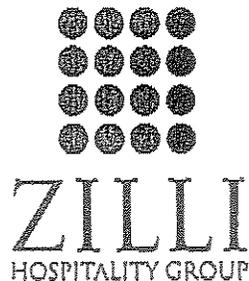
To seek mutual agreement on issues raised in this report, we recommend the Parks Director seek the following modifications to the April 17, 2007 MOU between Grandview Management, Inc. and the Milwaukee County Parks Department:

1. *Clarify that gross sales upon which commissions are calculated at the current Coast Restaurant venue apply to all revenue generated from restaurant, rental (excluding pass-throughs) and catering activities, and are not limited to food and beverages only.*
2. *Include a more comprehensive definition of "pass-through" items and require that Grandview maintain and produce, upon demand, explicit documentation of the lack of a mark-up for "pass-through" items provided at cost to clients at all County venues operated by Grandview.*
3. *Explicitly state that Grandview has exclusive rights to restaurant operations, venue bookings and food and beverage catering services, but that exclusive rights for any additional potential revenue streams must be expressly approved, in writing, by the Parks Director.*
4. *Specify the operating hours contemplated for operating a full service walk-in restaurant at the current Coast Restaurant site on Tuesday through Friday evenings.*

The Office of Corporation Counsel was consulted during the preparation of this report by the Department of Audit.

Douglas C. Jenkins
Deputy Director of Audits

cc: Lee Holloway, Chairman, Milwaukee County Board of Supervisors
Parks, Energy and Environment Committee Members
Scott Walker, Milwaukee County Executive
Sue Black, Director, Department of Parks, Recreation & Culture
Elroy Schneider, Parks Contract Administrator
Jim Zilli, CEO, Zilli Hospitality Group
Julie Esch, Senior Research Analyst, County Board Staff
Carol Mueller, Committee Clerk, County Board Staff



January 28, 2009

Sue Black
Parks Director
Milwaukee County Parks
9480 Watertown Plank Road
Wauwatosa, WI 53226

Dear Sue,

It is with great pride and humility that Zilli Hospitality Group provides you with the attached revised business model for the property located at 931 E. Wisconsin Avenue, Milwaukee, Wisconsin.

On behalf of our entire organization, I hope the attached document satisfies not only your requirement but also that of the Parks Department and the Parks Committee.

Zilli Hospitality Group will continue to provide marketing and sales associates whose primary responsibility is to promote Zilli Lake and Gardens, bringing to Milwaukee County a full-force sales effort on the lake!

Our intent is to upgrade the property located at 931 E. Wisconsin Avenue. The actual 10,000 square foot restaurant will not change much. The planned changes we would like to make include:

- Removal of a small private dining room and replacing the area with a semi-permanent wood dance floor
- Removal of 20 feet of a rounded wall. A new ceiling will be placed in this area to match existing as well as a floor

We are working with Brohn Building Corporation for these changes and are currently in the approval process with the City of Milwaukee, along with all required permits. We are not requesting the County pay for any of the improvements to the premises. Zilli Hospitality Group will absorb all costs associated with this upgrade.

Non-construction additions to the space include:

- A flat screen TV (above the fireplace)
- Cleaning and painting all walls (current colors to remain)
- Lighting effects and elements that mimic water movement and natural blue uplighting.
- Repairing and changing the bubble wall
- Re-staining interior doors

These changes outlined above will not change the structure of the venue but at the same time will enhance the customer's experience and provide a more stunning and open space.

In addition, we would like to submit the following for operation of the restaurant located at 931 E. Wisconsin Avenue, Milwaukee, WI,

- Open for Holidays and special occasions
 - Valentine's Day (open from 4:00 p.m. to 10 p.m.)
 - Mother's Day (open from 10:00 a.m. to 4:00 p.m.)
 - Father's Day (open from 10:00 a.m. to 4:00 p.m.)
 - Sweetest Day (open from 4:00 p.m. to 10:00 p.m.)
 - Thanksgiving Day (open from 11:00 a.m. to 4:00 p.m.)
 - New Year's Eve (open from 4:00 p.m. to ?)
- Open Tuesday through Friday evenings
- 20 times per year we would open the restaurant to non-profit organizations and community groups to have free access to the rooms. These groups would pay for food and bar, we would offer coffee, water and soda at no charge and also our audiovisual capabilities with our compliments.

I am personally very excited about this change and hope the County is as well. Should you or the Board have any questions or require further detail of these alterations to the premises, please do not hesitate to contact me at 262-844-1219 or email me at jim@zillihospitalitygroup.com

Sincerely,



Jim Zilli
Chief Executive Officer
Zilli Hospitality Group
613 N. Grandview Blvd.
Waukesha, WI 53188

JZ/ms