



Office of the City Auditor

**Report to the City Council
City of San José**

**GOLF COURSES:
LOSS OF CUSTOMERS
AND REVENUES REQUIRES
A NEW STRATEGY**

**Report 15-08
September 2015**

September 2, 2015




Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Golf Courses: Loss of Customers and Revenues Requires a New Strategy

The City of San José (City) owns three golf courses: Los Lagos, Rancho del Pueblo, and Muni. The purpose of our audit was to analyze the City’s financial losses from the three golf courses combined. The City subsidizes operating losses and also debt service at two of the golf courses. This year, the General Fund subsidy is budgeted at \$2.6 million (FY 2015-16).

Nationwide People Play Less Golf. After losing a large number of golfers over the last decade, the City’s golf courses are underutilized: Only 136 people played a round of golf at Los Lagos on an average day; 65 played at Rancho. Golf play has fallen 28 percent at Los Lagos and 42 percent at Rancho compared to 13 years ago. Muni was better off; it has lost only 13 percent of golfers and hosted 210 rounds of golf per day. The 2008 recession and plenty of competing golf courses nearby have exacerbated shrinking play and revenues. The City’s three golf courses face competition from at least 23 golf courses within 25 miles of downtown San José. As Los Lagos is a short 18-hole course and Rancho is a 9-hole course, they both are disadvantaged against their competitors. Revenue has fallen and the courses now commonly discount prices to attract more customers.


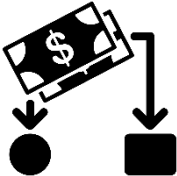

The City’s Subsidies Are Increasing. The City’s policy and industry practices generally expect golf courses to be financially self-sustaining. Last year, however, the General Fund subsidized golf with \$2.2 million (FY 2014-15). This covered \$600,000 in operating losses, \$100,000 in capital improvements, and \$2.0 million in debt service at Los Lagos and Rancho combined, and was offset by lease income from Muni to the City. Debt service for Rancho and Los Lagos runs through 2031, with a principal of \$23 million outstanding, plus interest of \$9 million.

Los Lagos	18 holes, 180 acres	Rancho del Pueblo	9 holes, 31 acres	Muni	18 holes, 145 acres
In South San José, lies on Coyote Creek		In East San José		In North San José, near Coyote Creek	
					
Usage	136 Rounds of golf / day	↓ 28% Since FY 03 opening	65 Rounds of golf / day	↓ 42% Since FY 03	210 Rounds of golf / day
			28 students from <i>The First Tee</i> per day		↓ 13% Since FY 03
City Op. Loss	\$300,000	City Debt Service	\$1.5 million	City Lease Income	Debt
	in FY 14-15		per year through 2031	\$400,000	None
			in FY 14-15	in FY 14-15	
			per year through 2028	\$6 per round of golf	
General Fund subsidy, per round of golf	\$6 operations + \$30 debt	General Fund subsidy, per round of golf	\$14 operations + \$19 debt		

Los Lagos received an additional \$85,000 subsidy (\$2 per round) for its capital improvement fund. Rancho received \$11,000 (less than \$1 per round) for its capital improvement fund.

Even as usage and revenues fell at Los Lagos and Rancho, expenses remained relatively steady. The City's operator has taken some action to contain costs at the two courses, but the City subsidy at Los Lagos amounted to **\$38 per golf round played** (\$6 for operations, \$2 for capital improvements, and \$30 for debt service). At Rancho, the City subsidy amounted to **\$33 per golf round played** (\$14 for operations and \$19 for debt service in FY 2014-15). At Muni, the City is locked into a long-term lease agreement which has provided steady income to the City, but the lease terms are favorable to the lessee. The City's income from Muni is about \$400,000 per year – 8.5 percent of revenue. In comparison, some other golf course leases return 20 to 30 percent of revenue to their public agency owner.

Policy choices: In light of growing General Fund subsidies, falling utilization of the golf course lands, and the heavy debt service, the City Council and the community face a choice in how to best use scarce public lands and scarce public funds. As detailed in this report, future opportunities and choices about policy priorities include:

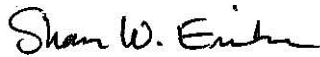
- (1) If policy makers and the community prioritize **keeping the three golf courses as they operate today**, the City will likely need to commit on-going subsidies, sufficient to cover operating losses and debt service of about \$2 million every year through 2031, while the land utilization will remain relatively low. If this status quo continues, the City should aggressively pursue customer growth to bring more golfers onto the golf courses. Los Lagos could perhaps break even on *operating expenses* by growing play by 11 percent. Rancho, however, would need to grow play by 60 percent; this seems unrealistic. To fully eliminate the General Fund subsidy for *operating losses and debt service*, we estimate Los Lagos would need to add 60 percent and Rancho would need to add 140 percent more golfers. We also recommend the City pursue more favorable contract terms when the current agreements expire. 
- (2) If policy makers and the community prioritize **reducing the General Fund subsidy**, the City needs to find a way to reduce the heavy debt burden. One option is selling a portion of land at one or more golf courses for \$23 million to pay off the debt. This could free the City of the on-going obligations to service the debt at *both* Los Lagos and Rancho. The City could then use the freed-up General Fund money for other purposes, such as other parks and recreation programs. Consolidating the golf courses this way could open the land at one or more golf courses for a variety of other recreation uses – including sports fields, as described next. 
- (3) If policy makers and the community prioritize **bringing more people onto the underutilized lands**, the City needs to consider reconfiguring one or more golf courses to other uses. Potentially, the City can add soccer/baseball/softball fields to address a large community demand for these sports fields and to activate the underutilized golf lands. While this would require one-time funding for reconfiguration and on-going funding for the new operations, soccer or diamond sports fields can serve dramatically more residents than the golf courses. 

These choices about priorities can be pursued in part or in combination, on one or more golf courses. We describe these policy choices here to highlight potential benefits, costs, and constraints for the City Council and the community to begin discussing and deciding their priorities. How to best use publicly-owned golf course lands and how to best use scarce General Fund subsidies is a policy decision that requires careful deliberation.

Our report includes five audit recommendations to increase utilization of the land, obtain more favorable contract terms, and improve oversight by the Department of Parks, Recreation and Neighborhood Services (PRNS). The Administration has reviewed this report and its response is shown on the yellow pages. We thank PRNS, *CourseCo, Inc.*, *Mike Rawitser Golf Shop*, and *The First Tee of Silicon Valley* for their time and insight during our audit.

We will present this report to the Neighborhood Services and Education Committee on September 10, 2015; we recommend the Committee accept this report and cross-reference it to the City Council.

Respectfully submitted,



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City Auditor

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This report is also available online at www.sanjoseca.gov/audits

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Introduction

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability and our audit reports provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services.

In accordance with the City Auditor's fiscal year (FY) 2014-15 Audit Work Plan, we have completed an audit of the three golf courses owned by the City of San José (City). The purpose of our audit was to analyze the City's financial losses from its three golf courses combined.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the *Audit Objective, Scope, and Methodology* section of this audit report.

We thank the Department of Parks, Recreation and Neighborhood Services; Finance Department; Office of Economic Development; City Manager's Budget Office; City Attorney's Office; *CourseCo, Inc.*; *Mike Rawitser Golf Shop*; and *The First Tee of Silicon Valley* for their time, information, insight, and cooperation during the audit process.

Background

The City of San José owns three golf courses: Los Lagos Golf Course, Rancho del Pueblo Golf Course, and the Municipal Golf Course. We summarize the facilities, customers, and history of these golf courses on the following pages.

The Game of Golf

Golf is a precision sport; golfers hit a ball with a club over long distances into a series of holes, using as few strokes as possible. Golf courses usually have 9 or 18 holes. Playing a *round of golf* of 18 holes takes about 4 to 5 hours, although sometimes golfers do not play all 18 holes (for example, with *twilight* prices). On each hole, golfers hit their ball from a *teeing ground* to the *putting green* which contains the *hole*, avoiding *roughs* and *hazards* (water, sand bunkers, etc.) along the way. To compare golf courses, *par* is the number of strokes that a skilled golfer expects to play. Generally, the game becomes more difficult as the distances and the par numbers increase.

Los Lagos Golf Course

Exhibit I: Los Lagos Overview

www.playloslagos.com

What are the golf facilities?

Golf course:

Opened in **2002**

18 holes **5,393** yards par **68**

This is shorter than many other 18-hole courses.

Driving range:

42 stalls over 2 tiers, with lights

Other facilities:

Golf practice areas for putting (but not chipping).
Clubhouse with a small shop, bar and restaurant, and office space. Maintenance facilities.

Acreage:

180 acres total, which includes:

82 acres irrigated for golf play (using recycled water and well water),

77 acres reserved for Coyote Creek and environmental mitigation areas.

Who are the golfers?

Golf course:

50,000 rounds of golf in FY 2014-15

136 rounds per day, on average

Driving range:

42,000 golfers or **114** per day

(our estimate – some of these also play a round of golf)

Demographics (2015 customer survey):

7 out of 10 golfers are San José residents

Most frequently mentioned neighborhoods:
Willow Glen, Cambrian, and Almaden Valley.

90% male **79%** age 50 or older

In 2008, half the customers had incomes larger than \$100,000.

Satisfaction (2015 customer survey):

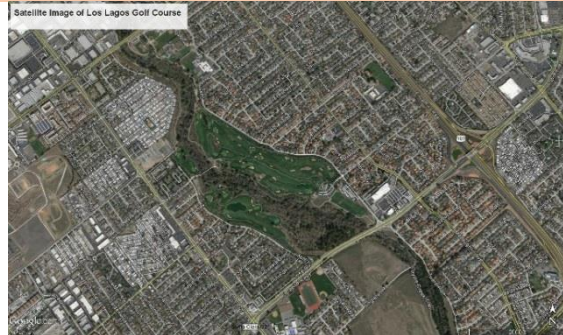
Satisfaction overall: 7.6 out of 10.0

Satisfaction with course conditions: 7.9

Likely to play more: 5.9 – this is low

Most customers play occasionally (fewer than 7 rounds per year)

Where is the golf course?



Los Lagos is in southern San José, near Capitol Expressway and McLaughlin Avenue, in Council District 7. Coyote Creek cuts through the course. It is surrounded by residential neighborhoods – primarily Vietnamese-American and Latino residents. Median household income ranged generally from the \$60,000s to the \$80,000s, but to the west, incomes ranged from \$25,000 to the \$40,000s (as of 2013).

See **Appendix E** for an enlarged aerial view.

How much do customers pay (list price)?

Green fees range from	\$35 to \$48
Seniors can play for as low as	\$22 to \$27
Juniors can play for as low as	\$13
To rent an electric golf cart	\$15 per golfer
100 golf balls at the driving range	\$11

These prices as of June 2015 are slightly cheaper than at Muni and lower than at other nearby golf courses. Prices are set annually in the mid-range of nearby golf courses, approved by the City.



What are the finances?

The operator receives revenues and pays all expenses. Ultimately, operating profits or losses are born by the City.

Revenues: **\$2.8 million**

Expenses: **\$3.1 million**

Largest expenses:

Personnel \$1.5 million, water \$300,000

Operating Loss: **\$300,000** in FY 2014-15

In addition, the City puts 3 percent of gross revenues, or \$85,000 in FY 2014-15, into a capital improvement fund.



How do operations work?

The City hired a professional golf management firm, *CourseCo, Inc.*, under a management agreement to operate Los Lagos on a day-to-day basis. We refer to them here as operator or as *CourseCo*. *CourseCo* manages a variety of other northern California and west coast golf courses.

Because construction was financed with tax-exempt bonds, the City could not enter into a lease agreement like it did at Muni – per federal tax regulations.

The agreement began in 2002 and expires in 2017.

CourseCo must operate the golf course, with an expectation that it is open to the public daily, and follow maintenance standards. The City requires *CourseCo* to pay prevailing/living wages to its maintenance and food service employees.

For more details, see **Appendix C**.

How large is the debt?

In 2000, the City of San José Financing Authority borrowed \$20.7 million in lease-revenue bonds to build the golf course.¹

As of June 2015, the City of San José Financing Authority owed bondholders \$18.3 million in principal and also interest payments totaling \$7.8 million through 2031. The City needs to make annual payments increasing from **\$1.5 million** to **\$1.7 million** through 2031.

Prior to June 2015, the City had already paid \$4.9 million towards the principal and \$13.6 million in interest.

In 2007, the City of San José Financing Authority refinanced the bonds. Interest rates on the 2007 bonds range from 4.20 to 4.75 percent.

What is the history?

The City built the course on a site which mainly had been undeveloped, City-owned open space, but it also displaced a few facilities. Brian Costello designed the golf course.

In 2002, the golf course opened to the public. For several years, *CourseCo* performed environmental mitigation near the creek.

In the following years, the City built additional fences to protect nearby homes from errant golf balls, including a \$2 million fence project.



¹ The financial and ownership structure is more complicated: The City of San José Financing Authority (the Authority) is a legal entity separate from the City, governed by the City Council and administered by City staff. The Authority issued lease-revenue bonds to finance the construction of the golf courses (1997 Series A, 2000 Series B, and 2007 Series A). Unlike general obligation bonds, lease-revenue bonds do *not* require voter approval and are expected to have a dedicated revenue stream.

The City leases the golf courses from the Authority and makes lease payments to the Authority; these lease payments have come from golf course profits and the General Fund. Then, the Authority uses the City's lease payments to pay back the bondholders. Note that this structure is different from the Muni lease.

Rancho del Pueblo Golf Course

**Exhibit 2:
Rancho Overview**

www.ranchodelpueblo.com

What are the golf facilities?

Golf course:

Opened in **2000**

9 holes **less than 1,500** yards par **28**

This falls short of regulation length.

Driving range:

27 stalls, with lights,
playing on real turf on some days.

Other facilities:

Golf practice areas for putting and chipping.
Clubhouse with a small shop, small café (no hot meals), and small office space. Maintenance facility.

Acreage:

31 acres

Irrigated with well water

Who are the golfers?

Golf course:

24,000 rounds of golf in FY 2014-15

65 rounds per day, on average

Youth program by *The First Tee of Silicon Valley*:

Served **800** unique students in 2014, or **28/day**.
840 hours of use of golf course and practice areas.
On Saturdays, *The First Tee* uses holes 1, 2, and 9.

Driving range:

23,000 golfers or **63** per day
(our estimate – some of these also play a round of golf)

Demographics (2015 customer survey):

8 out of 10 golfers are San José residents
Most frequently mentioned neighborhoods:
South San José and Evergreen. 14 percent of respondents were from Mayfair/Alum Rock/East SJ.

72% male **58%** age 50 or older

Satisfaction (2015 customer survey):

Satisfaction overall: 7.7 out of 10.0
Satisfaction with course conditions: 7.5
Likely to play more: 7.0

Where is the golf course?



Rancho is in eastern San José, near King Road and San Antonio Street, in Council District 5. It is surrounded by a majority-Latino residential neighborhood with a median household income of about \$30,000 to \$50,000 (as of 2013). On the west, it is bounded by the US-101 Freeway.

See **Appendix E** for an enlarged aerial view.

How much do customers pay (list price)?

Green fees range from	\$13 to \$15
Seniors can play for as low as	\$10
Juniors can play for as low as	\$7
90 golf balls at the driving range	\$9
Foot golf	\$10 to \$15
<i>The First Tee</i> access	\$1.⁵⁰/student

These prices are at the low end of nearby 9-hole golf courses. Prices are set annually and approved by the City.



What are the finances?

The operator receives revenues and pays all expenses. Ultimately, operating profits or losses are born by the City.

Revenues: **\$0.6 million**

Expenses: **\$0.9 million**

Largest expenses: personnel \$0.4 million

Operating Loss: **\$300,000** in FY 2014-15

In addition, the City puts 2 percent of gross revenues, or \$11,000 in FY 2014-15, into a capital improvement fund.



How do operations work?

The City also hired *CourseCo* (the operator) under a management agreement to operate Rancho on a day-to-day basis. The City selected *CourseCo* following a Request for Qualification process.

Because construction was financed with tax-exempt bonds, the City could not enter into a lease agreement – per federal tax regulations.

The agreement began in 1999 and expired in 2004, but the City and *CourseCo* have extended the term since then. PRNS intends to extend the term to 2016 so the operator can repair safety nets.

CourseCo must operate the golf course, with an expectation that it is open to the public daily. *CourseCo* must follow contractual maintenance standards. The City requires *CourseCo* to pay prevailing/living wages to its maintenance and food service employees.

For more details, see **Appendix B**.

How large is the debt?

In 1997, the City of San José Financing Authority borrowed \$6.9 million in lease-revenue bonds to build the golf course (refer to the footnote on Exhibit I for details on the ownership and financial structure).

As of June 2015, the City of San José Financing Authority owed bondholders \$4.5 million in principal and also interest payments totaling \$1.4 million through 2028. The City needs to make annual payments of **\$500,000** through 2028.

Prior to June 2015, the City had already paid \$2.9 million towards the principal and an estimated \$4.4 million in interest.

In 2007, the City of San José Financing Authority refinanced the bonds. Interest rates on the 2007 bonds range from 4.20 to 4.75 percent.

What is the history?

Rancho opened in 2000. The City built the course on a previously privately-owned 18-hole golf course (Thunderbird) after purchasing the land. Damian Pascuzzo designed the course. On another part of the previous golf course, 300 residential units were built by a developer.

In the following years, the City built additional fences to protect nearby homes from errant golf balls.



What are the finances?

The lessee receives all revenues and pays all expenses. The lessee pays the City a percentage of gross revenue as lease payment. Operating profits or losses are born by the lessee. This is typical for golf course leases.

Lessee's revenues: **\$5.2 million**

City's lease income: 8.5% of gross revenues =
\$400,000 in FY 2014-15

The lessee puts 1.5 percent of gross revenues, or \$78,000 in FY 2014-15, into a City-owned capital improvement fund.

How large is the debt?

There is no debt on Muni.



How do operations work?

Since 1988, the City has leased Muni to a lessee, *Mike Rawitser Golf Shop (Rawitser)*, which operates and maintains the golf course.² The City did not seek competitive bids from other potential lessees in 1988.

The lease agreement differs from the operations structure at Los Lagos and Rancho, placing more responsibilities and more risks on the lessee.

Rawitser must operate the golf course and open it daily to the public. The lessee must follow contractual maintenance standards.

For more details, see **Appendix A**.



What is the history?

Muni has been open since 1968 – the oldest of the City's three golf courses. It was designed by Robert Muir Graves.

For some years prior to 1988, the City carried out maintenance on the golf course while *Rawitser* had a golf concession. Since the 1988 lease, virtually all operations have been the responsibility of *Rawitser*.

In the early 1990s, *Rawitser* made large capital improvements on the golf course, as required by the lease agreement. *Rawitser* also funded renovations of the greens in 2010.

During summers, Muni hosts some evening concerts.



² Rawitser is also the lessee on the Santa Teresa Golf Course which is owned by the County of Santa Clara.

The Department of Parks, Recreation and Neighborhood Services Oversees Golf

The Department of Parks, Recreation and Neighborhood Services (PRNS) oversees the golf courses. Its mission is to “build healthy communities through people, parks and programs.” In addition, the City Manager’s Budget Office tracks the budget while the Finance Department manages the debt service. The City accounts for the golf course finances in the Municipal Golf Course Fund (Fund 518).³

Publicly-Owned Golf Courses Provide Public Benefits

As a direct benefit, publicly-owned golf courses make the game of golf accessible to the broad public. In contrast to private golf facilities and country clubs, publicly-owned golf courses generally charge lower green fees to golfers and do not require membership, enabling customers of a variety of ages and income levels to play. On an average day, 411 rounds of golf were played at the City’s three golf courses.

As open space, golf courses also provide community benefits, such as:

- Potential increases in property values on nearby lands, and thus also to City revenues from property tax (because residents value the open space and aesthetic benefits of being near a golf course)
- Habitat for animals and plants – notably, Los Lagos and Muni are situated on the Coyote Creek
- Cleaner air from trees and shrubs, as well as cleaner water from capturing rainfall that recharges ground water (as opposed to rain water entering the storm drain)

Combined, the three golf courses measure about 300 acres⁴ and make up 9 percent of the City’s parks and open space acreage. The clubhouses and patios can host non-golf visitors; for example, Muni has hosted summer concerts. For safety reasons, however, the golf courses are fenced off and visitors cannot walk onto the courses among golfers.

³ The Municipal Golf Course Fund accounts for the operations, repairs and maintenance, debt service, and administrative costs of all three City golf courses (Muni, Rancho, and Los Lagos). The Fund only shows the **net** financial result to the City: Operating revenues and expenses are carried on accounts held by the operators and summarized on separate financial statements for Los Lagos and Rancho; Muni’s expenses are the responsibility of the lessee.

In addition, the City incurs costs for overseeing the golf courses which are part of the PRNS operating budget. These are relatively small.

In the past, the City also paid for large capital improvements out of the General Fund or the *Construction and Property Conveyance Tax Fund: City-Wide Parks Purposes* (Fund 391), such as \$2 million for safety nets at Los Lagos, \$400,000 for a cart barn upgrade at Muni, and a current \$300,000 safety net installation at Rancho.

⁴ Excludes Coyote Creek and riparian buffer at Los Lagos.

The City's Golf Courses Have Been Studied Extensively

Over the years, the City has prepared or obtained a large number of studies regarding its golf courses. In this section, we highlight relevant reports.

In 1994, the Civil Grand Jury looked at several publicly-owned golf courses located within Santa Clara County and found lax financial auditing and oversight (including at Muni). The Civil Grand Jury also warned that public agencies had obtained unfavorable lease terms and could forego revenue when golf contracts were not bid competitively. The City and the lessee renegotiated the Muni lease following this Civil Grand Jury report.

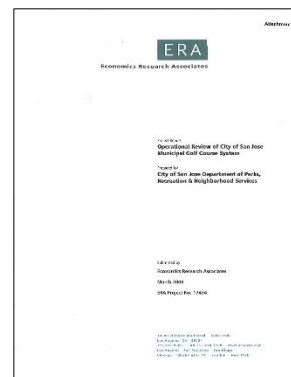
Around the year 2000, the City prepared or obtained several studies to build Los Lagos, including a feasibility study, a master plan, and environmental impact reports. The City also prepared official documents for the City of San José Financing Authority's issuance of lease-revenue bonds to finance the construction of the facility.

In 2006, *CourseCo* provided the City with an "Operational and Financial Report." For Los Lagos, it detailed that 33,000 more labor hours were needed above what the feasibility study had estimated and that the added costs of prevailing and living wage were \$306,000 per year.

In 2007, the City Auditor's Office carried out an "[Initial Review of Los Lagos](#)," reiterating the issues with the feasibility study.⁵

In 2008, the City obtained an "[Operational Review](#)" of all three golf courses from its consultant *Economics Research Associates*. The consultant described the golf market in detail, compared the unit costs and revenues at the City's golf courses to benchmarks, provided a framework for revenue enhancements, and described the general structure of lease versus management agreements.⁶

In 2009, the [Civil Grand Jury](#) reported that Los Lagos had failed to meet expectations to be financially self-sustaining.⁷



⁵ 2007 City Auditor's *Initial Review of Los Lagos Golf Course*:

<http://www.sanjoseca.gov/DocumentCenter/View/3407>. Our report also noted that the operator of Los Lagos and Rancho had assigned some Rancho management expenses of \$40,000 to Los Lagos, which effectively improved Rancho's operating loss and worsened Los Lagos' then-operating profit. According to *CourseCo*, this is no longer applicable.

⁶ 2008 Economics Research Associates' *Operational Review of City of San Jose Municipal Golf Course System*: <http://www.sanjoseca.gov/DocumentCenter/View/44731>

⁷ 2009 Civil Grand Jury's *Los Lagos Golf Course – San José's Financial Sand Trap*: <http://www.sanjoseca.gov/DocumentCenter/View/44732>

In 2009 and 2010, the City Council directed the Administration to prepare for a sale of Rancho, to eliminate the General Fund subsidy. City staff prepared several memoranda to the Council to describe the constraints on asset disposition, including the [Manager's Budget Addendum 31](#) from 2009 and the [Manager's Budget Addendum 38](#) from 2010.⁸

In 2010, the City's consultant *HMH* [studied residential development](#) at Rancho, estimating the land value at \$20 million.⁹ The consultant laid out three alternatives: (1) developing the western half, (2) the eastern half, or (3) the entire property. The potential residential development was discussed in three large and several smaller community meetings and by the Planning Commission, but the City ultimately did not sell any portion of Rancho, as the community strongly supported keeping the golf course and opposed residential development.

In 2011, City staff reported the [status of the golf course debt](#) to the City Council.¹⁰

In 2012, PRNS gave an updated financial history and analysis of alternatives to the City Council ([Manager's Budget Addendum 39](#)). The alternatives noted that *Rawitser* could be bought out of the lease agreement and that Los Lagos was located on parkland, thus requiring voter approval for changes to the parkland status. The report also reiterated the impact of prevailing and living wage requirements at Los Lagos and Rancho.¹¹

Audit Objective, Scope, and Methodology

The objective of our audit was to identify the causes of the operating losses at Los Lagos and at Rancho, as well as the losses in the Municipal Golf Course Fund. Through analysis, interviews with PRNS staff, and comparisons, we sought to understand the operations at all three golf courses. In particular:

- We reviewed prior studies and reports regarding the golf courses for background and historic understanding, including those summarized in the *Background* section above.
- We analyzed the finances of the golf courses, including debt service: We reviewed the financial statements for Los Lagos and Rancho

⁸ 2009 Manager's Budget Addendum 31 – *Operational Review of Municipal Golf Course System*:
<http://www.sanjoseca.gov/DocumentCenter/View/44733>;

2010 Manager's Budget Addendum 38 – *Assessment of Rancho del Pueblo Golf Course*:
<http://www.sanjoseca.gov/DocumentCenter/View/44735>

⁹ 2010 *HMH's Rancho del Pueblo Golf Course Assessment*:
<http://www.sanjoseca.gov/DocumentCenter/View/44734>

¹⁰ 2011 Staff report – *Golf Course Defeasance*:
<http://www.sanjoseca.gov/DocumentCenter/View/44736>

¹¹ 2012 Manager's Budget Addendum 39 – *Summary of Municipal Golf Courses*:
<http://www.sanjoseca.gov/DocumentCenter/View/44730>

(which are audited by an external auditor), the revenue statements for Muni, the debt service schedules, and the bonds' official statements. We identified major revenues, costs, and trends, analyzed the reasonableness of staffing levels, and reviewed reports of golf rounds played.

- We evaluated the benefits: We read customer surveys from Los Lagos and Rancho, visited each golf course, and interviewed the general managers of each golf course. We compared golf course usage to other sports and recreation activities. We interviewed the executive director of *The First Tee of Silicon Valley* to obtain an understanding of its programs at Rancho and Los Lagos.
- We identified potential costs, benefits, and constraints of some alternative business operations and potential alternative land uses. We also reviewed reports and interviewed staff from the Office of Economic Development about the City's effort in 2010 to sell Rancho for residential development.
- We reviewed the City's oversight of its golf program. This included reading the operating agreements and lease agreement, proposed budgets, and capital funds statements, as well as discussing the budget approval process.
- We made some comparisons to nearby golf courses, for which finances and activity data were available, by reviewing their budgets, financial statements, and staff reports, as well as by interviewing staff. Our comparisons included:
 - Santa Clara County: Santa Teresa Golf Course, Spring Valley Golf Course
 - City of Santa Clara: Santa Clara Golf and Tennis Club
 - City of Sunnyvale: Sunnyvale Golf Course, Sunken Gardens Golf Course
 - City of Cupertino: Blackberry Farm Golf Course
 - City of Mountain View: Shoreline Golf Links
 - City of Palo Alto: Palo Alto Municipal Golf Course
- We also reviewed the 2008 consultant study prepared for the City by *Economics Research Associates* which contains business analyses of the City's golf courses and detailed comparisons.
- We reviewed relevant management controls such as the City's process of monitoring the agreements, the financial statement audits for Los Lagos and Rancho, and we observed Muni's reporting process.

We found the financial data and the activity data obtained from the operators reasonable for our audit purposes and conclusions, but we did not carry out detailed data reliability testing. In addition, for financial data prior to FY 2014-15

at Los Lagos and Rancho, we relied on their financial statements, which were audited by an external auditor.

We did not adjust the financial figures in this report for inflation. To calculate average usage per day, we divided annual usage by 365 days. It should be noted that daily usage fluctuates with seasons and weather; typically summer days are busier. Due to rounding, figures may not sum.

For context, one acre is an area of land equivalent to about 70 yards by 70 yards, or about 90 percent of a football field.

Finding I The City Needs a New Golf Strategy

Summary

Golf play is falling and the City's three golf courses (Los Lagos, Rancho, and Muni) are underutilized. Golf play has fallen 13 percent at Muni, 28 percent at Los Lagos, and 42 percent at Rancho compared to 13 years ago. The 2008 recession and competition from nearby golf courses have exacerbated shrinking play and revenues. As Los Lagos is a short 18-hole course and Rancho is a 9-hole course, they both are disadvantaged against their competitors. Nationally, people play less golf.

As a result, the City's subsidies are increasing. Last year, the General Fund subsidized golf with \$2.2 million as shown in Exhibit 4 (FY 2014-15). This year, the General Fund subsidy is growing to \$2.6 million (FY 2015-16 budgeted). The City is obligated to cover debt service for Rancho and Los Lagos through 2031 – a principal of \$22.8 million plus interest of \$9.2 million remain.

The golf course operators have taken some action to contain costs, but the City subsidy at Los Lagos amounted to **\$38 per golf round played** (\$6 for operations, \$2 for capital improvements, and \$30 to cover debt service). At Rancho, the City subsidy amounted to **\$33 per golf round played** (\$14 for operations and \$19 to cover debt service). Muni returned about \$400,000 or \$6 per round in lease income to the City.

Exhibit 4: Financial Overview, FY 2014-15 – 3 Courses

	Muni	Los Lagos	Rancho (9 holes)	Total
Rounds of Golf	77,000	50,000	24,000	151,000
Compared to 13 Years Ago	minus 13%	minus 28%	minus 42%	
Operating Revenue	\$5.2 million	\$2.8 million	\$0.6 million	
Per Round	\$68	\$57	\$23	
Operating Expense		\$3.1 million	\$0.9 million	
Per Round	Unknown to the City	\$63	\$37	
Operating Profit (or Loss)		(\$0.3 million)	(\$0.3 million)	
Per round		(\$6)	(\$14)	
Contribution to Capital Fund	\$0.1 million	(\$0.1 million)	Less than (\$0.1 million)	
Per Round	\$1	(\$2)	Less than (\$1)	
Debt Service	No debt	\$1.5 million	\$0.5 million	
Per Round		\$30	\$19	
City's Revenue (or Subsidy)	\$0.5 million	(\$1.9 million)	(\$0.8 million)	(\$2.2 million)
Per Round	\$7	(\$38)	(\$33)	(\$15)

Source: Auditor analysis of CourseCo and Rawitser reports, debt service schedule

The City's policy and industry practices, however, expect the City golf courses to be financially self-sustaining. Just to break even on operating expenses (not counting payments to cover debt service), Los Lagos would need to grow play by 5,000 annual rounds or 11 percent, which may be attainable. At Rancho, play would need to grow by 14,000 rounds or 60 percent to break even on operating expenses – this is seems unrealistic.

At Muni, the City is locked into a long-term lease agreement anticipated to continue through 2022. Muni has provided a steady stream of income to the City, but the lease terms are favorable to the lessee. The City receives lease income of \$400,000 per year. This amount, however, is **not** sufficient to cover the losses at the other two golf courses.

If policy makers and the community want to keep operating the three golf courses, the City will need to commit on-going subsidies, including covering debt service of about \$2 million every year through 2031. Land utilization would remain relatively low.

We recommend the City Council consider consolidating its golf courses or implementing other land uses on the underutilized golf lands. One option is selling a portion of land to pay off the debt. If policy makers and the community prioritize bringing more people onto the underutilized golf lands, the City could potentially add soccer/baseball/softball fields. This would address a large community demand and activate the underutilized golf lands. While this would require significant one-time funding for reconfiguration and on-going funding for the new operations, sports fields can serve dramatically more residents than golf courses.

For those golf courses that remain, the City should (a) formulate an aggressive customer growth strategy to bring more golfers onto its underutilized golf courses, and (b) improve its oversight of the golf program and contracts.

The City's Golf Courses Lost a Large Number of Golfers Over the Last Decade

Golfers are not playing as frequently on the City's golf courses. Los Lagos has lost 28 percent of its golf rounds over the last 13 years. Rancho has lost 42 percent of golf rounds. Muni fared better, only losing 13 percent.

With these losses in customers, the City's golf courses are now underutilized. Only 136 people per day played a round of golf on Los Lagos' 100 acres of golf facilities. Only 65 people played a round of golf on Rancho's 31 acres per day. Muni, fared better with 210 rounds of golf per day on its 145 acres.

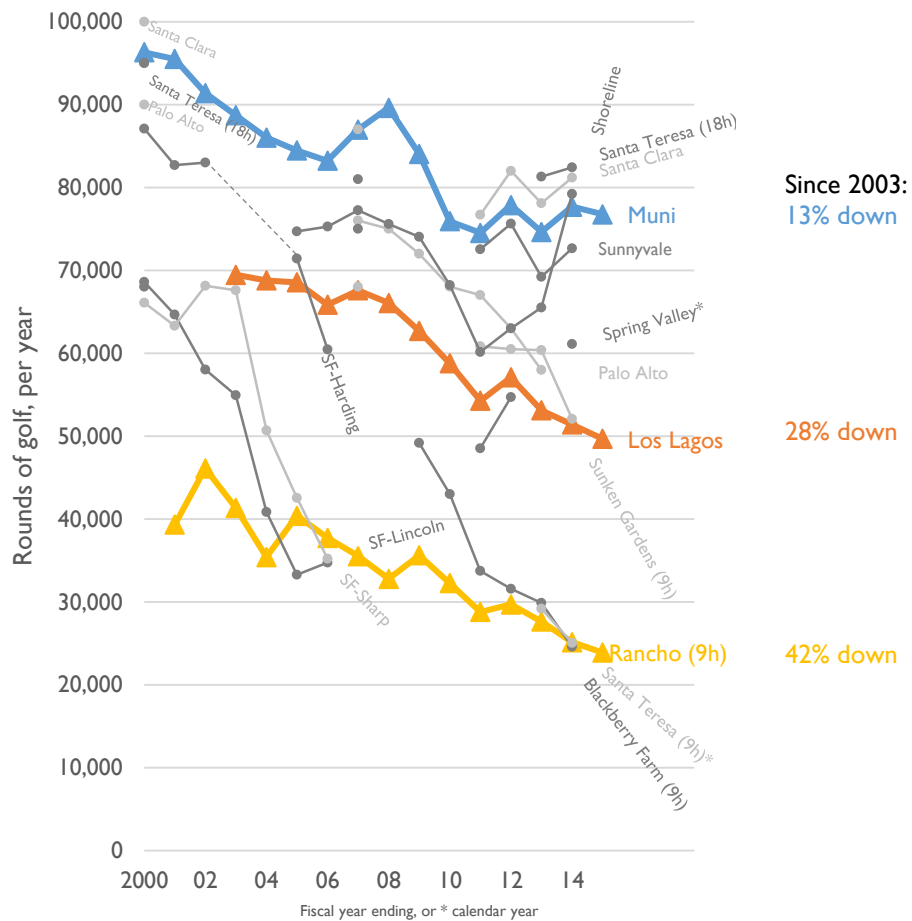
Nationally, Golf Play Is Decreasing

This decline in golf play reflects a national decline since 2005, which worsened during the recession of 2008 as golf play is associated with higher incomes. After

golf grew in popularity and new golf courses opened throughout the 1990s, golf play peaked nationally at 30 million golfers in 2005. Since then, 5 million golfers have been lost, due to a decline in new beginners and a problem in retention, according to the National Golf Foundation.

Exhibit 5 shows the decline in golf play over the years for the City’s golf courses, and compares usage at the three City courses against nearby publicly-owned golf courses.

Exhibit 5: Rounds of Golf Declined at Most Nearby Public Golf Courses



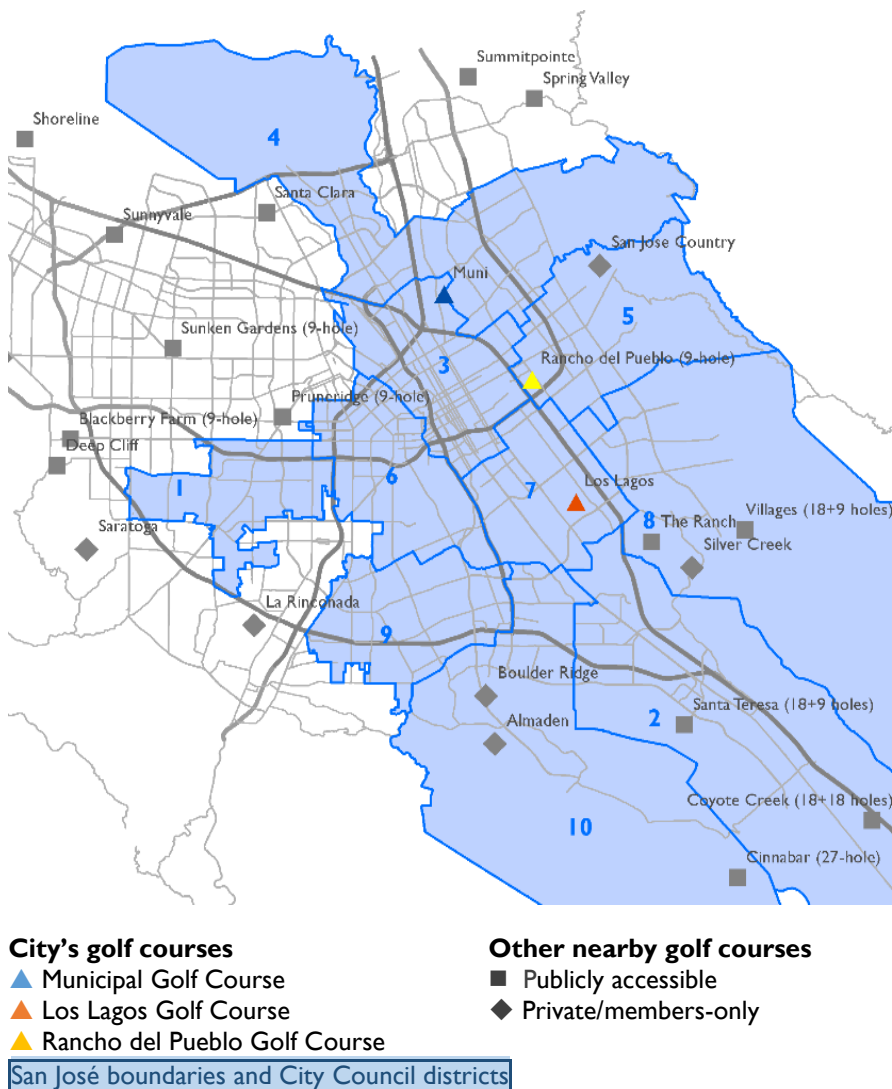
Source: CourseCo, Rawitser, Economics Research Associates, and other agencies’ reports
 Los Lagos and Rancho rounds since 2011 exclude complimentary rounds provided to golf course employees.

Many public golf courses in the southern Bay Area have lost golfers over the last 15 years. Play at Los Lagos now ranks near the bottom of nearby 18-hole municipal facilities. Comparing to other 9-hole courses, Rancho’s level of play seems similar to Blackberry Farm (Cupertino), but is only half of Sunken Gardens’ (Sunnyvale) play level.

Nearby Golf Courses Are Competing with San José's

There are at least 23 other golf courses within 25 miles of downtown San José. Some are private country clubs, but many are municipally owned or private, yet still accessible for a daily fee (that is, no membership is required). The map in Exhibit 6 shows many of these facilities, as well as the location of the City's three golf courses. When estimating golf demand, the industry commonly calculates that customers will not drive further than 15 to 30 minutes to a typical golf course;¹² the operator of Los Lagos and Rancho has noted that other golf courses are sited in more attractive locations.

Exhibit 6: Numerous Golf Courses Supply the Southern Bay Area



Source: Auditor analysis

¹² High-end golf courses can attract customers from further away.

Golf Courses Compete for Customers by Lowering Prices

With many golf courses in the region underutilized, their operators or managers now commonly discount prices to attract more customers. For example, they send marketing emails announcing discounts for certain days and certain times, or bundle green fees with a restaurant coupon. For the City's golf courses, this means that raising prices to bring in more revenues could potentially drive away customers. Golfers have many other opportunities to play golf in or near San José and may find other golf courses more attractive.

The decrease in golf play is the major cause for the poor financial performance at Los Lagos and Rancho, which we analyze in the following sections in more detail.

To continue operating its golf courses, the City needs to address this declining trend in golf participation – either to improve its golf courses' utilization and finances or – as described later in this report – to adapt to residents' changing recreation needs.

Los Lagos Is Underutilized and Fell Into an Annual Operating Loss of \$300,000

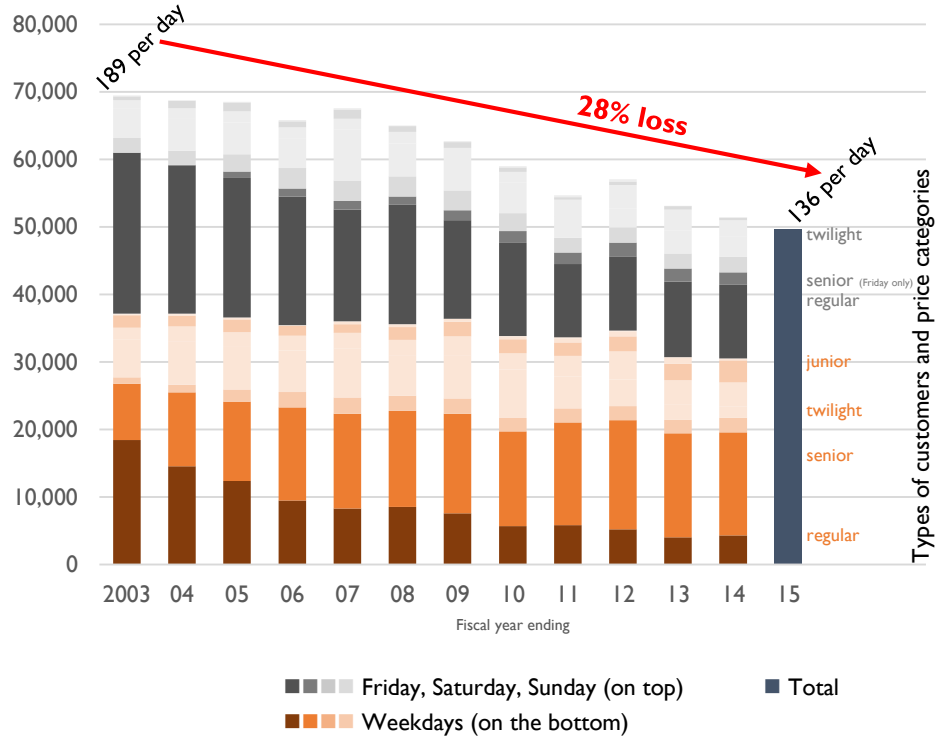
Only 136 people played a round of golf on an average day at Los Lagos; this is about half of the maximum capacity. In FY 2014-15, 50,000 rounds of golf were played at Los Lagos.¹³ In addition, an estimated 114 golfers used the driving range per day (42,000 per year), but some of these then go on to play a round of golf and would thus be counted twice.

Golf Play Has Fallen 28 Percent at Los Lagos, with Fewer Customers Paying Full Price

Play is 28 percent lower than the busiest, opening year of FY 2002-03. Since its opening 13 years ago, Los Lagos has steadily lost customers – a trend that only worsened with the recession of 2008, as shown in Exhibit 7.

¹³ This excludes complimentary rounds given to golf course employees.

Exhibit 7: Los Lagos – Rounds of Golf Fell 28 Percent Over the Last 13 Years



Source: CourseCo

This level of play is lower than at Muni and at other 18-hole golf courses in the area, as shown previously in Exhibit 5.

Customers paying full price (shown in dark orange and dark gray bars in Exhibit 7) have given way to more senior and junior golfers who pay discounted prices. Weekend play (shown as gray bars in Exhibit 7), which is traditionally popular among golfers and commands higher prices, has fallen. According to the operator, customers now are more price-conscious and seek discounts. In such an environment, raising prices could drive away existing customers and not attract new ones.

In addition to individual golfers, Los Lagos is also used by several high school teams, corporate customers, and church groups.¹⁴

¹⁴ These customers are included in the count of the rounds of golf played.

Los Lagos Faces Competition From Nearby Golf Courses

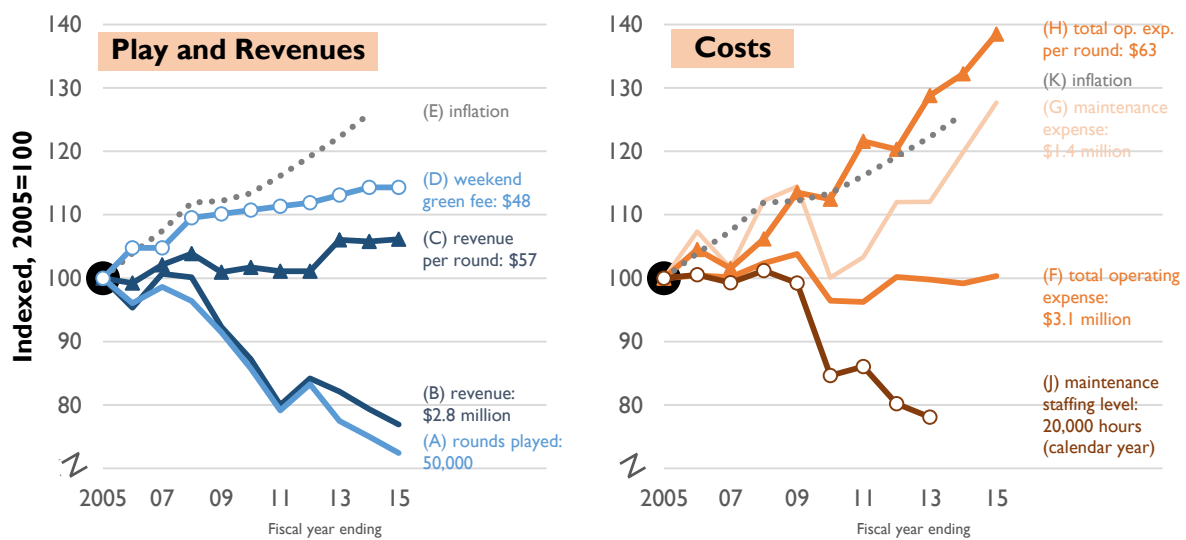
As a municipal golf course of short length (par-68, 5,393 yards), Los Lagos competes with numerous nearby golf courses for customers, as mapped previously in Exhibit 6. While this short course length appeals to golf learners and seniors, it is less attractive to regular and competitive golfers, according to the operator.

Los Lagos Fell Into an Annual Operating Loss of \$300,000

The decline in golf play has led to a drop in revenues of 23 percent compared to 11 years ago. Last year, revenues were at their lowest point at \$2.8 million, as shown by line B in Exhibit 8: Fewer customers pay for green fees, rent golf carts, order food and drinks, and buy merchandise at Los Lagos.

At the same time, the cost to operate Los Lagos has remained relatively steady (\$3.1 million last year, line F in Exhibit 8). These revenue and expense trends together resulted in an operating loss of \$300,000 in FY 2014-15. Exhibit 8 shows these two trends over the last 11 years.

Exhibit 8: Los Lagos – Play and Revenues Have Fallen; Unit Costs Have Grown Over Last 11 Years



Source: Auditor analysis of audited financial statements, *CourseCo* reports, Economics Research Associates, Bureau of Labor Statistics

On the revenue side, play declined, but each paying customer still yielded \$57 in revenue on average – this has been steady as seen in line C in Exhibit 8.¹⁵ Prices charged to golfers (line D) have not risen as fast as inflation (line E). On the expense

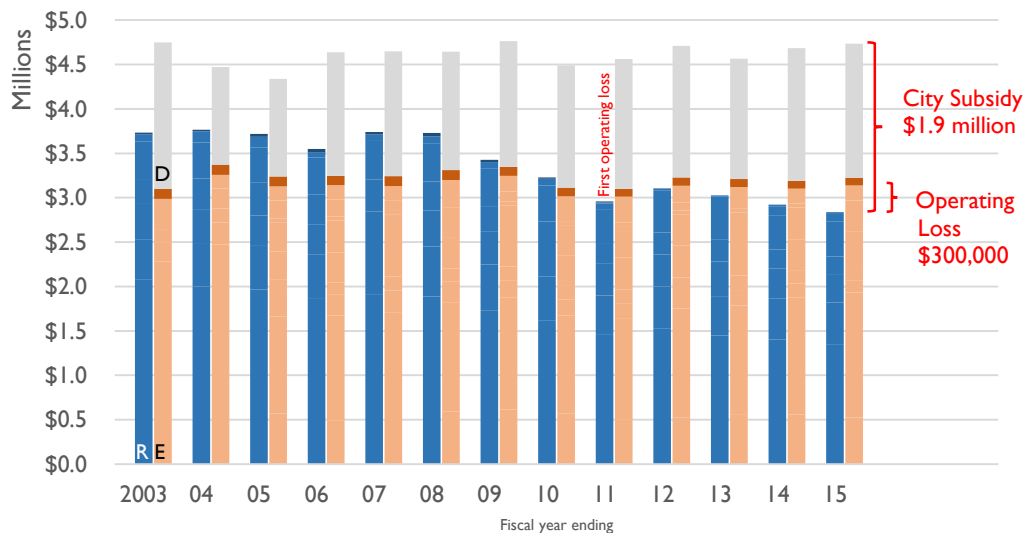
¹⁵ In FY 2012-13, a jump in the revenue per round is noticeable. Actually both the number of rounds and the total revenue declined that year, but rounds fell more deeply than the total revenue, leading to the increase in the ratio.

side, the operator has cut maintenance staff hours by a fifth (line J), yet expenses overall have not fallen and maintenance expenses are even growing (reaching \$1.4 million last year, line G).

Los Lagos’ Operating Profits Turned Into Operating Losses in FY 2010-11

While Los Lagos was operationally profitable in its initial years of operation, it has slipped into operating losses since FY 2010-11. Of concern, these operating losses have been growing. Furthermore, the heavy debt service at Los Lagos required a City subsidy every year. Counting the debt service, the City subsidy totaled \$1.9 million in FY 2014-15, as shown in Exhibit 9.

Exhibit 9: Los Lagos – Revenues and Expenses Over the Last 13 Years – Operating Losses Have Worsened Since FY 2010-11



Revenue (on the left) **Expense (on the right)**
 ■ Operating Revenue ■ Operating Expense
 ■ Contribution to Capital Improvement Fund
 ■ Debt Service

Source: Financial statements, CourseCo reports, budget reports, debt service schedule

The City Subsidized Each Golf Round at Los Lagos with \$38

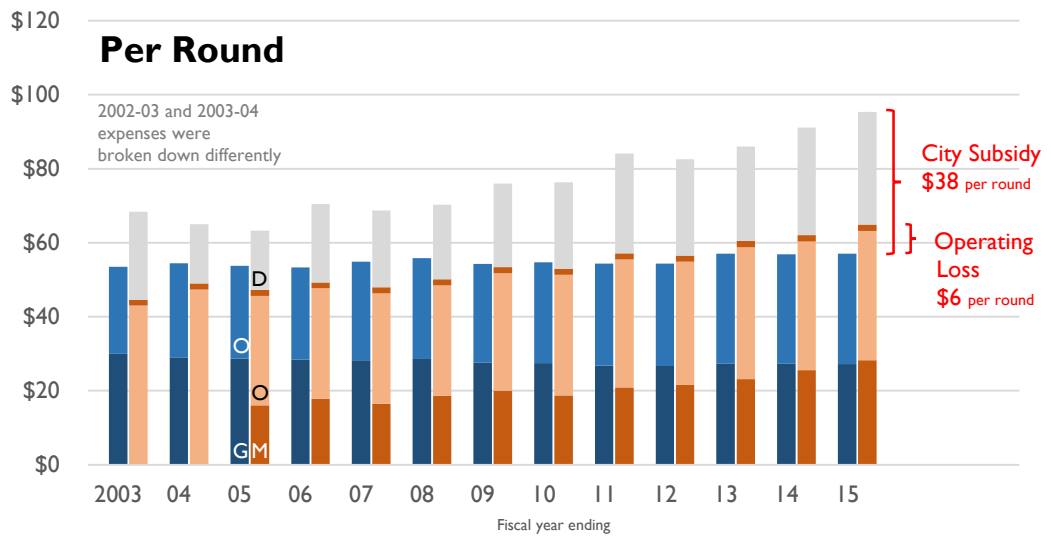
It is common in the golf industry to measure revenues, expenses, and profit on a per-round basis. This per-round average enables making comparisons and seeing trends.

Total expenses are now being spread over fewer and fewer golf patrons, such that the City now subsidizes each golf round at Los Lagos with \$6 for operations, \$2

for capital improvements, and \$30 to cover debt service, as shown in the following Exhibit 10 (FY 2014-15).

The largest revenue source are green fees (prices charged to customers for playing golf). Revenues from green fees have fallen by one third over the last 13 years. From an average round of golf, Los Lagos received \$27 in green fees, but the undiscounted price was \$48 – this demonstrates the wide extent of discounts given and taken.

Exhibit 10: Los Lagos – Per-Round Revenues and Expenses Over the Last 13 Years



Revenue (on the left)

- Green Fee Revenue
- Other Operating Revenue

Expense (on the right)

- Maintenance Expense
- Other Operating Expense
- Contribution to Capital Improvement Fund
- Debt Service

Source: Auditor analysis of financial statements, *CourseCo* reports, and debt service schedule

Los Lagos’ Revenues Are Below Their Potential

Revenues at Los Lagos totaled \$2.8 million in FY 2014-15. Revenues from green fees will remain low as long as the golf course is underutilized. As a short golf course, Los Lagos cannot charge as high green fees as other 18-hole golf courses.

Further, the driving range at Los Lagos is bringing in revenues below its potential. Per tee station per year, Los Lagos received \$8,000 in revenues from its driving range. This is low compared to nearby golf courses. For example, Muni’s strong driving range brought in \$15,000 per tee-station; Santa Clara received \$14,000 and Palo Alto \$13,000. The operator attributed lower revenues to the unattractive site location of Los Lagos compared to the other courses.

Other sources of revenue at Los Lagos were smaller compared to green fees and the driving range, as shown in **Appendix C**. In our opinion, these other sources have limited potential to grow and the City and its operator need to focus primarily on bringing more golfers onto the golf course.

Los Lagos' Expenses Are Relatively High

Operating expenses totaled \$3.1 million at Los Lagos in FY 2014-15. This is higher than at nearby publicly-owned golf courses. We noted that Los Lagos was well-maintained. In comparison, Sunnyvale, Shoreline, Palo Alto, and Santa Clara's operating expenses were about \$2.2 million each. Because of Los Lagos' low level of play, operating expenses per-round were high at \$63. Operating expenses per-round at nearby public golf courses were lower: At Palo Alto they were only \$36, at Sunnyvale \$31, and at Shoreline Links \$30. See **Appendix D** for further comparisons.

Prevailing Wage Requirement

The largest component of operating expenses at Los Lagos was personnel costs: \$1.5 million or 48 percent. Within that, maintenance expenses were a large driver. We did not find that the staffing level (hours worked) was excessive. The City requires *CourseCo* to pay prevailing wages to its maintenance workers and living wages to its food service workers. We confirmed that the estimated added cost from prevailing and living wage was \$370,000 compared to market wage. According to *CourseCo*, it is unusual in the golf industry to pay prevailing/living wages. It has been the policy decision of the City Council to continue requiring prevailing/living wages, although the City Council could potentially waive those requirements.¹⁶

Other Expenses at Los Lagos

The next largest cost is for water. Los Lagos used about 280 acre-feet of water per year, at a cost of \$270,000. About four fifths of water used had been recycled, but the remainder was pumped from groundwater wells.¹⁷ This total water usage is comparable to Muni.¹⁸

¹⁶ **Living wage:** City Council Policy 3-3 sets the living wage rate (\$18.32 with health insurance or \$19.57 without health insurance per hour, as of July 2015) and states that "persons doing work on, for or on behalf of the City for services that are provided directly to the City or for services otherwise provided by City employees or who receive financial assistance from the City should be paid a living wage."

Prevailing wage: The City also requires that workers on City-funded public works construction projects and City maintenance projects receive prevailing wage, which is a wage rate that differs by trade. The City Council's resolution 61144 from 1989 contains the core of the City's prevailing wage policy. In addition, the City has administratively included prevailing wage requirements in City contracts beyond those situations required by Council resolutions.

¹⁷ As of June 2015, Los Lagos needed to reduce well water consumption by 30 percent due to the drought. There were no reductions mandated for recycled water at the time of our audit.

¹⁸ Also, this level of water usage (recycled and well water combined) is equivalent to what 2,500 San José households would use.

It is notable that the food and beverage operations in themselves are not profitable.¹⁹

Debt Service for Los Lagos Continues Through 2031

As of June 2015 for Los Lagos, the City of San José Financing Authority owed bondholders \$18.3 million in principal and also interest payments totaling \$7.8 million through 2031. Prior to June 2015, the City had already paid \$4.9 million towards the principal and \$13.6 million in interest. The City needs to make annual payments that increase from \$1.5 million to \$1.7 million by 2031.²⁰

The bonds can be refinanced in as early as 2017, but potential savings from lower interest rates would be reduced by the costs of staff preparations and a new bond issuance.

The types of contracts and incentive fees at Los Lagos (as well as at Rancho) are restricted, due to federal tax regulations which limit private business activities at facilities financed by tax-exempt bonds.

Rancho del Pueblo Is Underutilized and Consistently Operated at a Loss of \$300,000 per Year

Rancho is also underutilized. It has lost golfers and revenues, incurs high costs, and thus makes an operating loss – similar to what was described above for Los Lagos. Rancho has required a City subsidy for operations in every year but one since it opened in 2000.

Rancho Is Underutilized

Only 65 people played a round of golf on an average day at Rancho. This sums to 24,000 rounds of golf in FY 2014-15.²¹ In addition, the driving range was used by an estimated 63 golfers per day (23,000 per year); some of these go on to play golf and would then be counted twice.

***The First Tee* Uses Rancho for Its Youth Program**

The City also provides usage of Rancho to the non-profit organization *The First Tee of Silicon Valley* for its youth program that teaches children the game of golf and life skills. Its curriculum aims to teach leadership and resiliency skills to students,

¹⁹ Revenues from food and beverage sales were \$395,000 which was not enough to cover the cost of sales of \$156,000 and operations expense of \$395,000. See **Appendix C** for details.

²⁰ Lease-Revenue Bonds 2000 Series B were subsequently refinanced by 2007 Series A bonds, issued by the City of San José Financing Authority. Interest rates on the 2007 bonds range from 4.20 to 4.75 percent.

²¹ This excludes complimentary rounds provided to golf course employees.

including at-risk youth, by combining golf instruction with life skills classes and mentorship.

In 2014, about 800 diverse students from grades K-12 participated in *The First Tee's* after-school classes at Rancho. This means that, on an average day, 28 *First Tee* students were at Rancho.

The First Tee uses Rancho for about 840 hours per year, including extensive use on Saturdays: For its Saturday classes, *The First Tee* occupies three holes on the golf course, the practice area, and parts of the driving range (regular golfers can play the remaining six holes twice). Saturdays are popular among participants of *The First Tee*, but Saturdays have traditionally also been popular among adult golfers and thus produced strong revenue for golf courses.

For weekday afternoon classes, *The First Tee* uses only the practice areas and parts of the driving range. Classes are held during 32 weeks of the year. From a student perspective, classes typically meet for 90 minutes per week over 8 weeks. *The First Tee* desires to grow its program, seeing demand for as many as 1,600 students per year. It has also cited a need to use more classroom and office space at Rancho.

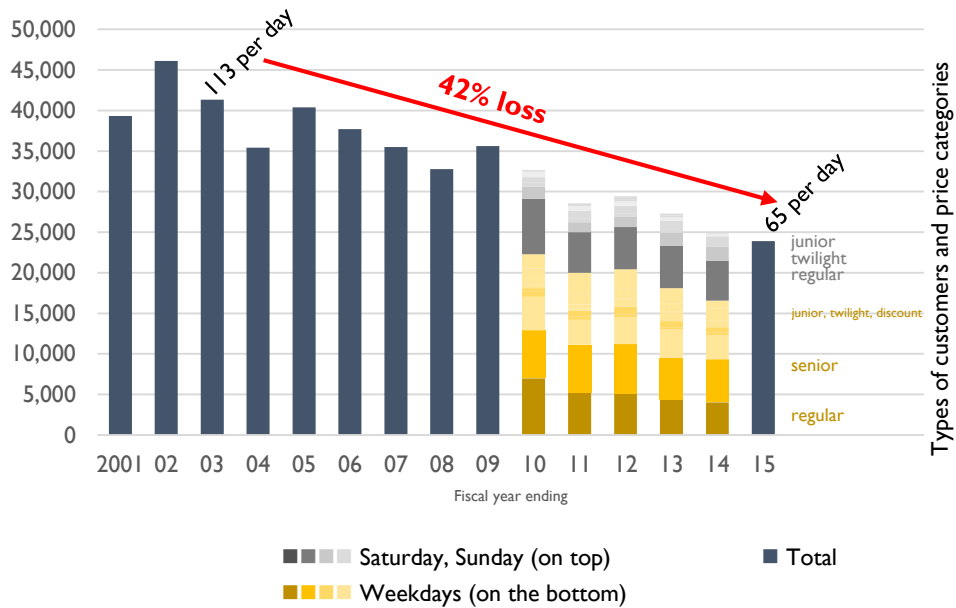
The City charges *The First Tee* heavily discounted access fees, generally \$1.50 per student per day.²² In total, Rancho received \$15,000 per year from *The First Tee*. Also refer to Recommendation 5 regarding *The First Tee's* access and fees.

Golf Play Has Fallen 42 Percent at Rancho

Since Rancho opened, golf play there has steadily fallen. Cumulatively, rounds of golf are 42 percent down compared to 13 years ago, as shown in Exhibit 11.

²² When *First Tee* students play 9 holes of golf, however, *CourseCo* receives \$5 to \$7 per round.

Exhibit 11: Rancho del Pueblo – Rounds of Golf Dropped 42 Percent Over the Last 13 Years



Source: CourseCo

Comparing Rancho to other 9-hole golf courses nearby, this level of play is much lower than at Sunken Gardens (owned by the City of Sunnyvale). It is close, however, to the short course at Santa Teresa (County of Santa Clara) and Blackberry Farm (City of Cupertino).

In addition to individual golfers, Rancho is also used by several high school teams, college groups, and senior groups.²³

Since 2014, Rancho has also offered foot golf – a game where players kick a soccer ball into marked holes, following rules similar to golf. On average, about 1 to 2 customers played foot golf per day.

Other 9-Hole Golf Courses Are Also Struggling

It appears that 9-hole golf courses generally are struggling, due to a nationwide decline in golf play, the recession of 2008, and plentiful competition from other golf courses. As detailed previously in Exhibit 5, public golf courses in the San José region have lost customers in recent years and are competing with each other for the remaining customers. According to the operator, Los Lagos and Rancho are competing for the same customer segment.

Rancho’s course length is **shorter** than regulation size, which makes the course less popular among skilled and competitive golfers. As such, it does not attract golf

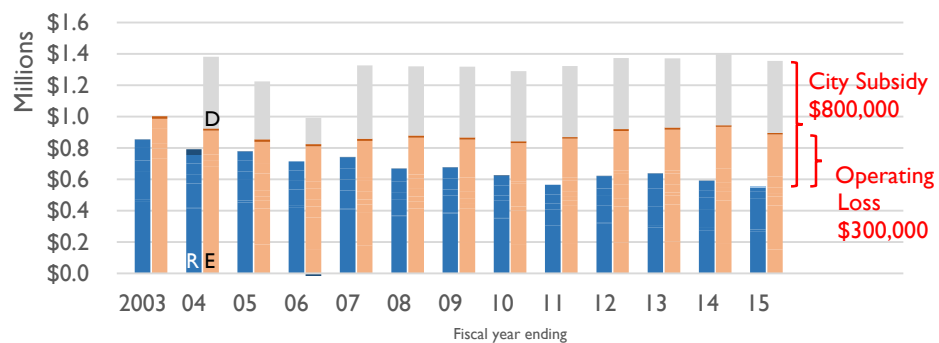
²³ These customers are included in the count of the rounds of golf played.

customers from further away, which limits the golf demand. The 9-hole Blackberry Farm golf course in Cupertino has also struggled financially. See **Appendix D** for further comparisons.

Rancho Consistently Incurred Operating Losses Since It Opened

In contrast to the recent losses at Los Lagos, Rancho has consistently operated at a loss since it opened in 2000. Last year, the operating loss was \$300,000, a result of revenues at \$600,000 and expenses at \$900,000 (FY 2014-15). In addition, the City pays \$500,000 to cover debt service each year. Exhibit 12 shows the revenue, expense, and loss trends for the last 13 years. Revenues have fallen by 35 percent since FY 2002-03, but expenses have fallen only by 10 percent.

Exhibit 12: Rancho del Pueblo – Revenues and Expenses Over the Last 13 Years – Consistent Losses



- Revenue (on the left)**
- Operating Revenue
- Expense (on the right)**
- Operating Expense
- Contribution to Capital Improvement Fund
- Debt Service

Source: CourseCo

The City Subsidized Each Golf Round at Rancho With \$33

Per round, Rancho received revenues of \$23 and paid \$37 in operating expenses. This operating loss was subsidized by the City with \$14 per round; in addition the City General Fund fully covered the debt service of \$19 per round (FY 2014-15). For further breakdowns of revenues and expenses, see **Appendix B**.

At Rancho, the Potential to Increase Revenues Is Limited

Rancho faces similar, if not worse, business challenges than Los Lagos. Due to heavy competition from other golf courses, raising prices to increase revenues may not be viable. Furthermore, there is limited potential to increase revenues from other sources: merchandise sales as well as food and beverage sales all rely on customers visiting the golf course. Due to low demand, the operator has already limited café open hours to the weekend only.

Expenses at Rancho

In order to remain attractive to customers, the operator has maintained the Rancho golf course well. Only limited comparisons to other 9-hole golf courses were available: Expenses at Blackberry Farm are comparable and expenses at Sunken Gardens appeared higher. At Rancho, we did not find the staffing level (hours worked) to be excessive.

Similar to Los Lagos, the City requires the operator at Rancho to pay prevailing wages to its maintenance employees and living wages to its food service employees. These wage rates are above market wage.

Debt Service for Rancho Continues Through 2028

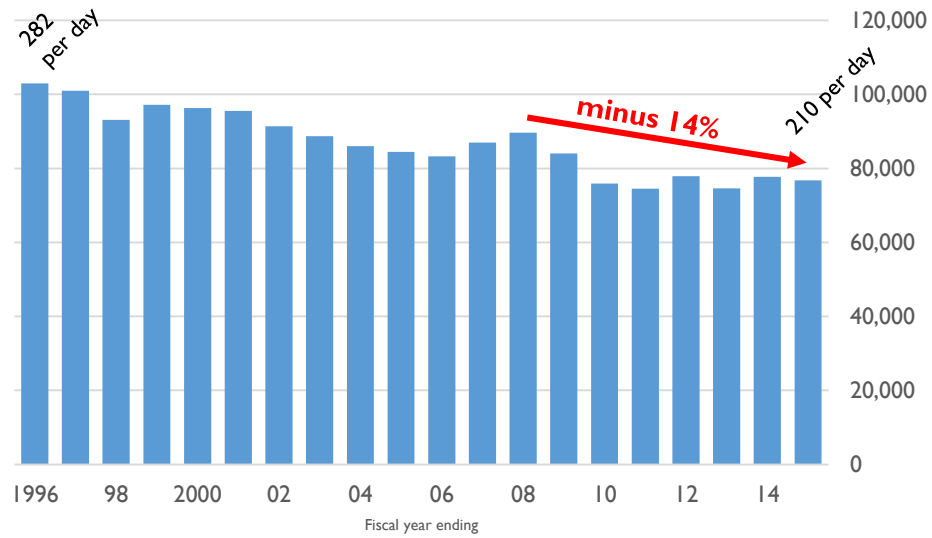
For Rancho, as of June 2015, the City of San José Financing Authority owed \$4.5 million in principal and \$1.4 million in interest to bondholders. The City needs to make payments of \$500,000 per year through 2028 to cover the debt service.

The City Receives Steady Lease Income From Muni, but the Contract Favors the Lessee

As a golf course and a business, Muni has performed better than Los Lagos and Rancho. Last year in FY 2014-15, 77,000 rounds were played, or 210 per day on average. Play declined by 13 percent since FY 2002-03 as shown in Exhibit 13 (compared to 28 and 42 percent declines at the City's other two golf courses). At Muni, we estimated at least 122 golfers used the driving range per day – compared to 114 at Los Lagos and 63 at Rancho (golfers may use the driving range in addition to playing a round of golf).

Muni is also underutilized compared to play levels from the late 1990s and early 2000s.

Exhibit 13: Muni – Rounds of Golf Over Last 20 Years

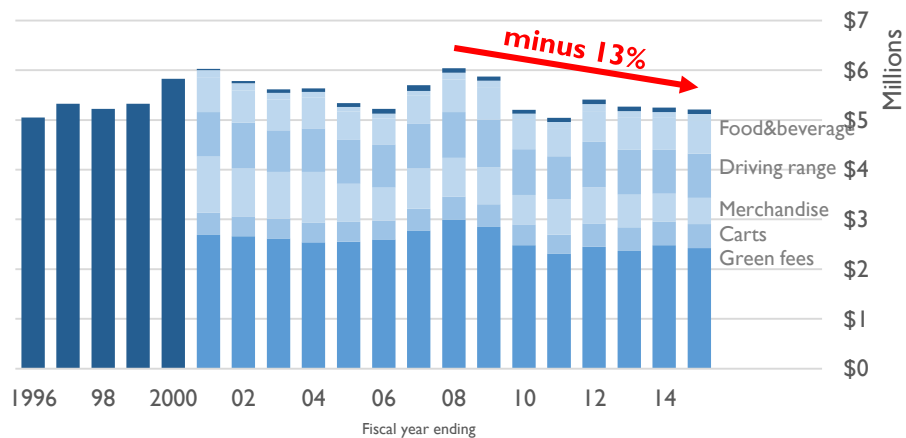


Source: *Rawitser and Economics Research Associates*

In addition to individual golfers, Muni is also used by high school groups and senior groups.

Revenues have also fallen – down to \$5.2 million – but not as far down as at Los Lagos and Rancho. Revenues fell by 13 percent since the last peak 8 years ago, before the recession, as shown in Exhibit 14. It appears that the lessee is still turning a profit.

Exhibit 14: Muni – Revenues Over Last 20 Years



Source: *Rawitser and Economics Research Associates*

Expenses at Muni Are the Lessee's Responsibility, not the City's

The operations structure at Muni differs from Los Lagos and Rancho. The City leases the golf course to a lessee – *Mike Rawitser Golf Shop* – who receives revenues and pays expenses and then **keeps** any profit or covers losses. The City does not require the lessee to report its expenses or to pay prevailing/living wage to its employees.

The City receives a contractual lease payment from the lessee that is currently 8.5 percent of gross revenues or about \$400,000 per year.

Notably, the City does not bear the financial risk of incurring operating losses, but also does not gain as much when the golf course performs well financially. There is no debt at Muni.

The Muni Lease Favors the lessee

The current lease agreement dates back to 1988/1994 and *Rawitser* has sole discretion to extend the term through 2022 – making this a 35-year lease. It is industry standard to run leases over 15 to 30 years. See **Appendix A** for more details on the agreement.

The lease income to the City is low. Since 2008, the agreement has required a payment of 8.5 percent of gross revenues; previously it had been even lower at only 1.5 percent. For comparison, some other golf course leases return 20 to 30 percent of gross revenues to their public agency owners.²⁴ The City's consultant *Economics Research Associates* detailed these other leases in its 2008 report to the City:²⁵ For example, the lessee at Crystal Springs in Burlingame pays 25 to 35 percent of golf revenues to the owner,²⁶ the lessee at Metropolitan in Oakland pays up to 27.5 percent of green fees,²⁷ and several southern California golf course lessees pay in the 20 to 40 percent range. See **Appendix D** for further detail.

The City did not seek competitive bids for the 1988 lease and thus missed out on potentially more favorable terms and higher lease incomes – an issue which the Civil Grand Jury had identified in 1994.

²⁴ According to golf industry experts, all terms of an agreement should be considered, including the length, compensation, capital funding requirements, service levels, etc. Some of these golf leases with terms more favorable to the public agency owner were negotiated during golf boom times.

²⁵ 2008 Economics Research Associates' *Operational Review of City of San Jose Municipal Golf Course System*: <http://www.sanjoseca.gov/DocumentCenter/View/44731>

²⁶ Crystal Springs is owned by the San Francisco Public Utilities Commission and leased to *CourseCo* under a 1997/2004 agreement. The lessee pays 8 percent on merchandise and food and beverage.

²⁷ Metropolitan is owned by the City of Oakland and leased to *CourseCo* Under a 2001 agreement. The lessee pays up to 4 percent on merchandise and food and beverage.

The General Fund Subsidy for Golf Grew to \$2.2 Million in FY 2014-15

The General Fund subsidy towards golf has grown and reached \$2.2 million last year (FY 2014-15). It breaks down as follows:

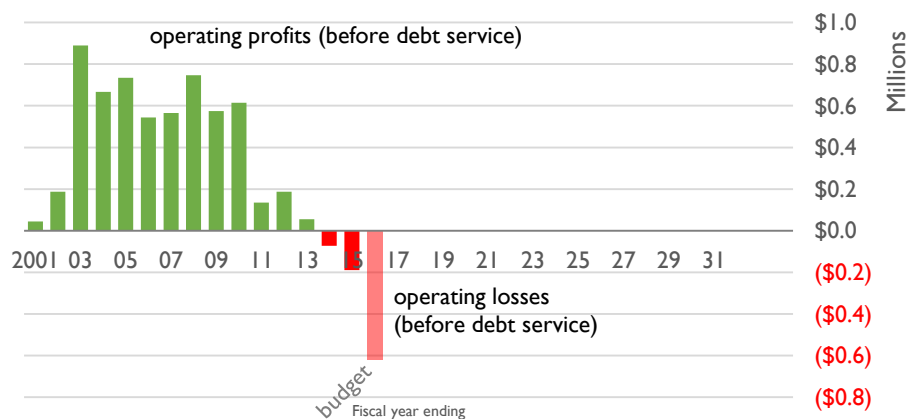
- At Los Lagos, the City paid \$300,000 in operating losses, \$100,000 in capital improvements, and \$1.5 million to cover debt service
- At Rancho, the City paid \$300,000 in operating losses and \$500,000 to cover debt service
- At Muni, the City received \$400,000 in lease income

The General Fund subsidy is growing. Two years ago, the General Fund subsidy was \$2.0 million (FY 2013-14). Last year, the City Council originally budgeted a General Fund subsidy of \$1.6 million (FY 2014-15); it increased this by \$300,000 in October 2014 and by another \$300,000 in February 2015 after revenues fell below and expenses increased above expectations. The positive income from Muni’s lease covered some, but not all the losses at Los Lagos and Rancho. For this year, the City budgeted a \$2.6 million subsidy (FY 2015-16).²⁸

Operating Losses Are Worsening

In part, the General Fund subsidy is needed to cover operating losses which have worsened in recent years. Rancho has consistently made operating losses and Los Lagos slipped into operating losses in FY 2010-11. The size of the operating losses depend on revenues and expenses, which we described in detail earlier in this report for each golf course. Exhibit 15 shows the worsening operating losses for the three golf courses combined.

Exhibit 15: Operating Losses Are Getting Worse – 3 Courses Combined



This excludes debt service. Source: Los Lagos and Rancho financial statements, Muni revenue reports, budget reports.

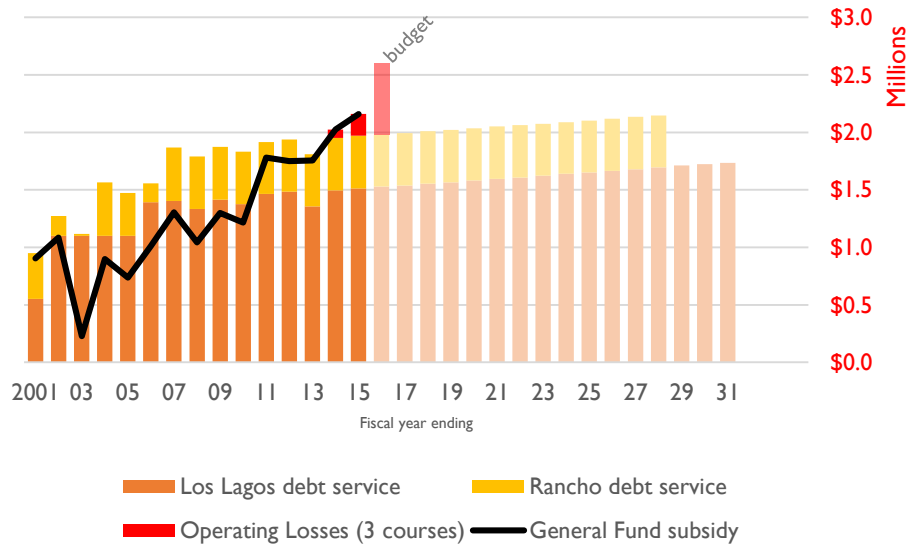
²⁸ The budgeted amount of \$2.6 million was based on an early estimate. PRNS expects that operating losses will be similar to 2014-15 and that parts of this subsidy may fall to the ending fund balance in the Municipal Golf Course Fund.

Debt Service Continues Through 2031

The City of San José Financing Authority issued a total of \$27.6 million in lease-revenue bonds in 1997 and 2000 to pay for construction of Los Lagos and Rancho. The City will be covering the debt for the foreseeable future: Los Lagos payments range from \$1.5 million to \$1.7 million per year through 2031 and Rancho payments of \$500,000 continue through 2028. The General Fund has been covering most of these debt service payments as – even in the profitable years – operating profits were not sufficient to cover the entire debt service. There is no debt at Muni.

Cumulatively over the last 15 years, the General Fund subsidy has totaled \$19.2 million to date, as shown by the black line in Exhibit 16.²⁹

Exhibit 16: General Fund Subsidy Has Grown Over the Last 15 Years



Source: Los Lagos and Rancho financial statements, Muni revenue reports, Finance Department debt service schedules, budget reports.

In the past, the General Fund subsidy was lower than the debt service because Los Lagos and Muni returned operating profits to the City. Here we do not project the magnitude of potential **future** operating losses, so future subsidies could be higher than shown.

²⁹ In addition to the General Fund subsidy to the Municipal Golf Course Fund, the the City incurs costs for overseeing the golf courses which are part of the PRNS operating budget. These are relatively small.

In the past, the City also paid for large capital improvements out of the General Fund or the *Construction and Property Conveyance Tax Fund: City-Wide Parks Purposes* (Fund 391), such as \$2 million for safety nets at Los Lagos, \$400,000 for a cart barn upgrade at Muni, and a current \$300,000 safety net installation at Rancho.

Trade-Offs in the General Fund

When the General Fund has to subsidize losses in the Golf Course Fund, those monies become unavailable for other service needs, such as police; fire; parks, recreation, and neighborhood services; public works; library; and so on. For context, the golf subsidy of \$2.2 million in FY 2014-15 from the General Fund compares in size to the following services:

- Expanded library hours, including Saturday service – the City recently added \$2.3 million to the Library’s annual budget³⁰
- The City’s gang prevention program – it granted \$2.2 million to community-based organizations that served 3,829 unique youth participants in FY 2013-14
- Building one new soccer field – estimated at \$1.2 to \$2.5 million, depending on the amenities and type of turf, according to a consultant estimate for a new City field currently in design.

When golf requires a subsidy, the community and policy makers need to confront the trade-offs, such as whether golf is more important than other recreation activities or other City services.

Golf Should Get Minimal Subsidies, per City Policy

Despite the on-going subsidies, the City expects the golf courses to sustain themselves financially. The City Council’s policy regarding PRNS pricing and revenue directs PRNS to minimize subsidies for “private services” including golf:

*Private services provide benefit to the individual, are typically specialized and provide minimal to no benefit to the community. These services should receive a minimal subsidization (if any) and the fee to participate is the responsibility of the user/customer. Examples of private services include facility rentals, language classes and **golf**. [Emphasis added]³¹*

This expectation of cost recovery and self-sustainability is common across public agencies that operate golf courses: The majority of them are considered enterprise operations and expected to generate enough revenue to cover operations and

³⁰ The Library is adding 28 full-time equivalent staff at an annual cost of \$2.3 million to expand library hours from 33 per week to 47 per week. This will enable Saturday service at all library branches. This is being funded by a library parcel tax and by the General Fund; the General Fund will gradually assume full funding over the next 5 years. For more information, see our Audit of Library Hours and Staffing at <http://www.sanjoseca.gov/DocumentCenter/View/28146>.

³¹ Council Policy 1-21 is available online: <http://www.sanjoseca.gov/DocumentCenter/View/44755>. Aside from private services, the policy also defines **public services** (accessible broadly, highest subsidy level, for example: parks) and **merit services** (benefits to community and the individual, cost sharing, for example: swim lessons). The policy does not speak about capital costs.

maintenance costs, **as well as** capital debt service. We describe the finances of several nearby public golf courses in **Appendix D**.³²

It is common for municipalities to subsidize certain services, especially parks and recreation services. Golf courses, however, are accessible to fewer customers, and not publicly accessible or walkable like a public park. Moreover, many other subsidized services still have a corresponding funding sources, such as user fees, and developer fees or bond issuances for parks/facilities. For golf courses, this corresponding revenue source has always been intended to be fees charged to golfers.

It Is Expected that Golf Sustains Itself Financially

Since the 1990s, the Administration has promoted expectations of cost recovery: Revenues from the golf course operations should be sufficient to cover expenses and debt.

Before constructing Los Lagos, the feasibility study saw excellent prospects for financial success and suggested golf operations would be profitable and financially successful.³³ In staff reports to the City Council in 2000, it was suggested Los Lagos would be financed to the greatest extent possible through user fees and would have a positive impact on the operating budget. Further, a memorandum stated that golf courses “had greater potential for being self-supporting” than swim facilities or sports parks, and cautioned that Los Lagos would need General Fund support at least **in the early years** (our emphasis added). In 2002, just before Los Lagos opened, the Council received reports that that Los Lagos would be “essentially self-supporting over at least the first six years” and after that operating profit should be sufficient to fund “virtually all obligations and to generate an operating surplus in future years.”

In hindsight, projections of golf rounds and revenues were overly optimistic.

³² The following nearby municipal golf courses return income to their owner agency: Santa Teresa and Spring Valley (County of Santa Clara), Santa Clara Golf and Tennis (City of Santa Clara), and Palo Alto Municipal. See **Appendix D** for summaries of these. Further away, the San Francisco Public Utilities Commission receives income from its golf courses, as does the City of San Diego, and the County of Los Angeles for some of its courses.

Some golf courses, however, are also struggling financially: for example, Blackberry Farm (9 holes, City of Cupertino).

³³ As was detailed by studies and reports in the meantime, the feasibility study by the National Golf Foundation had overestimated revenues and severely underestimated costs. In addition, construction costs ballooned, necessitating a larger debt issuance. During our audit we did not locate a similar feasibility study for Rancho.

Increasing Golf Play Could Improve the Operating Finances, as Could Reducing Costs

To address the underutilization of its golf courses, especially at Los Lagos and Rancho, the City needs to identify how it will increase golf customer usage. Increased usage by golfers would bring new revenues. It would also spread the high operating costs over more customers, thus reducing the *per-customer* subsidy and the *total* operating subsidy from the General Fund.



Growth Needed to Break Even

If Los Lagos grew its annual play by 5,000 rounds – 11 percent on top of the current level of 50,000, – it could perhaps break even on *operating expenses* (before debt service). This is probably attainable through improved marketing, outreach, and customer service. However, even if Los Lagos could improve to break-even status, the level of land utilization would still be low compared to more intensive recreational uses. Golf, compared to other sports, requires many acres, whereas a sports field can serve more residents on a smaller footprint.

Rancho, on the other hand, would need to increase its annual play by 16,000 rounds or 60 percent on top of the current level of 24,000 rounds to break even on *operating expenses* (before debt service). This appears unrealistic, as plenty of other golf courses compete for customers in the southern Bay Area. The consensus opinion is that 9-hole golf courses are not competitive due to their limited revenue potential.

We see, however, few prospects of operating revenues fully covering future debt service payments, so the General Fund will likely continue subsidizing the golf courses at about \$2 million per year. Los Lagos would need to grow by 60 percent and Rancho by 140 percent to fully cover their operating losses *and* debt service.

At Muni, the lessee has a stronger profit motive to increase customer usage and revenues, compared to the management agreement structure at Los Lagos and Rancho. The Muni lease places most responsibilities on the lessee. More golfers and more revenue would trickle down to a higher lease income for the City, but large increases are unlikely.

If it was intended to cover the Los Lagos and Rancho operating losses from Muni's lease income alone, Muni would have to grow its golf play by 42 percent. This, too, seems unrealistic.

The City Needs to Identify How It Will Increase Golf Customers

Facing underutilization and financial losses at Los Lagos and Rancho, the City and its operator need to aggressively grow the number of golfers, by setting targets, marketing to new customer groups, and analyzing effective growth strategies. Relying on the existing customers limits the growth potential.

Even though the operator has the primary responsibility and expertise for golf marketing and managing customer relationships, under the current management agreement structure, the City ultimately retains control and direction over these aspects. In our opinion, the City needs to more strongly exercise this control and work with the operator to attract more golfers, building on the marketing plan already articulated by the operator.

PRNS and the operator have preliminarily discussed potential facility improvements that could draw more people onto the Los Lagos golf course. These include a new practice area for chipping and potential additions to the clubhouse, but no funding has been identified.

Because target customers, facility enhancements, costs and service levels, as well as the competitive position are all interrelated, the City and operator need to dedicate more work towards determining the City’s desired services and business approach.

The following rubric in Exhibit 17 summarizes the potential effects of this action – increasing golf customers – on several utilization criteria and financial criteria. In the following sections, we use the same rubric to analyze further options that the City should consider in managing its golf courses and the publicly-owned lands.

Exhibit 17: Potential Effects of Increasing Golf Customers

Increase Golf Customers	
Criterion	Potential Effect
Utilization of the land	Bringing more golfers on the golf course slightly increases the land utilization
Parks and recreation usage	The golf course would continue to provide recreation space and facilities, but per-acre usage and total usage would remain well below other sports
Golf course usage	The golf course would continue to provide recreation space and host more golfers
Golf operating losses	Additional revenue from more golfers could improve the operating losses of \$300,000 at Los Lagos and \$300,000 at Rancho. Los Lagos may potentially turn into operating profits, but this appears difficult at Rancho
Golf debt service	Remains at \$1.5 million per year at Los Lagos through 2031 and \$0.5 million per year at Rancho through 2028
New revenues	More golf customers contribute to more golf revenues, but this creates no new revenue sources
New costs	New expenses may be needed marginally to add golf staffing and increase service levels

Source: Auditor analysis

Costs Could be Contained Further

The City and its operator at Los Lagos and Rancho have already taken steps to contain the growing costs. For example, the hours worked by maintenance staff at Los Lagos were cut by 19 percent compared to 2009. Maintenance levels, especially on the outskirts of the golf courses, have declined. The operator also limited café hours at Rancho. Yet, unit costs for labor, water, fertilizer, and for other supplies have increased.

There may be further potential to cut costs by reducing open hours of the golf courses, driving ranges, restaurants, and shops to align open hours with utilization. The City and operator could also choose to further reduce maintenance levels on the golf courses, such as mowing the grass less frequently and letting certain areas of grass deteriorate, beginning with those areas that do not affect golf play. Such actions could, however, also reduce revenues and lower customers’ usage of the golf courses, as described in the rubric in Exhibit 18.

Exhibit 18: Potential Effects of Further Reducing Costs

Further Reduce Costs	
Criterion	Potential Effect
Utilization of the land	By reducing service levels such as open hours, existing golfers would either choose to play at a different time or stay away from the golf courses. This potentially lowers usage by the community.
Parks and recreation usage	The golf course would continue to provide recreation space
Golf course usage	By reducing service levels such as open hours, existing golfers could either choose to play at a different time or stay away from the golf courses. This potentially lowers usage by the community. By reducing maintenance levels, the golf courses become less attractive to golfers; this potentially reduces usage by the community.
Golf operating losses	As expenses are reduced, operating losses could improve. But if revenues also shrink because golfers stay away, operating losses could worsen. Expenses could also be reduced and operating losses improved by removing the prevailing and living wage requirements. It has been the policy decision of the City Council to continue requiring prevailing and living wages, although the Council could potentially waive those requirements. Prevailing and living wages are not common in the golf industry.
Golf debt service	Remains at \$1.5 million per year at Los Lagos through 2031 and \$0.5 million per year at Rancho through 2028
New revenues	No new revenues anticipated from lowering service levels
New costs	No new costs anticipated from lowering service levels

Source: Auditor analysis

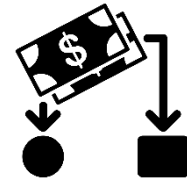
To Keep Its Three Golf Courses, the City Needs to Commit On-Going Subsidies

To keep the status quo – the City continues offering its three golf courses – the City would need to commit a General Fund subsidy for the foreseeable future. This directly benefits golfers as they enjoy subsidized green fees and subsidized recreation facilities. Debt service payments amount to about \$2 million every year through 2031, as shown previously in Exhibit 16. Growing out of operating losses seems perhaps attainable at Los Lagos, but unrealistic at Rancho. Growing golf play to cover debt service in full is unrealistic.

Furthermore, by keeping the status quo, the lands would remain underutilized. Currently, the 300 golf course acres combined host 411 rounds of golf per day, on average. This usage is much lower than usage during the early 2000s. It is also much lower compared to other sports which do not require a large acreage footprint like golf.

To Permanently Reduce Its Subsidies, the City Would Need to Lower the Debt Burden and Consider Selling Portions of the Land

If policy makers and the community desire to reduce the General Fund subsidy that goes towards golf operations and debt service, the City needs to find a way to reduce the heavy debt burden. The City of San José Financing Authority still owed bondholders \$22.8 million in principal, plus \$9.2 million in interest as of June 2015.



The City Explored Selling Rancho in 2010

Around 2010, the City studied selling **the entire** 31 acres at Rancho to a developer that would have built up to 200 residential units. At that time, it was estimated that a sale could generate \$20 million.³⁴ The City Council had directed the Administration to prepare for the sale of Rancho for residential development, to eliminate the General Fund subsidy. This effort ended after the community strongly supported keeping the golf course and opposed residential development in several community meetings.

Because of Appreciating Land Values, a *Partial* Land Sale Could Pay Off the Debt

Land values have appreciated since 2010. Today, selling **parts** of the golf course land (which total 300 acres) for development could generate one-time revenue to pay off the debt. At a current land value estimate of \$2.6 million per acre, selling just 9 acres of Rancho's 31 acres could potentially generate sufficient funds to pay

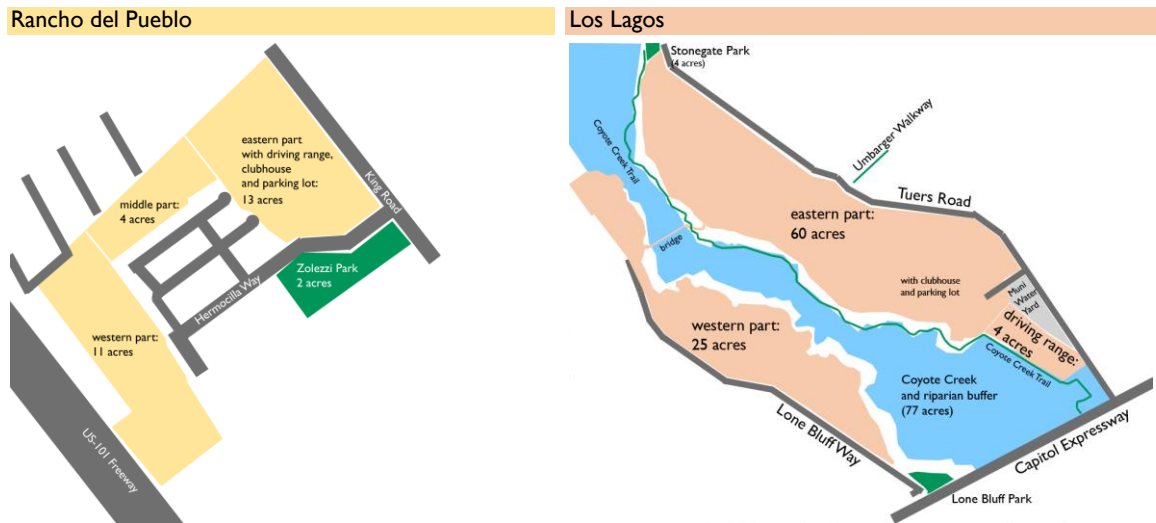
³⁴ 2010 HMM's Rancho del Pueblo Golf Course Assessment: <http://www.sanjoseca.gov/DocumentCenter/View/44734>

Golf Courses

off the principal debt at **both** Los Lagos and Rancho. Using more conservative land value estimates of \$1.0 million per acre,³⁵ selling 23 acres could generate sufficient funds to pay off the debt on **both** Rancho and Los Lagos.

The following Exhibit 19 shows the layouts and acreage of Rancho and Los Lagos.

Exhibit 19: Rancho and Los Lagos – Golf Course Layouts and Acreage



Source: Auditor analysis in Google Earth Pro, Assessor's map of Rancho, Los Lagos master plan

Note that the scale on the Rancho map differs from the scale on the Los Lagos map. Muni consists of 145 acres. The acreages are estimates that do not sum due to rounding.

See **Appendix E** for larger aerial views of all three golf courses.

Selling Los Lagos as a Golf Course

During the course of this audit, we learned that potential buyers have expressed an interest in purchasing Los Lagos as golf course. If the City pursues this, it also has the potential to pay off the debt. As part of the sale negotiations, the City could require that Los Lagos continues to operate as a golf course and be open to the public.

Benefits From Removing the Debt

Freeing the City from the heavy debt burden opens up several new opportunities for the City's publicly-owned golf lands and public funds currently spent on golf subsidies:

³⁵ PRNS derived this estimate from 2012 land values for the Alum Rock area to set its 2014-15 parkland fees. For the South San José area where Los Lagos is located, PRNS also estimated a land value of \$1.0 million per acre. For the Berryessa area where Muni is located, PRNS estimated a land value of \$1.5 million per acre.

- *Making General Fund money available for other uses* – As described earlier in the General Fund subsidy section, other important services could be enhanced if the annual General Fund subsidy of about \$2 million was not needed for the golf courses.
- *Enabling the City to enter into more favorable golf contracts* – Because of federal tax regulations, the City cannot enter into certain types of performance-based contracts and private business use is restricted at Los Lagos and Rancho because they were financed them with tax-exempt bonds. Upon repayment of the bonds, the City could potentially lease Los Lagos and/or Rancho to a golf operator who would then bear the business and financial risk that the City currently is paying for. Golf course leases usually return a steady income to the owner agency, generally a percentage of gross revenues.
- *Raising revenue for facility enhancements* – Funding for facility improvements is limited. For example, the City only had \$100,000 in uncommitted park dedication fees available for Council District 5 (where Rancho is located), and only \$300,000 for District 7 (where Los Lagos is located) as of June 2015. Sale proceeds after paying off the outstanding bonds could conceivably be used to build sports fields as described in the following section. For example, at Los Lagos, such revenues could conceivably be used to make the golf course more attractive to golfers by expanding the parking lot, upgrading the clubhouse, and adding another practice area that could also be used by *The First Tee*. Or, the City could construct **non-golf** community amenities, like family/community recreation spaces, or fund other parks and recreation programs.

Other Considerations Before Selling Some Portion of Golf Course Lands

At each of the golf courses, there are some constraints to consider before pursuing a potential land sale:

- For Rancho, there have occasionally been questions as to whether the City is obligated to keep a golf course on the land in perpetuity, as a condition of the land purchase in 1997. The City Attorney's Office, however, has reviewed the land purchase and sale agreement and has found nothing to substantiate that claim. Furthermore, *The First Tee* uses Rancho for its youth program.
- For Los Lagos, PRNS has noted that the land was dedicated as parkland and changes to this parkland use would require approval by the voters. According to PRNS, the land was purchased using funds from a state parks bond which may have additional restrictions. A 3-acre portion near the parking lot contains contaminated soil and is thus restricted from residential development. Moreover, if the City reconfigured Los

Lagos to a smaller golf course, it would likely become less attractive to golfers and negatively impact the operating finances.

- For Muni, the City is locked into a long-term lease agreement with the lessee that is anticipated to expire in 2022. The City could buy the lessee out of the contract before then, but this could carry a cost.
- If a golf course were to be reconfigured to another use or some portion of the land were sold, the immediate neighborhoods would be impacted. An extensive community engagement process would be needed to assess the benefits and impacts of alternative uses.³⁶
- Selling a portion of golf course lands could run counter to the goal of land banking for future open space needs.

Finally, due to the structure of the outstanding bonds, the City of San José Financing Authority can repay or refinance the debt as early as 2017. Repaying or refinancing the bonds prior to that will lead to additional costs from a pre-payment penalty.

The rubric in Exhibit 20 details the potential impacts of selling some golf lands.

Exhibit 20: Potential Effects of Selling Some Land

Sell Some Land to Pay Off Bonds	
Criterion	Potential Effect
Utilization of the land	Could bring more users, depending on the recreational uses of the remaining land
Parks and recreation usage	Golf course would be reconfigured or close partially. Potentially permanent loss of some open space.
Golf course usage	Golf course would be reconfigured or close partially
Golf operating losses	Full golf course closure would remove losses of \$600,000 at Los Lagos and Rancho
Golf debt service	Outstanding principal of \$22.8 million at Los Lagos and Rancho combined could be paid off from partial land sale
New revenues	One-time revenue from land sale
New costs	Reconfiguration of golf course and transaction costs

Source: Auditor analysis

³⁶ The following City-owned parks and recreation facilities serve the immediate neighborhoods:

Los Lagos is near Lone Bluff Park (0.5 acres), Stonegate Park (4 acres), the Umbarger Walkway (0.5 acres), the Tully Community Ballfields (10 acres), Ramblewood Park (9 acres), Solari Park (8 acres), the Nuestra Tierra Community Garden (3 acres), and the Coyote Creek Community Garden (1 acre). Coyote Creek Trail cuts through the golf course.

Rancho is near Zolezzi Park (2 acres), Emma Prusch Farm Regional Park (44 acres), Mayfair Park (6 acres) and the Mayfair Community Center, Plata Arroyo Park (11 acres), Bonita Park (1 acre), and the stadium of the Police Activities League.

Muni is near Townsend Park (8 acres), Flickinger Park (14 acres), and Vinci Park (3 acres).

To Increase the Community's Use of the Land, the City Could Build New Sports Fields

As described earlier, fewer people are playing golf in San José and utilization of the golf lands is relative low. If policy makers and the community prioritize bringing more people onto the underutilized golf lands, the City needs to consider reconfiguring one or more golf courses to other parks and recreation uses. Policy makers and the community face the question of how much land they want to dedicate to golf and what other uses can serve residents' recreation needs. Other uses can also activate the underutilized golf lands.



Large Need for Soccer and Baseball/Softball Fields

Adding soccer or baseball/softball fields would address a big community need and improve the land's utilization. The City is underserved by such ball fields: A 2008 study for PRNS identified a City-wide need for an additional 57 rectangular and 96 diamond fields.³⁷

Sports Fields Have Much Higher Utilization Than Golf Land

These types of sports fields require less space and attract higher usage per acre than golf. For example, while the entire Los Lagos Golf Course hosted 136 golf rounds per day on its 100 golf acres, the City's busiest soccer field hosted 247 players per day on a 3-acre site.³⁸

A soccer field measures about 2.2 acres and a softball diamond 2.0 acres. Sports fields could potentially coexist alongside a reconfigured golf area designed specifically for youth. With higher utilization, concerns may arise over traffic impacts and noise. The City would need to carefully consider how to lay out any new facilities. **Appendix E** shows an aerial view of the golf courses and surrounding lands and the previous Exhibit 19 shows a layout of Los Lagos and Rancho currently.

New Costs

Building a new soccer field costs \$1.2 to \$2.5 million, depending on the amenities and type of turf, according to a consultant estimate for a current City soccer field under design. On-going maintenance costs per acre could be higher than the golf courses currently cost; PRNS estimated an annual cost of \$22,000 per baseball field (2 acres, artificial turf) and \$15,000 per neighborhood parks acre, whereas currently the golf course maintenance averages to \$10,000 per acre. Some public

³⁷ The *Community Sports Fields Study* is available online at <http://www.sanjoseca.gov/DocumentCenter/View/44899>

³⁸ This is estimated from PRNS soccer reservation data which does not even count players who did not make a reservation, for example from pick-up games.

agencies, however, receive positive income from their sports fields by leasing them out – for example Morgan Hill’s soccer complex.

The rubric in Exhibit 21 details potential impacts from adding sports fields.

Exhibit 21: Potential Effects of Adding Sports Fields

Add Other Types of Sports Fields, Such as Soccer/Baseball/Softball	
Criterion	Potential Effect
Utilization of the land	Different recreation facilities, for example soccer or diamond fields, increase utilization by the community
Parks and recreation usage	Could reserve golf use but also add new sports uses
Golf course usage	Reconfigure of the golf course
Golf operating losses	If golf courses continue, the operating losses will remain \$600,000 at Los Lagos and Rancho
Golf debt service	Remains at \$1.5 million per year at Los Lagos and \$0.5 million per year at Rancho, but could be paid off with a land sale
New revenues	Potential lease income to the City from new sports fields
New costs	Construction and operation of new facilities (with potential General Fund impacts)

Source: Auditor analysis

Policy Makers and the Community Need to Prioritize How to Use Publicly-Owned Golf Course Lands and Scarce Public Funds

This report has described the past and present of the City’s golf courses: The course lost a large number of golfers over the last decade. The 300 golf course acres are now underutilized, hosting only 411 golf rounds per day. The General Fund subsidy has grown, now budgeted at \$2.6 million for this year (FY 2015-16). The City covers operating losses at Los Lagos and Rancho, in addition to heavy debt service on both golf courses. At Muni, the City is locked into a long-term lease agreement.

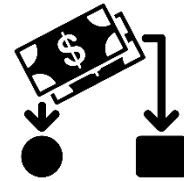
The City Council, in our opinion, should consider consolidating its golf courses and implementing other land uses on the underutilized golf lands. As detailed in the preceding sections, future opportunities and choices about policy priorities include:

- (1) If policy makers and the community prioritize **keeping the three golf courses as they operate today**, the City will likely need to commit to paying on-going subsidies, including covering debt service for the outstanding bonds – about \$2 million every year through 2031 – while the land utilization will still remain relatively low. If this status quo continues, the City should aggressively grow customer usage to bring more golfers onto the golf courses. Los Lagos could potentially break even on operating expenses; this seems unrealistic at Rancho. Moreover, it is unrealistic



to expect golfer growth to cover the debt service – Los Lagos would need to add 60 percent and Rancho would need to 140 more golfers to fully cover their operating losses and debt. The City should also pursue more favorable contract terms when the current agreements expire.

- (2) If policy makers and the community prioritize **reducing the General Fund subsidy**, the City needs to find a way to reduce the heavy debt burden. One option is selling a portion of land at one or more golf courses to pay off the debt of \$23 million in principal. This could free the City of the on-going obligations to service the debt at *both* Los Lagos and Rancho. The City could then use the freed-up General Fund money for other purposes, such as other parks and recreation programs. Consolidating the golf courses this way could open the land at one or more golf courses for a variety of other recreation uses – including sports fields as described next.


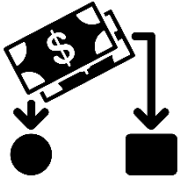



- (3) If policy makers and the community prioritize **bringing more people onto the underutilized lands**, the City needs to consider reconfiguring one or more golf courses to other uses. Potentially, the City can add soccer/baseball/softball fields to address a large community demand for these sports fields and to activate the underutilized golf lands. While this would require one-time funding for reconfiguration and on-going funding for the new operations, soccer or diamond sports fields can serve dramatically more residents than the golf courses.



These priority choices are summarized in the following Exhibit 22. They can be pursued in part or in combination, on one or more golf courses. We describe these here to highlight potential benefits, costs, and constraints for the City Council and the community to begin discussing and deciding their priorities. How to best use publicly-owned golf course lands and how to best use scarce General Fund subsidies is a policy decision that requires careful deliberation.

Exhibit 22: The City Faces Choices for Its Policy Priorities

<p>Golf today:</p> <p>Los Lagos: 180 acres – 136 golf rounds per day Operating loss: \$300,000 per year Outstanding debt: \$18.3 million principal</p> <p>Rancho: 31 acres – 65 golf rounds per day Operating loss: \$300,000 per year Outstanding debt: \$4.5 million principal</p> <p>Muni: 145 acres – 210 golf rounds per day City's lease income: \$400,000 per year</p>			
<p>Policy Objective</p> <p><i>What is the City Council's and the community's priority?</i></p>	<p>Keep 3 Golf Courses</p>	<p>Reduce the General Fund Subsidy of \$2.6 million</p>	<p>Increase Land Utilization</p>
<p>Pathway</p> <p><i>How to get there?</i></p>	<p>Keep the Status Quo</p> <p><i>Recommendation 1:</i> PRNS should obtain more favorable contracts.</p> <p><i>Recommendation 3:</i> PRNS and operators should grow customers aggressively and effectively reach and retain golfers.</p>	<p>Sell portion of golf course lands to pay off debt (principal: \$23 million). A partial sale of Rancho could potentially pay off entire debt.</p> <p>Offers to purchase Los Lagos could relieve the City of a large portion of the debt.</p> <p>Left-over funds could pay for other facility improvements.</p> <p><i>Recommendation 2:</i> City Council should provide policy direction and begin community engagement.</p>	<p>Reconfigure one or more golf courses to other uses, such as soccer, baseball, or softball fields.</p> <p>Building a soccer field takes 2 acres and costs about \$1.2 million to \$2.5 million, for example.</p> <p><i>Recommendation 2:</i> City Council should provide policy direction and begin community engagement.</p>
<p>Results</p> <p><i>What will the future look like for golfers, for the community, for the General Fund subsidy, and for the golf lands?</i></p>	<p>Debt service continues through 2031 at \$2 million every year.</p> <p>Operating losses could slightly improve at Los Lagos, but this is unlikely at Rancho.</p> <p>Usage of golf courses and lands could grow modestly, but for golfers only.</p>	<p>General Fund subsidy freed up for other important services, such as other recreation and parks programs.</p> <p>City can enter into less risky golf contracts.</p> <p>Potentially build new recreation facilities, after consolidating golf courses.</p>	<p>Building such sports fields addresses a large, City-wide community need and activates the underutilized golf course lands. Usage of public land would be dramatically higher, for example as high as 250 soccer players per day on just one field.</p>
			

Source: Auditor summary

Community engagement, business studies, environmental studies, and planning/designing/building facilities would likely take several years to complete, but with upcoming contract expirations at Rancho anticipated in 2016, at Los Lagos in 2017, and at Muni anticipated in 2022, the City should begin thinking about its priorities now.

Recommendation #1: To obtain more favorable contract terms, when the lease and management agreements expire, the Department of Parks, Recreation and Neighborhood Services should seek competitive proposals from potential golf course lessees/operators that lower the City's financial risks and grow customer usage.

Recommendation #2: To address underutilization and financial losses, the City Council should provide policy direction and direct the Administration to begin a community engagement process regarding consolidating the golf courses and implementing alternative land uses on the underutilized golf lands. Potential policy directions include:

- a) Continue the General Fund subsidy to keep the three golf courses as they operate today,
- b) Reduce the General Fund subsidy through a competitive sale of some portion of golf course lands to pay off the outstanding lease-revenue bonds, and/or
- c) Increase community utilization of scarce open space by reconfiguring one or more golf courses to other uses, for example constructing new sports fields.

Recommendation #3: To improve the utilization and finances of its golf courses, the Department of Parks, Recreation and Neighborhood Services and its operators should:

- a) More clearly articulate a competitive position that covers the facilities, pricing, and the brand,
- b) Develop a more aggressive customer growth strategy, identifying target customers and utilization goals, and
- c) Implement more effective outreach and retention plans.

PRNS Needs to Improve Program and Contract Oversight

The responsibilities to oversee the golf courses and contracts are primarily with a parks manager from the PRNS parks division, who also has other unrelated duties. Additional oversight is exercised by staff members from the PRNS administrative

division and the City Manager's Budget Office. PRNS primarily carries out its oversight by meeting monthly with the operator and lessee, and by routinely approving operator/lessee reports. For further detail, **Appendices A, B, and C** summarize the contract requirements and City responsibilities.

PRNS can improve its oversight in the following areas:

Assigning Sufficient Resources to Oversight

Responsibilities have rotated among different employees, as is common across all City departments. Moreover, the hours dedicated to golf oversight have shrunk over the years due to budget cuts. Currently, the parks manager spends only a few hours per month on golf, whereas previously the City had dedicated more staff time to golf.

It may be beneficial to add strategic resources to golf oversight, as the business operations, contracts, and potentially land uses need to be evaluated and directed in the near future. One advantage of the management agreement structures at Los Lagos and Rancho is the greater level of control afforded to the City, for example regarding fee-setting, maintenance standards, operating policies, and service levels. By assigning more resources, the City can take advantage of the authority it already has.

Recommendation #4: To improve oversight of the golf courses and contracts, the Department of Parks, Recreation and Neighborhood Services should assign sufficient resources to oversight.

Financial Auditing and Record-Keeping Regarding Muni

The lease agreement enables, but does not require the City to audit gross revenues, which form the basis for the City's lease income. Audits of the financial reporting and controls have been sporadic, for example in 1997 and 2008. Without such audits, the City is trusting the revenues self-reported by the lessee. This exposes the City to underreporting and underpayment of lease income, as the Civil Grand Jury already warned in 1994.³⁹ The City has also not audited the capital improvement fund which the lessee maintains for the City. Partly because the lessee sends reports to the Finance Department, PRNS records were sparse.

³⁹ Following the Civil Grand Jury's report, the City committed to auditing Muni's gross revenues every 3 years.

Timely Record-Keeping Regarding Los Lagos and Rancho

In some cases, PRNS has not taken timely contract actions or kept records accessible. For example:

- Financial audits for Los Lagos and Rancho were obtained late by half a year
- The approvals for Rancho safety nets were delayed by a year
- The operating budget for Los Lagos and Rancho to be effective July 2015 had not yet been approved as of August 2015
- A contract for environmental mitigation at Los Lagos from 2003 through 2013 was not retained
- PRNS has informally revised contractual maintenance standards to lower costs, but not formally amended the agreements to reflect these practices.

Many files were kept on paper rather than organized electronically or centrally. Decentralized files make business analysis and oversight more difficult for City staff.

Relationship with *The First Tee*

The First Tee of Silicon Valley uses Rancho for its youth program. Some *CourseCo* staff members were part-time employees on *The First Tee's* payroll. On behalf of the City, *CourseCo* bills fees to *The First Tee* for using the golf course and schedules the hours when *The First Tee* can use the golf course. Among the City, *CourseCo*, and *The First Tee*, there was no formal documentation of the fee rates and the access schedule that are currently in place.

Recommendation #5: To improve oversight of the golf courses and contracts, the Department of Parks, Recreation and Neighborhood Services should:

- a) Regularly audit Muni's gross revenues and capital improvement fund**
- b) Keep all golf records centrally and ensure they are obtained timely**
- c) Formalize the revised maintenance standards**
- d) Formally approve the fees charged and discounts given to *The First Tee* and the schedule of access hours**

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Conclusion

The City needs a new golf strategy. The City's golf courses – Los Lagos, Rancho, and Muni – have lost a large number of golfers over the last decade. Los Lagos is underutilized and fell into operating losses of \$300,000 per year. Rancho is also underutilized and consistently operated at a loss of \$300,000 per year. At Los Lagos and Rancho, the City needs to cover debt service of about \$2 million per year. The City receives steady lease income from Muni, but the contract favors the lessee. The General Fund subsidy for golf grew to \$2.2 million in FY 2014-15. Increasing golf play could improve the operating finances, as could reducing costs, but to keep all three golf courses, the City needs to commit on-going subsidies. To permanently reduce its subsidies, the City needs to lower the debt by potentially selling portions of the land. To increase the community's use of the land, the City could build new sports fields. Policy makers and the community need to prioritize how to best use publicly-owned golf course lands and scarce public funds. Finally, the City should improve program and contract oversight.

RECOMMENDATIONS

Recommendation #1: To obtain more favorable contract terms, when the lease and management agreements expire, the Department of Parks, Recreation and Neighborhood Services should seek competitive proposals from potential golf course lessees/operators that lower the City's financial risks and grow customer usage.

Recommendation #2: To address underutilization and financial losses, the City Council should provide policy direction and direct the Administration to begin a community engagement process regarding consolidating the golf courses and implementing alternative land uses on the underutilized golf lands. Potential policy directions include:

- a) Continue the General Fund subsidy to keep the three golf courses as they operate today,
- b) Reduce the General Fund subsidy through a competitive sale of some portion of golf course lands to pay off the outstanding lease-revenue bonds, and/or
- c) Increase community utilization of scarce parkland by reconfiguring one or more golf courses to other uses, for example constructing new sports fields.

Recommendation #3: To improve the utilization and finances of its golf courses, the Department of Parks, Recreation and Neighborhood Services and its operators should:

- a) More clearly articulate a competitive position that covers the facilities, pricing, and the brand,
- b) Develop a more aggressive customer growth strategy, identifying target customers and utilization goals, and
- c) Implement more effective outreach and retention plans.

Golf Courses

Recommendation #4: To improve oversight of the golf courses and contracts, the Department of Parks, Recreation and Neighborhood Services should assign sufficient resources to oversight.

Recommendation #5: To improve oversight of the golf courses and contracts, the Department of Parks, Recreation and Neighborhood Services should:

- a) Regularly audit Muni's gross revenues and capital improvement fund
- b) Keep all golf records centrally and ensure they are obtained timely
- c) Formalize the revised maintenance standards
- d) Formally approve the fees charged and discounts given to *The First Tee* and the schedule of access hours.

APPENDIX A

Contract and Finances at Muni

The City of San José (City) owns three golf courses: Los Lagos Golf Course, Rancho del Pueblo Golf Course, and the Municipal Golf Course. In addition to the description of the facilities in the Background section, Appendices A, B, and C describe the operating structures and contracts in more detail. We also break down the finances.

Structured as a Lease

The Muni operations are structured as a lease (which differs from the Los Lagos and Rancho operations): Generally, under golf course lease agreements, the owner – here the City – gives the golf course to a lessee for day-to-day operations and maintenance. Lease agreements for golf courses usually run for 15 to 30 years.

Financially, the lessee receives revenues (such as green fees, merchandise sales), and pays its own expenses (staff wages and salaries, equipment, raw materials, water and utilities). The lessee then pays the owner a lease fee, usually a percentage of gross revenue. What is left is the lessee's profit. The owner receives only the lease fee, with relatively small financial risk.

Exhibit I: Muni – Photos

Golf Course



Clubhouse and Patio



Driving Range and Practice Area



Source: Auditor photographs, spring 2015

1988 Lease Agreement

Lessee and Term: Since 1988, the City has leased Muni to *Mike Rawitser Golf Shop* (here referred to as *Rawitser* or lessee).¹ The City did not ask for competitive bids from other potential lessees. (For some years before 1988, the City had provided maintenance on the property and *Rawitser* had held a concession for golf sales only.)

Amendments: The City and *Rawitser* agreed in 1994 to amend and restate the 1988 agreement to modify the lease fee formula and to provide *Rawitser* two 5-year extension options beyond the original 2012 end date. The lessee intends to extend its lease through 2022.

In various other amendments, the City and the lessee also agreed to remove minor portions of land and to install a fence.

Compensation: The City has received 8.5 percent of gross revenues since 2008. Before 2008, the formula was even more favorable to the lessee. The Civil Grand Jury had criticized some of the contract terms as too generous to the lessee.

Service Level: The lessee must operate the golf course daily and maintain it. *Rawitser's* staff must meet certain qualifications.

Maintenance Standards: The lessee must follow maintenance standards related to horticulture and agronomy, such as mowing, watering, fertilizing, aerifying the grass; controlling pests and weed, repairing ball marks, and maintaining equipment.

Fees Charged to Customers: *Rawitser* can set its green fees in the mid-range of other nearby golf courses.

Capital Improvements: *Rawitser*, since in 2008, has put 1.5 percent of gross revenues into the Capital Improvement Fund. In years before 2008, the formula differed. In the early years of the contract, the City had required the lessee to fund \$1 million in capital improvements. The City approves the 5-year Capital Improvement Plan proposed annually by the lessee. Notably, *Rawitser* has also funded some capital improvements from its own profits, including renovations of all greens.

Reports and Audit Clause: The City can request an annual gross revenue audit (but it is not required) and may inspect records related to gross revenue as well as facilities. *Rawitser* has to submit a monthly report of gross revenue. The lease does not require the lessee to disclose its expenses.

¹ *Rawitser* is also the lessee on the Santa Teresa Golf Course which is owned by the County of Santa Clara.

Revenue Breakdown

The following Exhibit 2 breaks down the revenues at Muni. Green fees were the largest component of total revenues, at \$2.4 million in total or \$31 per round. The driving range also performed strongly, bringing in \$0.9 million in revenue. The City only receives 8.5 percent of gross revenues, or about \$400,000 per year.

Exhibit 2: Muni – Revenue Breakdown

FY 2014-15	Total	Per Round
Green Fees	\$2,423,000	\$31
Cart Rental	483,000	6
Driving Range	893,000	12
Merchandise Sales	525,000	7
Food and Beverage Sales	676,000	8
Lessons	118,000	2
Other	93,000	1
Lessee's Total Revenue	5,211,000	68
City's Lease Income (8.5% of Gross Revenues)	443,000	6
Lessee's Contribution to Capital Improvement Fund (1.5% of Gross Revenues)	78,000	1

Source: *Rawitser*

Merchandise sales and food and beverage sales shown are net of sales tax.

In contrast to Los Lagos and Rancho, there is no debt at Muni and the 1988 lease agreement does not require the lessee to pay its staff prevailing or living wage.

APPENDIX B

Contract and Finances at Rancho

The City of San José (City) owns three golf courses: Los Lagos Golf Course, Rancho del Pueblo Golf Course, and the Municipal Golf Course. In addition to the description of the facilities in the Background section, Appendices A, B, and C describe the operating structures and contracts in more detail. We also break down the finances.

Structured Under a Management Agreement

Rancho operations are structured as management agreement: Generally, under management agreements for golf courses, the owner – here the City – hires a management firm to operate the golf course day-to-day on the owner’s behalf.

The operator collects revenues (such as green fees, merchandise sales). The operator also pays all expenses, including the wages/salaries of the management firm’s staff, equipment, raw materials, water and utilities. The City pays the management firm a management fee for its services; this is the profit to the management firm. The City’s profit or loss is revenues minus expenses minus management fee. Notably, under these types of agreements, the City ultimately bears the risks of financial losses. Management agreements usually run for 5 years.

Because construction was financed with tax-exempt bonds, the City could not enter into a lease agreement for Rancho – per regulations by the Internal Revenue Service (IRS).

Exhibit I: Rancho – Photos

Golf Course



Clubhouse



Driving Range and Practice Area



Source: Auditor photographs, spring 2015

1999 Management Agreement

Operator and Term: The City has hired *San Jose Golf, LLC* to operate the golf course since 2000, after a Request for Qualification (RFQ) process. *San Jose Golf, LLC* is a 90-percent subsidiary of *CourseCo, Inc.*, and here referred to as *CourseCo* or as operator.¹ *CourseCo* also manages Los Lagos for the City.

The original agreement expired in 2004, but the City and *CourseCo* have extended the term. As of May 2015, it was a month-to-month agreement.

PRNS intends to extend the term through 2016 so the operator can repair nets.

Amendments: The City and *CourseCo* agreed on various amendments to allow Rancho staff to supervise the Los Lagos Golf Course, to delay some financial audits in the early years, to modify the management fee, and to extend the term.

Compensation: Since 2004, the City has paid *CourseCo* a management fee of \$212,753 per year, adjusted for inflation, plus 1 percent of gross revenues. One percent of gross revenues is about \$6,000. Before 2004, the fee was \$46,800 per year, adjusted for inflation, plus 1 percent of gross revenues. This 2004 change moved three management salaries out of the expenses into the management fee to comply with IRS regulations.

Service Level: The expectation is that the course is open daily to the public. Staff must meet certain qualifications. Private business use is prohibited.

Maintenance Standards: *CourseCo* must follow maintenance standards related to utilities, buildings, facilities, irrigation systems, furniture/fixtures, trees, and turf – fertilizing, pesticides, mowing, etc.

Fees Charged to Customers: The operator sets fees that are then approved by the City.

Capital Improvements: The City puts 2 percent of gross revenues into a capital improvement fund.

Prevailing and Living Wage: The City required *CourseCo* to play prevailing wage to its maintenance staff and living wages to food service staff.

¹ *CourseCo, Inc.* is a California corporation that manages a variety of golf courses, primarily in northern California. They include Metropolitan Golf Links (owned by the City of Oakland), Callippe Preserve Golf Course (City of Pleasanton), Crystal Springs Golf Course (San Francisco Public Utilities Commission), Boundary Oak Golf Course (City of Walnut Creek), and Deep Cliff Golf Course (privately owned in Cupertino).

Shared Staff: Since *CourseCo* also operates Los Lagos for the City, they share management staff across both courses.²

Budgets, Reports, and Audits: Annually, *CourseCo* must propose an operating budget and a 5-year capital budget, which the City approves. Further, *CourseCo* provides an annual marketing plan, maintenance plan, security plan, and insurance list. Budget deviations more than 10 percent require approval by the City Council.

Monthly, *CourseCo* must prepare financial reports. Weekly, *CourseCo* must prepare a maintenance report. Further, the City can review or audit all records. An external financial auditor audits the financial statement annually.

Revenue and Expense Breakdown

The following Exhibit 2 breaks down the revenues and expenses at Rancho.

Exhibit 2: Rancho – Revenue and Expense Breakdown

FY 2014-15	Total	Per Round
Operating Revenues		
Green Fees	\$266,000	\$11
Cart Rental	14,000	1
Driving Range	117,000	5
Merchandise Sales	78,000	3
Food and Beverage Sales	46,000	2
Lessons	27,000	1
Other	8,000	
Total	557,000	23
Operating Expenses		
Golf Operations	154,000	6
Golf Course Maintenance	278,000	12
Merchandise Cost of Sales	57,000	2
Food and Beverage Cost of Sales	23,000	1
Food and Beverage Operations	36,000	2
General and Administrative	70,000	3
Management Fee to <i>CourseCo</i>	266,000	11
Total	885,000	37
City's Operating Profit or (Loss)	(328,000)	(14)
Contribution to Capital Fund (2% of revenue)	11,000	Less than 1
Debt Service	459,000	19
City's (Subsidy)	(798,000)	(33)

Source: *CourseCo*

The management fee includes three salaries for staff, in accordance with federal tax regulations. Otherwise, these would have been a golf operations or maintenance expense.

² In 2007, the City Auditor's Office issued an *Initial Review of Los Lagos*, finding – among other things – that management costs are accounted for under Los Lagos alone, instead of splitting them across Los Lagos and Rancho. According to *CourseCo*, this is no longer applicable.

City-Funded Capital Improvements

Errant golf balls were hitting adjacent homes and vehicles on the freeway, leading to property damage and personal injury claims against the City. The City installed safety nets at a significant cost. A lawsuit by the City against the developer has been settled.

APPENDIX C

Contract and Finances at Los Lagos

The City of San José (City) owns three golf courses: Los Lagos Golf Course, Rancho del Pueblo Golf Course, and the Municipal Golf Course. In addition to the description of the facilities in the Background section, Appendices A, B, and C describe the operating structures and contracts in more detail. We also break down the finances.

Similar to operations at Rancho, the City hired *CourseCo* to operate Los Lagos under a management agreement on a day-to-day basis. Here, too, construction had been financed with tax-exempt bonds, so the City could not enter into a lease agreement – per IRS regulations.

Exhibit I: Los Lagos – Photos

Golf Course



Clubhouse and Patio



Driving Range and Practice Area



Source: Auditor photographs, spring and summer 2015

2002 Management Agreement

Operator and Term: The City has hired Los Lagos Golf, LLC to operate the golf course since 2002. Los Lagos Golf, LLC is a 90-percent subsidiary of the golf management firm CourseCo, Inc., and here referred to as CourseCo or as operator. The 15-year agreement expires in 2017.

In case the City wanted to terminate the agreement before 2017, it has various options to do so.

Amendments: A 2003 amendment clarifies capital improvement procedures. The City and CourseCo had also entered into a separate agreement under which CourseCo performed some environmental mitigation in the Coyote Creek area.

Compensation: The City pays CourseCo a management fee of \$132,000 per year, which increases with inflation. The City would also pay CourseCo an incentive fee tied to increases in gross revenue, but the incentive targets have not been met.

Service Level: CourseCo must maintain the golf course and operate it, with an expectation that is open daily to the public. CourseCo's staff must meet certain qualifications. In accordance with federal tax regulations, private business use is not allowed, nor are non-golf uses.

Maintenance Standards: CourseCo must follow maintenance standards for buildings, facilities, fixtures, equipment, and turf.

Fees Charged to Customers: CourseCo can set green fees in the mid-range of other nearby golf courses, but the City approves price changes.

Capital Improvements: The City puts 3 percent of gross revenues into a capital improvement fund. Aside from this, the City has also funded large capital improvements to construct safety nets that protect adjacent homes from golf balls, including a \$2 million project.

Prevailing/Living Wage: The City required CourseCo to pay prevailing wages/living wages to its maintenance employees and living wage to food service employees.

Budget, Reports, and Audits: Annually, CourseCo must propose an operating budget and 5-year capital budget, which the City approves, and a marketing plan.

Monthly, CourseCo provides the City with a financial report and a maintenance report, and meets with City staff. The financial statement is audited by an external auditor annually. Further, the City can review or audit all records.

Revenue and Expense Breakdown

The following Exhibit 2 breaks down the revenues and expenses at Los Lagos.

Exhibit 2: Los Lagos – Revenue and Expense Breakdown

FY 2014-15	Total	Per Round
Operating Revenue		
Green Fees	\$1,351,000	\$27
Cart Rental	468,000	9
Driving Range	320,000	6
Merchandise Sales	201,000	4
Food and Beverage Sales	395,000	8
Lessons	83,000	2
Other	17,000	0
Total	2,834,000	57
Operating Expense		
Maintenance	1,402,000	28
Golf Operations	527,000	11
Merchandise Cost of Sales	135,000	3
Food and Beverage Cost of Sales	156,000	3
Food and Beverage Operations	395,000	8
General and Administrative	355,000	7
Management Fee to <i>CourseCo</i>	168,000	3
Total	3,138,000	63
City's Operating Profit or (Loss)	(304,000)	(6)
Contribution to Capital Fund (3% of Revenues)	85,000	2
Non-Operating Income	2,000	
Debt Service	1,512,000	30
City's (Subsidy)	(1,899,000)	(38)

Source: *CourseCo*

Miscellaneous

Here, too, errant golf balls hit adjacent homes resulting in claims against the City. At least once, around 2007, the City funded a fence installation of \$2 million to protect adjacent homes. In 2003, the City sued the designer of Los Lagos for negligence and breach of contract for failing to adequately design to the course to minimize the risk of errant golf balls hitting adjacent properties. The lawsuit was settled without admission of liability by the City or the designer.

There are some land restrictions at Los Lagos: According to PRNS, it is dedicated parkland, requiring voter approval for any changes to the parkland status, and apparently was purchased using funds from a state parks bond which may have additional restrictions. The City established a 100-foot-buffer around the Coyote Creek for environmental protection. About 3 acres of the site by the parking lot are toxically contaminated with lead and petroleum. The City capped and covered the site, but the uses are limited to parking, recreational, open space, or commercial uses.

APPENDIX D

Comparison to Nearby Golf Courses

	Santa Teresa (27 holes)	Santa Clara	Shoreline Links	Muni	Sunnyvale	Spring Valley	Palo Alto	Los Lagos	Sunken Gardens (9 holes)	Blackberry Farm (9 holes)	Rancho del Pueblo (9 holes)
Facilities											
Owner	County	Santa Clara	Mtn. View	San José	Sunnyvale	County	Palo Alto	San José	Sunnyvale	Cupertino	San José
Maintenance	Lessee	Operator	Operator	Lessee	City	Lessee	City	Operator	City	Contractor	Operator
Golf shop							Concession			City+Concass	
Acres	~ 160	~ 150	~ 220	145	125	~ 150	135-170	100-180	30	~ 15	31
Par, Yardage	Note A	Par 72, 6,723	Par 72, 6,988	Par 72, 6,700	Par 70, 6,255	70-72, 6,143	Note B	Par 68, 5,393	1,502	Par 29, 1,544	28, <1,500
Driving Range	~ 40 stalls	25 stalls	29 stalls	60 stalls	No	22 stalls	26 stalls	42 stalls	18 stalls	No	25 stalls
Activity											
Rounds/Year	103,000	81,000	79,000	77,000	73,000	61,000	58,000	50,000	52,000	25,000	24,000
Finances											
Weekend Green Fee	\$63	\$38-\$53	\$47-\$54	\$52	\$45-\$50	\$59	\$39	\$48	\$19-\$21	\$19	\$15
Total Revenue	\$5.6 million	\$3.1 million	\$2.5 million	\$5.2 million	\$2.5 million	\$3.5 million	\$2.5 million	\$2.8 million	1.0 million	\$400,000	\$557,000
Revenue Per Round	\$55	\$38	\$32	\$68	\$34	\$57	\$44	\$57	\$18	\$15	\$23
Total Op. Expense		\$2.1 million	\$2.3 million		\$2.3 million (estimate)		\$2.1 million	\$3.1 million	\$1.0 million (estimate)	\$700,000	\$885,000
Op. Expense Per Round	Lease	\$26	\$30	Lease	\$31	Lease	\$37	\$63	\$19	\$27	\$37
Operating Income to Agency	8% of revenue: \$450,000	\$1.0 million	Appears breakeven	8.5% of revenue: \$440,000	Appears breakeven, but future losses anticipated	10.5 to 15.0% of revenue: \$400,000	\$400,000, before debt	Loss of \$304,000 before debt	Appears breakeven, but future losses anticipated	Loss of \$300,000	Loss of \$328,000 before debt

Note A: 18-hole course at Santa Teresa is par-71 with 6,737 yards. Short course (9 holes) at Santa Teresa is par-27 with 922 yards. Note B: Palo Alto is undergoing reconfiguration; currently par-67 with 5,558 yards

Source: Auditor analysis of staff reports and budgets from, and interviews with other jurisdictions. Data for most recent fiscal year available. Some figures are estimates or rounded.

Golf course leases with lease payments more favorable to the public agency

(source: Economics Research Associates, <http://www.sanjoseca.gov/DocumentCenter/View/44731>)

1993 Spring Valley (10.5-15% of revenues)

1995 Presidio (30% of green fees, 6% of merchandise)

1997/2004 Crystal Springs (25-32% of revenues)

1997 Monarch Bay (25-30% of golf, 5-6% of merchandise)

2001 Metropolitan (15-27.5% of golf, 4% of merchandise)

2001/2005 Foxtail (12.5-20% of green fees, 4-6% of merchandise)

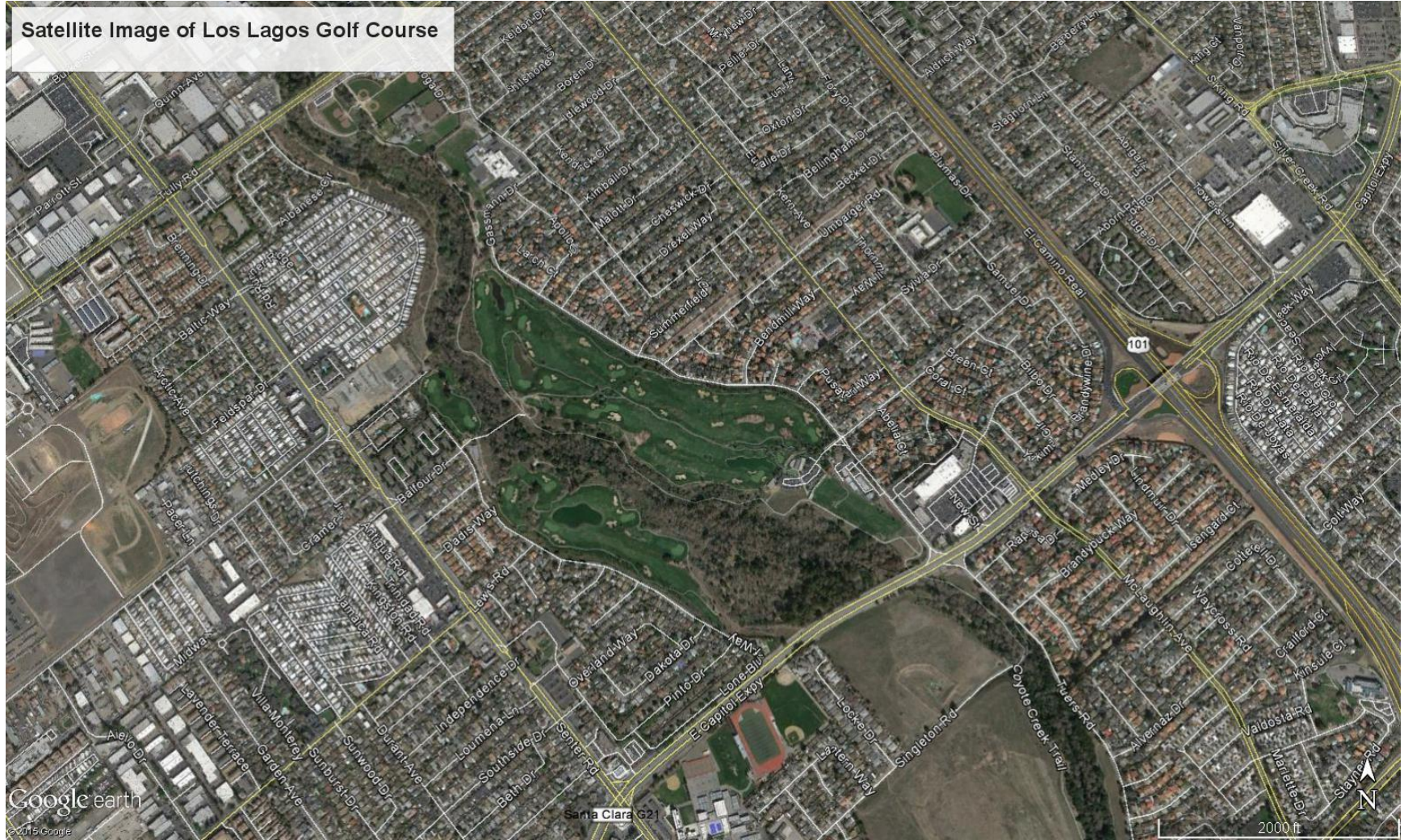
APPENDIX E

Aerial Views

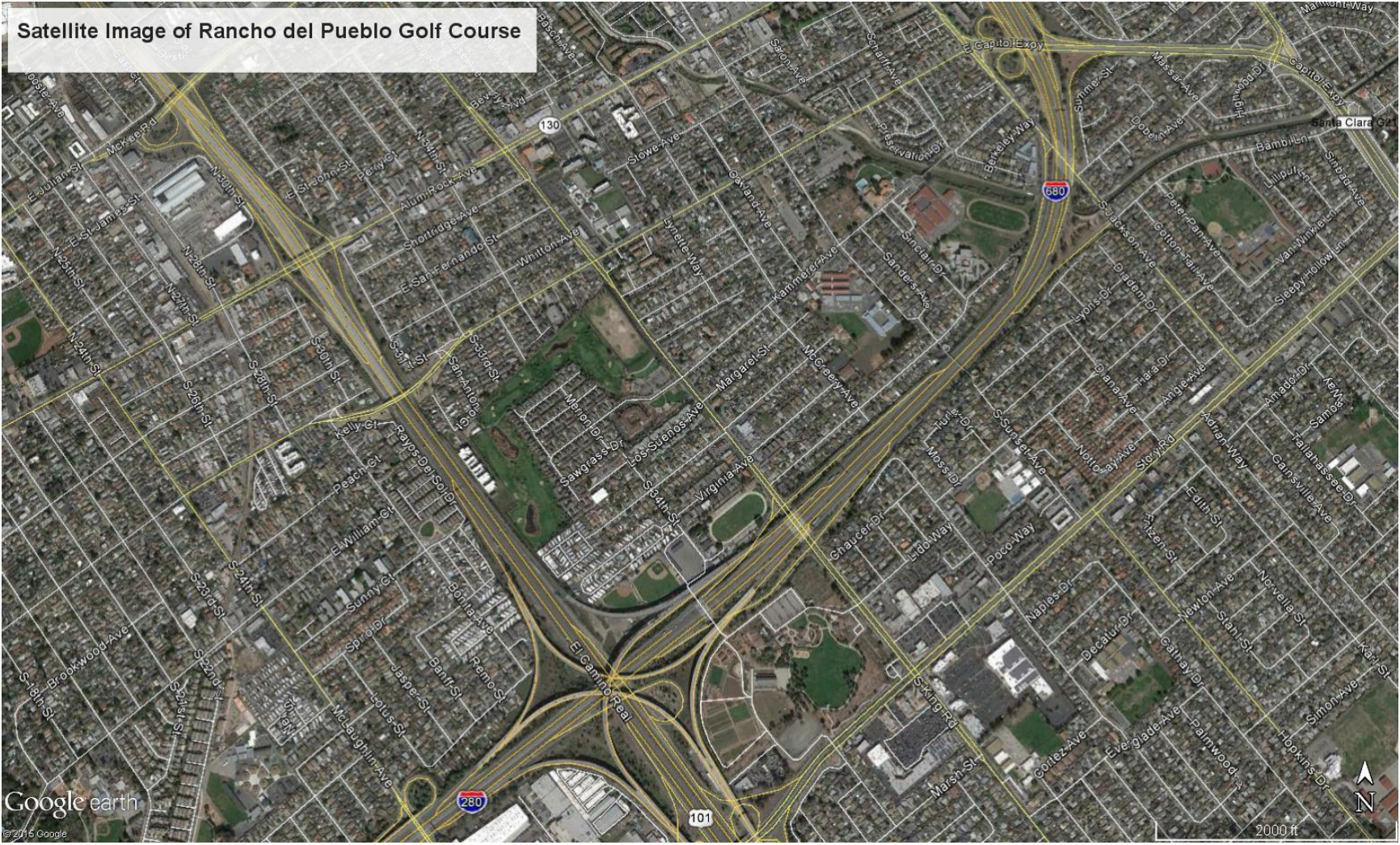


Source: Google Earth Pro

Satellite Image of Los Lagos Golf Course



Source: Google Earth Pro



Source: Google Earth Pro

Memorandum

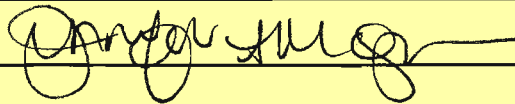
TO: SHARON ERICKSON
CITY AUDITOR

FROM: Angel Rios, Jr.

**SUBJECT: RESPONSE TO THE AUDIT
OF CITY GOLF COURSES**

DATE: September 1, 2015

Approved



Date

9-1-15

BACKGROUND

The Administration has reviewed the City Auditor's *Golf Courses* audit report and agrees with the recommendations identified in the report. Golf is one of many forms of recreation offered by the City. The Department of Parks, Recreation and Neighborhood Services (PRNS), which oversees operation of the three City-owned golf courses, provides a diverse variety of programs, classes, camps, and events spanning preschool, after-school, dance, music, health and fitness, gymnastics, and theater, among many other program areas. In the last year, 50,000 people signed up for these programs, with assistance from the department's scholarship programs. Countless more visited and enjoyed parks, community centers, and community-building events, including 150,000 rounds of golf played across the City-owned courses.

National Decline in Golf Play

The City has made golf accessible to the general public since the Municipal Golf Course opened in 1968. In 1999 and 2002, Rancho del Pueblo and Los Lagos golf courses opened, respectively, creating more opportunities for residents and visitors to enjoy San José's open space, especially in areas that previously lacked amenities like golf courses. The audit report states that a national decline in golf play since 2005, coupled with competition from new private golf courses in the area, has led to a decline in the number of rounds of golf played at City-owned courses and at most nearby public golf courses.

Significant Constraints on Golf Course Management

As the audit report notes, the decline in usage has been detrimental to financial results in the City's Municipal Golf Course Fund. Although initial City-commissioned studies optimistically concluded that cost-neutral operations, including debt service, were feasible for City-owned courses, the reality has been that golf has been greatly supported by the General Fund. From an operational standpoint—setting aside debt service—the General Fund subsidy in 2014-2015 was approximately \$200,000, which is similar to the General Fund maintenance budget for a new 13-acre park (the golf courses combined total 356 acres).

The greatest obstacle to cost-neutral golf operations is debt service. This debt service, which is the cost of acquiring and improving the land that became Rancho del Pueblo and Los Lagos golf courses, totals about \$2 million each year. Besides the direct financial impact, the form of this debt service also constrains the Administration's ability to incentivize the operator for these golf courses—the City must use a qualified management agreement, pay a fixed management, and bear all financial risk for performance, unlike the model employed for the Municipal Golf Course where the operator pays the City a fixed percentage of revenue regardless of bottom-line results.

Moreover, prevailing and living wage requirements on the operator for Rancho del Pueblo and Los Lagos golf courses constrains the Administration's ability to limit operating losses. This requirement is unusual in the golf industry and not in place for the Municipal Golf Course. According to the audit report, the requirement adds \$370,000 in annual operating expenses when compared to market wages at Los Lagos alone. Debt service and prevailing and living wages account for nearly \$2.4 million in annual expenses; for context, the General Fund provided a \$2.2 million subsidy for City-owned golf courses in 2014-2015.

Opportunities For Improvement

Unable to reduce debt service or the burden of prevailing and living wages, PRNS has worked closely with golf course operators to find other ways to reduce costs and increase revenue. PRNS regularly evaluates and, with the operators, modifies maintenance practices. Where appropriate, the City has authorized the operator to reduce time spent on mowing and other standard maintenance. The audit report states this has allowed the operator to reduce maintenance staff hours by a fifth at Los Lagos alone while continuing to maintain an attractive course. Additionally, where safe, PRNS has delayed the replacement of maintenance equipment. And to bolster usage, PRNS has encouraged the development of a Foot Golf Program at Rancho del Pueblo, hosted a Farmer's Market, created an annual "Field Day" event with Stonegate Elementary School, and implemented after-hours events, such as Glow Ball Tournaments and wedding receptions.

These collaborative efforts have helped the City contain operating expenses, while promoting enjoyment of the courses. Although the cards are stacked against golf as a cost-neutral enterprise for the City, we believe there are opportunities for improvement and there is opportunity to be cost neutral for the operational side of golf. Some ideas implemented included the reduction of non-essential turf, and the addition of a second putting green at Los Lagos and a chipping area and club repair center at Rancho. Now under consideration are hosting a number of non-golf social events to broaden the user-base at the courses, and capital expenditures such as the construction of a short-game practice area at Los Lagos to provide a full-service golf program and to expand parking capacity to support parking needs.

Preserving Open Space and Recreational Opportunities for Future Generations

To chart a path forward with golf courses and operations, difficult policy choices and trade-offs will have to be made. Prevailing and living wage requirements place Los Lagos and Rancho del Pueblo at a competitive disadvantage in cost terms. Paying off debt service on the golf courses could be accomplished by selling a portion of the land, but that action would address today's "short term" problem by reducing the amount of open space available to future generations of San José residents. Changing the golf courses to other outdoor recreational uses may increase the number of users on any given day, but that would reduce the opportunity for a type of recreation—golf—not often available to certain residents and would come at a great expense. None of these choices will be easy to make, but they are critically important to establish realistic expectations for City golf operations.

Staff feels strongly that preserving open space and parkland, and access to it, is a priority. Together, the three courses provide 356 acres of open space, a welcome break from City life, supporting physical and mental health and providing economic and environmental benefits according to studies by the Trust for Public Lands. Selling a portion or an entire golf course would set the City back tremendously in terms of open space and parkland, especially in East San José where it is challenging to identify and fund park acquisition. The City's smallest golf course—Rancho del Pueblo—represents more than 10 percent of developed regional parkland in the Alum Rock planning area, and selling it would reduce the regional parkland level of service by approximately 0.35 acres per 1,000 residents. To put this into perspective, Rancho del Pueblo represents more City regional parkland than exists in 7 of 12 planning areas across the City.

RECOMMENDATIONS AND RESPONSE

The audit analyzed the financial losses from the three City-owned golf courses, and made recommendations to improve the golf program. The Administration's response to each of the audit's recommendation is presented below.

Recommendation #1: To obtain more favorable contract terms, when the lease and management agreements expire, the Department of Parks, Recreation and Neighborhood Services should seek competitive proposals from potential golf course lessees/operators that lower the City's financial risks and grow customer usage.

Administration Response: The Administration agrees with this recommendation. When the management agreement for Los Lagos expires in 2017, the City intends to seek competitive proposals for its operation, in conjunction with Rancho del Pueblo, pending the results of City Council discussions concerning this audit report and potential next steps for the City's golf program. The lessee at the Municipal Golf Course has sole authority to exercise options to extend its agreement with the City until 2022. At that point, the City intends to seek competitive bids but staff will certainly reevaluate the situation leading up to the end of the current agreement and its optional extension periods.

Recommendation #2: To address underutilization and financial losses, the City Council should provide policy direction and direct the Administration to begin a community engagement process regarding consolidating the golf courses and implementing alternative land uses on the underutilized golf lands. Potential policy directions include:

- (a) Continue the General Fund subsidy to keep the three golf courses as they operate today,**
- (b) Reduce the General Fund subsidy through a competitive sale of some portion of golf course lands to pay off the outstanding lease-revenue bonds, and/or**
- (c) Increase community utilization of scarce parkland by reconfiguring one or more golf courses to other uses, for example constructing new sports fields.**

Administration Response: The Administration agrees that policy direction and community engagement are critically important to moving forward. However, as explained above, the Administration has serious reservations about reducing parkland and open space. Preserving all of the existing open space and parkland for future generations is a priority.

Recommendation #3: To improve the utilization and finances of its remaining golf courses, the Department of Parks, Recreation and Neighborhood Services and its operators should (a) more clearly articulate a competitive position that covers the facilities, pricing, and the brand, (b) develop a more aggressive customer growth strategy, identifying target customers and utilization goals, and (c) implement more effective outreach and retention plans.

Administration Response: The Administration agrees with this recommendation. Staff strongly believes that utilization at the Los Lagos and Rancho del Pueblo golf courses can be increased. To this end, in approving the 2015-2016 budget for the operator of Los Lagos and Rancho del Pueblo golf courses, PRNS requested that the operator develop strategies to increase usage and submit a clear and detailed plan to the City for review and discussion by the close of October 2015. Increased golfer usage could include, but is not limited to, expanding local club use, increasing outside tournament rounds, and creating Home Course Clubs for men, women and juniors. The City believes that expanding the social opportunities that clubs and tournaments provide will also increase the food and beverage opportunities and grow the bottom line.

The City also asked the operator to expand its focus on opportunities that will not only increase golfer usage but also attract alternate uses to the property as well. PRNS specifically asked the operator to implement at least two non-golf social activities/opportunities at Los Lagos and Rancho del Pueblo, each, for the community to experience in 2015-2016. The purpose of this request is to attract residents to the property so that the property not only serves as a golf course but also as an activity center for the community. It is the City's desire that the operator continue to expand these non-golf social activities annually. These non-golf social activities support placemaking, a key PRNS initiative, that seeks to help San José flourish creating quality places, wherein people want to live, work, play, and learn.

Lastly, recognizing that social media is an instrumental marketing tool, the City requested that the operator focus its marketing opportunities using social media as well as main stream media opportunities.

The department will continue working with the operator throughout the year, with the goal of including the following in the operator's 2016-2017 budget and marketing plan: (a) a more clearly articulated competitive position that covers the facilities, pricing, and the brand, (b) a more aggressive customer growth strategy, identifying target customers and utilization goals, and (c) more effective outreach and retention plans.

Recommendation #4: To improve oversight of the golf courses and contracts, the Department of Parks, Recreation and Neighborhood Services should assign sufficient resources to oversight.

Administration Response: The Administration agrees with this recommendation. Over the last many years, budget deficits and reductions forced many difficult choices. One of these choices was to reduce the amount of staff time assigned to overseeing the three City-owned golf courses and the management firms that operate them. This is not sufficient to provide the amount of oversight needed, but resources assigned to other programs are stretched thin as well. Staff will evaluate the addition of staffing resources for golf oversight among other priority needs City-wide as part of the 2016-2017 budget process.

Recommendation #5: To improve oversight of the golf courses and contracts, the Department of Parks, Recreation and Neighborhood Services should:

- (a) Regularly audit Muni's gross revenues and capital improvement fund**
- (b) Keep all golf records centrally and ensure they are obtained timely**
- (c) Formalize the revised maintenance standards.**
- (d) Formally approve the fees charged and discounts given to The First Tee and the schedule of access hours.**

Administration Response: The Administration agrees with this recommendation. The department will implement these administrative clean-up actions during 2015-2016.

CONCLUSION

The audit report provides a valuable operational and financial history of the three City-owned golf courses, and makes a clear call for action: It is time to evaluate financial support for golf in San José, and decide what creates the most value for the City, residents, and businesses going forward. The Administration has begun addressing many of the report's recommendations, and will continue to work on them throughout 2015-2016 and beyond. We would like to thank the City Auditor and staff, especially Minh Dan Vuong, for their time, attention, and perspective.

/s/
ANGEL RIOS, JR.
Director of Parks, Recreation and
Neighborhood Services

For questions, please contact Matt Cano, Assistant Director, at (408) 793-5553.