



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Albert Balagso

**SUBJECT: OPERATIONAL REVIEW OF
MUNICIPAL GOLF COURSE
SYSTEM**

DATE: May 15, 2009

Approved

Date

5/22/09

BACKGROUND

The General Fund Structural Deficit Elimination Plan identified revenue generation from lease or sale of underutilized properties a priority. While the three golf courses are among the largest City-owned properties, the contractual agreements associated with management and maintenance of the courses, as well as the constituencies that support their current use, must be considered in any decision to sell. The golf courses are not in the asset management work plan for FY 2009-10, recently adopted by the City Council, which instead is focused on large properties that are vacant or clearly underutilized. It is estimated that the community outreach, fiscal analysis, environmental review, and decisions on reuse or sale on the current work plan properties will take at least 12 to 18 months. For an active golf course, not only are the timelines for the steps listed above likely to be longer, but any buyer of property this large will likely want to condition the close of escrow on approval of necessary entitlements.

In an attempt to provide general information regarding the status of the three City owned golf courses, staff has prepared this review. The enclosed information will provide a general overview of the Municipal Golf Program including: the terms of each agreement, cost recovery status, debt service and asset disposition considerations.

ANALYSIS

Agreements

San Jose Municipal

The City of San Jose has a long-term facility lease with Mike Rawitser Golf Shop, Inc. for operation of San Jose Municipal Golf Course (the agreement expires in 2022, assuming the lessee exercises two five-year term extension options). The lease agreement requires the operator to assume all operational expenses and provides the City with a lease payment. The lease payment increased in January 2008 from 2% of gross revenue to 8.5% of gross revenue. On average, this will equate to approximately \$500,000 in annual payments, which are deposited into the Municipal Golf Fund to offset the debt service costs for the golf program. The operator is also required to contribute to a capital improvement fund at a rate of 2% of gross revenue. Annually, the operator submits a five-year capital plan outlining

the proposed improvements for City approval. PRNS has the authority to approve the plan and monitor the progress of the improvements.

Los Lagos Golf Course

This golf course operates under a management agreement. This option relates to a fee-for-service agreement with Los Lagos Golf Course, LLC, which is a subsidiary company of CourseCo, Inc., a professional golf management company. The agreement expires in 2017 and the operator is paid a fixed annual fee which was set in 2002 at \$132,000 payable in twelve equal monthly installments. The rate is adjusted annually upon each anniversary (April 1) based on the Consumer Price Index for all Urban Consumers in the San Francisco-Oakland-San Jose area per the U.S Department of Labor, Bureau of Labor Statistics. The agreement also provides for an incentive fee equal to one percent (1%) of the increase in gross revenues for each year of the agreement. A capital improvement fund is funded between three percent (3%) and ten percent (10%) of annual gross revenues. The current rate set by the Director is three percent (3%).

Rancho del Pueblo Golf Course

The City of San Jose is currently drafting an Amendment to the management agreement with San Jose Golf, LLC, a subsidiary company of CourseCo, Inc., for the operation of Rancho del Pueblo Golf Course (presently on a month-to-month agreement). The term of the agreement is proposed to expire in 2017 to coincide with the expiration of the Los Lagos Agreement. The fee for service is not to exceed \$219,000 annually. The management fee is calculated differently than the Los Lagos fee due to IRS regulations related to bond funding requirements. The regulation requires all salaries of lower level supervisory staff be included with the fixed management fee. This fixed management fee includes costs associated with the golf course operations and food and beverage management. Los Lagos' lower level supervisory staff salaries are deducted as operational expenses. Therefore, its management fee is less than Rancho's. Similar to Los Lagos, Rancho's terms support management fee increases annually based on the Consumer Price Index, an incentive fee option of one percent (1%) of the increase in gross revenue and a capital improvement fund requirement of two percent (2%) of annual gross revenues.

Cost Recovery Status

As stated by Economics Research Associates in its March 2008 operational review of the municipal golf program, "Overall, the three municipal golf courses are in very good physical condition, are maintained above competitive levels and have no significant deferred maintenance. The level of customer service and efficiency at each site is outstanding and, despite the difficult Bay Area Golf Market, San Jose courses have maintained relatively constant revenue and net income performance."

San Jose Municipal

San Jose Municipal generates enough revenue to cover all of its operational expenses, contributes two percent (2%) to a capital improvement fund and submits its annual lease payment which is estimated at approximately \$500,000. There is no debt service associated with this property. San Jose Municipal has a strong clientele with approximately 90,000 rounds played in calendar year 2008 and is tracking to play 87,000 to 90,000 rounds this calendar year.

Los Lagos Golf Course

Los Lagos traditionally recovers all of its operational expenses and last year contributed approximately \$525,000 in net operating income. Since it opened in 2002, annual surplus revenue has ranged from approximately \$350,000 to \$677,000. All net income is deposited into the Municipal Golf Fund to offset debt service payments. The profit and loss statement for the one month period and year-to-date ending March 31, 2009 indicates rounds are down by approximately 1,000 (-17%) as compared to March 2008. As well, revenue is down approximately \$52,000 (-16%) as compared to March 2008. Los Lagos played approximately 68,000 rounds last fiscal year and is projected to play 66,000 rounds in FY 2008-09. After reviewing the rate structure of comparable courses, it was determined that rate increases of \$1.00 for a round of golf will go into effect on or before June 1, 2009.

Rancho del Pueblo Golf Course

Rancho has had a difficult time recovering 100% of its operational expenses. Since its opening in 2000, there has only been one year (2001-02) where it made a net profit (\$70,639). Since the course opening in 2000 through Fiscal Year 2007-08, the City has contributed a total of \$419,117 towards operational expenses. Rancho played approximately 32,000 rounds last fiscal year and is projected to play 36,000 rounds in FY 2008-09. This fiscal year, rounds are tracking at approximately 10% above March 2008 and revenue is tracking at approximately 9% higher than March 2008. The positive increase is due in part to the success of The First Tee of San Jose Program, a collaborative program between PRNS and San Jose Sports Authority. The First Tee of San Jose is a youth life skills program that uses the game of golf as the means to mentor low income/at risk youth to obtain positive life skills. In calendar year 2008 the program increased participation by 17% and reached approximately 2,000 youth through its instruction and outreach programming.

Debt Service

Historically debt service has not been attached to recreational facilities. Golf courses are one of the few assets where the City attempts to cover the entire investment. The program has been successful at contributing approximately one third of the debt payment obligation annually and it covers all of the operational expenses. Part of the underperformance of not meeting the full debt service obligation stems from the original feasibility study conducted by National Golf Foundation in 1997 and updated in 1999. The original feasibility study did not consider several key factors when developing the operational expenses at Los Lagos Golf Course. Those key factors are:

1. Adoption of the Prevailing/Living Wage Ordinance added an additional \$570,000 per year to employee costs (wage increases for 2009, which are effective annually on March 1, will add approximately \$30,000 to projected operating expenses);
2. The cost recovery factor was based on construction costs of \$14.2 million, while actual costs were about \$20.7 million; and
3. Mitigation maintenance added approximately \$75,000 annually to operating expenses.

As stated by Economics Research Associates in its March 2008 operational review of the municipal golf program, "Overall, the golf program generates sufficient revenue to fund direct operating expenses and will produce an operating surplus of nearly \$1 million annually. However, due to substantial debt incurred in recent years related to the construction of Los Lagos and Rancho del Pueblo, the program has been unable to fully fund the \$1.9 million in annual debt service. Most

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established cities, because their golf systems have been in place for a long period, are not burdened with golf facility debt and thus are self sustaining. The repayment of the golf course debt over the next 20 years will eventually allow the City of San Jose golf courses to fully achieve financial self-sustainability, and potentially produce surplus revenue for other elements of the City's golf program."

<u>Fiscal Year 2007-08</u>	<u>City Operating Income</u>	<u>Less: Debt Service</u>	<u>Net Cash Flow</u>	<u>Outstanding Debt</u>
<u>Golf Course</u>				
San Jose Municipal	\$ 493	N/A	\$ 493	N/A
Los Lagos	624	\$1,418	(794)	\$20,000+/-
Rancho del Pueblo	(176)	488	(664)	\$ 6,000+/-
Total	\$ 941	\$1,906	\$(965)	\$26,000+/-

Asset Disposition

Council has inquired multiple times regarding the asset disposition of the golf properties. Last fiscal year the item was referred to the Asset Management Committee for consideration. As part of the Committee's consideration, it requested that Public Works Real Estate provide an analysis on the property disposition. Factors were evaluated against parkland constraints such as deed restrictions, bond covenants and other legal matters. Based on the many constraints associated with each property and the current real estate market, the Asset Management work plan for the coming fiscal year does not include further review of the golf properties. Should the Council decide to direct the Asset Management Committee to place a review of one of the golf properties on the work plan in January 2010, funding of approximately \$50,000 will need to be identified to support appropriate Real Estate work (i.e. analysis of buy-out costs, getting an appraisal, and researching site encumbrances, title reports and underlying documentation). These constraints make it difficult to get a clear understanding of the potential options and revenue available through the conversion or sale of these facilities, such as the sale of one of the properties to pay down the debt service on one or both of the other properties. Staff has, however, identified a few key steps to develop an accurate estimate of the potential value for the golf courses.

The first step is to acknowledge and agree that any conversion of use and/or sale of properties at this scale is a very complex process that could involve considerable staff time, upfront money, and several years to complete the overall project. Step two includes agreeing on a site, allocating needed funds for upfront staff work, and authorizing staff to initiate the process outlined in the Surplusing City-Owned Property policy. Following this work, staff would have a better understanding of the issues associated with the conversion of use or sale of the property, as well as an estimate of potential revenue generated from the property.

The information below is a summary of each of the golf course properties and a list of known conditions based on existing financial data, existing lease conditions and information from the ERA golf report.

San Jose Municipal - The 18-hole San Jose Municipal Golf Course sits on 146 acres and is currently operated by Mike Rawitser Golf Shop Inc. The existing contract goes through

December 30, 2012, and has two five-year extensions that may be executed by the operator that could ultimately extend the agreement to 2022. If the City desired to buy the operator out of this contract, it is estimated that it could cost the City \$8 - \$12 million dollars. Currently the facility is in good condition, it is very competitive in the local golf market, it does not have any debt obligations, and it generates nearly \$500,000 in annual rental income, which is used to offset debt service at the other golf facilities.

Los Lagos – Los Lagos is also an 18-hole golf course. It occupies 180 acres, 90 of which are dedicated parkland. In addition to the parkland constraint, this site has environmental mitigation constraints due the proximity to Coyote Creek. Many of the environmental issues have been addressed in the planning and design for the golf course. However, these constraints increase the operational cost for the golf course, and they could prove to be very restricting should the City desire to convert portions of the property to other uses. Any proposed conversion of dedicated parkland would require a vote of the general population and could require a significant capital investment. If the parkland was converted to general park uses the ongoing operation and maintenance of the facilities could not be guaranteed, and it is unlikely that any of the debt service would be covered.

The golf operation is managed by Los Lagos Golf, LLC, a subsidiary of CourseCo and the term of this agreement expires at the end of 2017. The golf complex cost approximately \$20.7 million to construct and was funded through bonds that expire in 2030. The facility is currently generating an estimated \$600,000 in annual net income, which is used to offset a portion of the \$1.4 million annual debt service.

Rancho del Pueblo – The Rancho del Pueblo facility is a 9-hole executive golf course designed to introduce the game of golf to new players, as well as provide an opportunity for residents to practice and enjoy a quick round of golf. The facility is located on 33 acres and is currently operated under a management agreement with San Jose Golf, LLC, a subsidiary of CourseCo, Inc. on a month-to-month basis. Since the opening of the facility, it has not generated sufficient revenue to cover operational or debt service costs. However, the facility is continuing to develop a very successful First Tee Program for at-risk youth as well as offer an excellent senior golf experience.

Conversion of this property to another use could eliminate the current operating deficit of about \$70,000 per year, but the \$487,000 annual debt service obligation would remain. In addition, due to the current real estate market condition, it does not appear that conversion of this property would be attractive for the next several years.

In addition to the preliminary feasibility analysis, it would also be important to consider the impact that closing the facility would have on the other courses. A specific concern would be that the impact of the displaced junior and senior rounds would now be discounted at the other courses. Junior and senior play make up over 50% of the rounds at Rancho del Pueblo. This could have a significant impact to the success of the other two facilities. Due to the weak financial performance of the Rancho del Pueblo course, it makes sense to continue to look for opportunities to reduce City obligations.

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CONCLUSION


The City of San Jose's three municipal golf courses contribute valuable open space providing aesthetic, recreational, and environmental benefit to the community. These amenities strengthen our community and make our neighborhoods more attractive places to live. In addition, they provide recreational opportunities to a broad and diverse segment of San Jose residents.

As with other recreational facilities, golf courses are an investment. They contribute to the City's core services by providing vibrant leisure opportunities that stimulate the economy and lead to a healthy quality of life for its residents. The current land use of providing public golf in the community, providing a form of outdoor recreation and providing for large areas of open space is well supported by a multi-generational clientele. Programs such as The First Tee of San Jose, High School Golf, and Senior/Adult/Adaptive activities continue to grow in popularity and support. Support and interest in golf by the city's diverse population can be seen in the nearly 190,000 total rounds of golf played by San Jose citizens, of which over 5% were from youth and almost 45% were seniors.

The City's golf program is well established and respected in the Municipal Golf industry. Evidence of this can be seen through national recognition for turf management, wildlife protection, customer service, and its programming efforts. All in all, in its short history, the golf program has provided San Jose with positive recognition and continues to offer innovative opportunities for its residents.

COORDINATION

This memorandum was coordinated with the City Manager's Office, Budget Office, Public Works Real Estate and Finance.


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Neighborhood Services

For questions regarding this report please contact Mark Marney, Deputy Director, at 535-3582.