



DATE: October 23, 2018

CATEGORY: New Business

DEPT.: Public Works

TITLE: **Transfer of Michaels at Shoreline Restaurant Operations to Touchstone Golf, LLC**

RECOMMENDATION

1. Approve the request of the tenant to terminate the Michaels at Shoreline lease between the City of Mountain View and The Faravelli Company, Inc., to be effective December 31, 2018.
2. Approve a payment of \$88,000 as full satisfaction for the acquisition of all tangible and intangible assets of Michaels at Shoreline, following satisfaction of rents owed to the City by the tenant.
3. Approve an amendment to the Golf Course Management Agreement between the City of Mountain View and Touchstone Golf, LLC, to incorporate the terms and conditions recommended in this report.
4. Increase budgeted revenues and appropriate \$825,000 in expenditures in the Shoreline Golf and Restaurant Fund for operations of the restaurant for the period of January 1, to June 30, 2019. (Five votes required)
5. Acting in its capacity as Board of Directors of the Shoreline Regional Park Community, appropriate \$1,100,000 from the Shoreline Regional Park Community to Planned and Emergency Facilities Projects, Project 19-18, to refurbish Michaels at Shoreline.
6. Acting in its capacity as Mountain View City Council, appropriate \$88,000 from the General Fund Reserve Account as compensation to The Faravelli Company, Inc. for the acquisition of assets of Michaels at Shoreline. (Five votes required)
7. Authorize the City Manager or his designee to execute all documents and take all necessary actions related to the approved recommendations contained in this report.

BACKGROUND

The City first entered into a lease with Theodore Faravelli of what is now commonly known as Michaels at Shoreline on March 30, 1993. On April 1, 2011, the City entered into a new lease with The Faravelli Company, Inc., for the lease and operation of Michaels at Shoreline. The new lease followed an investment of approximately \$430,000 by the City in 2011 for upgrades to the kitchen area, replacement of major kitchen appliances, replacement of some furniture, and carpet replacement. The initial five-year term of the lease had an expiration date of March 31, 2016. The lease had a five-year option period that was timely exercised by the tenant. The current lease, including all renewal periods, expires on March 31, 2021. The current tenant advised staff in March 2018 that he wants to step away from the lease for personal reasons at the end of this calendar year. At that time, the lease will have a little over two years remaining.

The Council, following deliberations on the terms for the termination of the lease with The Faravelli Company, Inc., directed staff to work with Touchstone Golf, LLC (“Touchstone”) to integrate the Michaels operation into the Touchstone golf course management agreement. The City and Touchstone Golf, LLC entered into a golf course management agreement in January 2012. That agreement currently expires on December 31, 2021. Under the terms of the golf course management agreement, the City receives all revenues and is responsible for covering all expenses. For its services, Touchstone is currently paid a management fee of \$8,500 per month plus incentives for achieving certain financial goals.

The recommended action is not a traditional assignment of the Michaels lease where all of the obligations of the tenant, including payment of rent and a division of maintenance responsibilities, are assigned to a successor tenant. Rather, if the recommended actions are approved, the City will be terminating the lease early and establishing an entirely new, and differently structured, agreement with Touchstone.

ANALYSIS

There are four primary elements to this Council action:

1. Approve the terms and conditions for terminating the Michaels at Shoreline lease with The Faravelli Company, Inc., including an appropriation of \$88,000.

2. Approve the terms and conditions for amending the golf course management agreement with Touchstone Golf, LLC, to integrate the operation of Michaels at Shoreline into the management agreement.
3. Increase budgeted revenues and appropriate \$825,000 in expenditures for operations of the restaurant for the period from January 1 to June 30, 2019.
4. Appropriate funds to refurbish Michaels at Shoreline.

Each of these elements is discussed in greater detail below.

Termination of the Michaels at Shoreline Lease

As stated earlier, the current lease, including all renewal periods, expires on March 31, 2021. The current tenant advised staff in March 2018 that he wants to step away from the lease for personal reasons at the end of this calendar year. While the lease terms do not provide the tenant with the right to terminate the lease, and the tenant is legally responsible for a minimum monthly rental payment of \$10,000, accommodating his wishes is in the best interests of all concerned and will ensure the continuous operation of Michaels.

The tenant possesses certain tangible and intangible assets that would be acquired by the City and provided to a successor to the Michaels operation. These assets would remain the property of the City and could be provided to future operators as well. The assets include tangible personal property such as furniture and fixtures, cookware, dishes, and silverware, small appliances, and other items one might normally associate with a restaurant. All of the major kitchen appliances are already owned by the City. Another significant asset is the liquor license, but State law prohibits public agencies from holding a liquor license. The City would pay to purchase the liquor license and have it transferred from the current tenant to Touchstone. There will be a provision in the amended Touchstone management agreement that they would hold the liquor license and transfer it at no cost to a third party designated by the City upon the expiration or termination of the Touchstone management agreement. Other intangible assets include the name "Michaels," business "goodwill," and any remaining nonperishable food and beverage items at the termination date of the lease. Subject to City Council approval, staff and the tenant have reached an agreement in principle on a value of \$88,000 for all of the tangible and intangible assets of the business.

The tenant has also agreed to pay \$27,935.94 in back rent owing, but not yet paid. The City will release the full amount of a \$10,000 security deposit paid by the tenant at the inception of the current lease after a close-out inspection and all termination obligations

of the tenant are satisfied. The current tenant will cease operations of Michaels on December 31, 2018, and Touchstone will assume operations and management on January 1, 2019.

Staff recommends an appropriation of \$88,000 from the General Fund Reserve for the acquisition of the assets from the current tenant.

Amend the Touchstone Golf, LLC (Touchstone) Management Agreement

The challenge for the continued operation of Michaels was to find an entity with the will and demonstrated ability to operate and manage the restaurant seamlessly in the short term until the City could develop a longer-term strategy for the golf course and Michaels. Touchstone manages golf courses in 13 states, including 17 courses in California, many of which have a restaurant and catering operation associated with them. They have the organizational structure in place and financial and marketing resources to effectively incorporate operation and management of Michaels into their management of Shoreline Golf Links.

The City entered into a Golf Course Management Agreement (Agreement) with Touchstone with a commencement date of January 8, 2012. The Agreement, as amended, expires December 31, 2021. Under the terms of the Agreement, Touchstone deposits all receipts into a City-held account and all "Direct Costs" (which include labor, rentals, maintenance, etc.) are then paid from a separate City account. Each year, the City and Touchstone establish an Annual Plan through the City's budget process, setting goals for revenues and expenditures. Touchstone is paid a Fixed Management Fee. If Touchstone achieves a certain financial goal set forth in the Agreement, Touchstone is paid a management fee of \$9,000 per month; if they do not achieve that financial goal, they are paid a monthly management fee of \$8,500.

Staff has met with Touchstone representatives to discuss potential agreement terms and facility improvements at Michaels at Shoreline. Touchstone has submitted a pro forma for the restaurant operation, which has been reviewed by staff. The pro forma shows a growth in gross receipts and net profit over time, most of which would accrue to the City under the management agreement. The revenue growth is attributed to aggressive marketing for wedding receptions (in partnership with the Rengstorff House wedding schedule) and conferences and to the synergistic effect of a joint operation of the golf course and restaurant.

Staff and Touchstone have reached an agreement in principle, subject to City Council approval, on the terms and conditions of an amendment to the Agreement to also manage the Michaels at Shoreline restaurant. As with the existing Agreement, daily

revenues would be deposited into a City-controlled account and Direct Costs would be paid from a separate City-controlled account. Touchstone would receive an increase in the Fixed Management Fee of \$1,000 per month and a restaurant incentive fee as follows:

- A one-time signing bonus of \$5,000 for assuming management of Michaels contingent upon achieving a positive Net Operating Income in 2019.
- 1.5 percent of gross revenues if there is an annual Net Operating Income greater than \$150,000.
- 2.0 percent of gross revenues for an annual Net Operating Income greater than \$300,000.

The incentive formula above is predicated on the improvements contemplated for the restaurant facilities as described below. If the contemplated improvements are not completed by June 30, 2020, effective July 1, 2020, Touchstone's incentive fee will be 15 percent of the Net Operating Income of the restaurant operations until such fiscal year that the improvements are completed. However, the parties can mutually agree to not invoke this provision.

Staff recommends an appropriation of \$825,000 in the Shoreline Golf and Restaurant Fund for the operations of the restaurant from January 1 to June 30, 2019.

Staff also recommends including an option to extend the Touchstone management agreement by five years to December 31, 2026, subject to City approval. The intent is to allow time for Touchstone to develop the business at Michaels.

Touchstone has agreed to offer employment to all current eligible Michaels employees and will pay benefits to all full-time employees.

As with the golf course management agreement, the City would be responsible for all capital maintenance and repairs. Unlike the current Michaels lease, the City would also be responsible for the maintenance and replacement of the restaurant furniture, fixtures, and equipment.

Project Budget and Approval

The restaurant building was constructed in the early 1990s and was last refurbished in 2011. The interior of the building is showing significant wear-and-tear and some immediate restorative work is required to refurbish the space (see photos in Attachment

1). In addition, the restaurant currently receives substandard Internet services and has outdated audio-visual equipment, which limits the ability to attract business to the meeting and banquet facilities. Staff has developed a scope of work to refurbish and upgrade Michaels at Shoreline to increase the attractiveness of this regional amenity and its income-earning potential.

Some of the near-term (Phase I) work identified by staff includes:

- Replacing the carpet
- Painting
- Deep cleaning the tile, kitchen, and restrooms
- Restoring the wood trim
- Landscaping
- Cleaning exterior spaces

Upgrades (Phase II) to the facility include:

- Retrofitting the lights for energy efficiency.
- Installing an audio-visual system to attract more meetings and conferences.
- Providing improved Internet connectivity, which requires infrastructure improvements from off-site to the building.
- Purchasing indoor and outdoor tables and chairs to replace the current aging inventory.

Staff has estimated the cost for the Phase I and Phase II work, including contingencies, design, and project management costs, to be \$1,100,000. Staff recommends an appropriation at this time of \$1,100,000 from the Shoreline Regional Park Community to the Planned and Emergency Facilities Projects, Project 19-18. The restaurant would be closed from late December 2018 to January 25, 2019 to complete the Phase I work. The Phase II work would be started during the closure and would continue after the restaurant reopens, with an estimated completion in early 2019.

Future improvements (Phase III) to the facility include reconstructing the food service counter and expanding the bar, replacing the existing floor tiles to brighten the interior space, and further enhancing the interior spaces. The cost of the Phase III work is estimated to be approximately \$500,000, and the nature of the work will require a two-to three-week closure of the restaurant operations in the future. Staff will further develop the Phase III improvement scope of work and request funding as part of the Fiscal Year 2019-20 Capital Improvement Program to be approved by the City Council in June 2019. If approved, the work is expected to be done around the end of 2019.

FISCAL IMPACT

The Michaels at Shoreline lease is a percentage lease with the tenant paying \$10,000 per month, or 8 percent of gross sales, whichever is greater. Monthly rents have consistently exceeded the minimum \$10,000 per month rent. The total annual rents paid in 2017 were \$141,742 based on gross sales of \$1,716,200.

With the termination of the lease and the execution of an operating agreement, the restaurant facility and the financial transactions will occur in a fashion similar to the golf course, with the City receiving all revenues and being responsible for all expenditures. Except for 2019, the first year of Touchstone's management of Michaels, net revenues to the City are expected to increase. Due to the closure and the transfer of operations in 2019, revenues for 2019 are projected only slightly higher than prior years. Expenditures are projected to increase primarily due to increased personnel costs for wages and benefits. Although the first year is expected to return less revenues to the City, higher returns are projected in subsequent years due to the potential for increased revenues related to catering for weddings and the synergy of the consolidated operations of the golf course with the restaurant.

CONCLUSION

Approving the termination of the lease with The Faravelli Company, Inc., and paying for the tangible and intangible assets of the tenant, will allow the Michaels operation to continue without having to purchase all-new assets. Approving the amendment of the Touchstone golf course management agreement to incorporate Michaels into the agreement will ensure the continued operation of Michaels by a qualified and experienced operator. In addition, having both the golf course and Michaels under the management of one entity will create a business synergy that should benefit both operations. Finally, the refurbishment plans should increase the revenue generation potential of the restaurant.

ALTERNATIVES

1. Council could decide not to approve the acquisition of the assets of The Faravelli Company, Inc., the amendment to the Touchstone Golf Management Agreement, and/or an appropriation for the improvements to the restaurant.
2. Council could provide other direction.

PUBLIC NOTICING

Agenda posting and a copy of report to The Faravelli Company, Inc. and Touchstone Golf, LLC.

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DPD-DSC/2/CAM
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Attachment: 1. Current Condition Photos