APPROVED
MAY 02 2012
BOARD OF RECREATION and PARK COMMISSIONERS

REPORT OF GENERAL MANAGER NO. 12-125

DATE May 2, 2012 C.D. Various

BOARD OF RECREATION AND PARK COMMISSIONERS

SUBJECT: EVALUATION OF OPERATING OPTIONS FOR THE DEPARTMENT OF RECREATION AND PARKS GOLF COURSE SYSTEM

R. Adams ______ *K. Regan ______
H. Fujita ______ M. Schull ______
V. Israel ______ N. Williams ______

as amended

General Manager

Approved ______ Disapproved ______ Withdrawn ______

RECOMMENDATIONS:

That the Board:

1. Approve the Full Self-Operation Plan for the Golf Division as stated in the summary of this Report except for food services; merchandising, and lesson functions;

2. Conceptually approve the use of contracts, leases or permits to continue operations of food services, merchandising, and lesson functions on an interim basis;

3. Approve the establishment of a Golf Business Analysis Section as stated in the summary of this Report; and,

4. Conceptually approve the use of a Request for Information, Request for Qualification or Request for Proposal to assist Recreation and Parks management in developing a Golf Business Analysis Section.

SUMMARY:

The City of Los Angeles (City) Department of Recreation and Parks (RAP), Golf Division maintains and operates 14 golf facilities: seven 18-hole golf courses, three 9-hole golf courses, two 9-par golf courses, one 18-hole pony golf course, and a state-of-the-art junior training facility for the enjoyment of the game of golf by the residents of the greater Los Angeles area.

In the Fiscal Year 2010-11 Adopted Budget, the Mayor and Council approved the reorganization of the RAP Golf Division into a self-sustaining operation (i.e., the Golf Division would receive no RAP or City General Fund financial assistance).

On May 17, 2010, the RAP Board approved an increase in golf greens fees to be effective July 1, 2010 (Board Report No. 10-128). The Board also directed RAP staff to: (1) review the proposed budget for the golf course operations to determine the ability to remain self-sustaining over the next three years; (2) further review the golf greens fee increase impact; and, (3) review and evaluate the options for the future of RAP's golf course system. This included the hiring of consultants if needed. To date, three consultants were hired and completed the following:

1. On July 14, 2010, an informational board report was presented to the Board stating that an independent auditor (Mayer Hoffman McCann P.C.) found that the Golf Division can be financially self-sustaining for the next three fiscal years beginning July 1, 2010.

2. On March 23, 2011, an informational board report was presented to the Board stating that an independent consultant (Pro Forma Advisors, LLC) found that the greens fees increases had affected play volumes significantly, resulting in a revenue neutral situation.

3. On April 13, 2011, RAP executed a contract with Tom Frost Golf, Incorporated to review and evaluate the operating options for RAP's golf course system. The remainder of this report deals with the findings of the consultant.

<u>Consultant Background and Experience</u>

Mr. Tom Frost has over 30 years background in golf operations and management of golf facilities, has managed a portfolio that included over 50 golf courses, 2,000 employees, and $150 million in annual revenue. Mr. Frost was instrumental in starting the City of Long Beach Junior Golf Program; the leasing of the Maggie Hathaway Golf Course to the Western States Golf Association to develop inner-city junior golf programs; is a founding member of the Board of Trustees for the First Tee of Northern Nevada, and serves on the Board of the California Golf Course Owners Association and the Los Angeles County Junior Golf Foundation.

<u>Consultant Report Release and Publication</u>

At the October 5, 2011 RAP Commission Task Force on Concessions meeting, the consultant's report on "Evaluation of Operating Options Los Angeles Municipal Golf Course System" was presented to the Board and released to the public. The consultant's report contains information on the current golf market conditions (nationally and locally); a description of operating operations; interviews with the Golf Advisory Committee (GAC); food and beverage concessionaires; RAP employees; and the Service Employees International Union (SEIU) Local 721.

The consultant's report was published on RAP's internet site and written comments on the report were accepted. Subsequent to the release of the consultant's report, the Department received eleven 11 comments from the golfing public, the GAC, the Southern California Golf Association (SCGA), and SEIU Local 721.

On March 14, 2012 a verbal review of the report and proposed recommendations were presented to the RAP Commission Task Force on Concessions by RAP staff. On March 19, 2012, RAP staff met with the GAC to further discuss proposed RAP Board recommendations and to receive additional input from the golfing community.

Staff Review of Consultant Report

A review by RAP staff of the consultant report and public comments indicate that the primary concerns are the ability of the RAP Golf Management to adequately address changing market conditions in a timely manner (including greens fee structures, food and pro shop operations, marketing, etc.) and the ability of RAP to fund and provide capital improvements to the golf courses and facilities. RAP staff concurs that with numerous private, public, and municipal golf courses available to a limited number of golfers, it is necessary and imperative to change the current way of doing business in order to remain competitive and profitable. As stated in the March 23, 2011 informational Board report, "There is strong competition for the decreasing number of golfers amongst the 1,140 municipal, public, and private golf courses in California."

According to the consultant's report, the current issues affecting golf, nationally and locally, are: (1) the current economic condition resulting in less disposable income; (2) over saturation of golf courses throughout the region, and (3) the decline in the number of golfers. The consultant's report further notes:

- Between 1996 and 2008,the inventory of public golf courses in the 7-County Southern California region increased from 158.5 to 207.5 courses (18-hole equivalents), an increase of 49 golf courses (31 percent), while the population in the region increased by 17 percent.

- The current weak golf market condition, in large part, does not appear to be cyclical, but rather a reflection of long-term shifts in the underlying demands for golf.

- Manifestations of the weak golf market are declining rounds and revenue, capital improvement cutbacks, excessive discounting, and financial failures (including the local market).

- The mid to long-term outlook for the regional golf market is highly uncertain and expected improvement in overall economic conditions are likely to be partially offset by a continued decline in the overall fundamental demand for golf.
- A return to play levels at individual courses generated in the pre-2000 period will likely take at least 15 to 20 years.
- The report specifically states, "There is no evidence at this time which suggests that the golf market will experience a strong rebound when overall regional economic conditions improve."

The consultant's report finds that course operators who have elected to absorb short term operating losses instead of reducing expenses in order to not affect course conditions and service levels have a brighter outlook.

Operating Options / Models

The consultant's report identifies five operating options and lists the strengths and weaknesses of each. A pro forma financial "Annual Net Operating Income" table from the report is summarized below:

Options / Models	Gross Revenue (less cost of goods)	Total Expenses	Net Operating Income (PROFIT)
1. Facility Lease	$ 8,597,000	$ 6,740,000	$ 1,857,000
2. Management Agreement	$ 25,967,000	$ 22,942,000	$ 3,025,000
3. Modified Management	$ 23,982,000	$ 23,023,000	$ 959,000
4. Full Self-Operation	$ 25,704,000	$ 24,666,000	$ 1,038,000
5. Current Model	$ 23,982,000	$ 23,456,000	$ 526,000

Facility Lease

Under the Facility Lease model as referenced in the consultant's report, the golf course owner contracts all golf course functions to a private party (lessee). This would include: operations, maintenance, driving range; golf professional shop, lesson services, and the food and beverage operations (which may be subcontracted by the lessee or contracted out separately by the owner). The lessee would also be responsible for required and ongoing capital improvements, which requires the length of the lease to be related to the cost of the capital improvements. Lease payments are typically based on a minimum lessee rental payment versus a percentage of gross revenue. This model can best be described as a "turn key" operation with all functions turned over to the private party (lessee).

According to the consultant's report, a Facility Lease, similar to the lease used by the County of Los Angeles, is less appealing to the current and anticipated market environment, and recent experience shows that leasing public golf courses is less favorable to municipalities now than it was in the past.

The primary advantages of the Facility Lease model include: a guaranteed minimum rent payment; potential benefits of private industry golf professional management; limited required participation by the owner; minimum financial risk, and private capital improvement funding availability. The primary disadvantages of the facility option include: waiving control over operating policies and procedures; commitment to longer term agreements, and limited participation in upside financial performance. Under the Facility Lease model, there would no longer be RAP employees, RAP equipment or RAP concessionaire contracts providing golf services on City courses. However, the RAP Board would still maintain control over the fees for the various golf services. A Facility Lease would also subject the operator (leasee) to additional requirements (e.g., living wage, equal benefits, insurance, possessory interest, business tax, etc.).

Under this model, *all* RAP Golf employees would cease to perform Golf functions as City employees. This could result in layoffs and/or reassignments to other City positions or lower wages and benefits to those employees who accept employment with the lessee. The contracting out of work presently performed by existing City employees is governed by City of Los Angeles Charter (Section 1022) requirements and by various negotiated labor contracts. City Charter Section 1022 requires that a determination be made that it is more feasible or economical for work to be performed by a contractor than by City employees before a City Department enters into a contract. The authority to make this determination is vested with the Board of Recreation and Park Commissioners. The various labor contracts, at a minimum, require notification of the intent to contract or discussion of the proposed contract and in some cases prohibit the loss of City employment.

Management Agreement

Under the Management Agreement model as referenced in the consultant report, the golf course owner contracts with an operator to oversee all golf functions. The owner receives all revenue and pays the operator a management fee (typically a base fee plus performance incentives) and may pay for other services provided by the management company. Under a typical management agreement, the facility owner receives all revenues and is responsible for funding all capital improvements; operating expenses, and financial reserves. Under this model, the owner of the system would be responsible for paying for non-City labor forces hired; expenses, and capital improvements incurred by the operator. The RAP Board would still maintain control over the fees for the various golf services.

The consultant's report states that Management Agreements are used by other municipal golf operations (e.g., Thousand Oaks, Corona, Encinitas, Carlsbad, and Yorba Linda). However, the consultant report does not provide information regarding profitability or satisfaction levels of the municipalities. It has been reported in various media that the City of Burbank is considering a $2 million bailout of the City's De Bell golf course (the course operates under a Management Agreement) and is losing hundreds of thousands of dollars annually.

The report states that while the management firms provide input and recommendations, the City ultimately retains near-full control over all operating decisions. This "near-full control" by the City would still subject an operator under a Management Agreement to current bureaucratic constraints (as referred to by the consultant) as inhibiting the ability to adapt and respond quickly to changing market practices and conditions. A Management Agreement would also subject the operator (management firm) to additional requirements (e.g., living wage, equal benefits, insurance, possessory interest, business tax, etc.).

Also, aside from the management fee and other services provided by the operator, RAP would be responsible for funding all capital improvements, operating expenses, and reserves for ongoing capital reinvestment and would be obligated to fund all maintenance.

The primary advantages of the Management Agreement model include: the benefits related to private industry expertise and knowledge of golf course management; a lower wage and benefit structure due to private sector employment; shorter term contractual commitments; full control over the operations, and possibly provides a strong financial return to the owner and full participation in upside financial performance. The primary disadvantages of the Management Agreement model include: greater participation on the part of the owner; high level of financial risk and inability to attract private funding for capital investments in facilities.

Under this model, *all* RAP Golf employees would cease to perform Golf functions as City employees. This could result in layoffs and/or reassignments to other City positions or lower wages and benefits to those employees who accept employment with the operator who has the Management Agreement. As discussed above, the contracting out of work currently performed by City employees is subject to Charter requirements and negotiated labor contract.

Modified Management Agreement

The Modified Management Agreement is similar to the Management Agreement, except that the operator would oversee functions, primarily in the areas of golf course management; marketing and sales; revenue management; and possibly food and golf merchandise operations. Maintenance of the courses would still be the responsibility of the owner. The focus of this type of agreement is to assist in increasing rounds and revenues at each facility. The primary advantages and disadvantages as discussed under the Management Agreement would transfer to this option with a lower base fee.

Under this model, *some* RAP Golf employees would cease to perform Golf functions as City employees. This could result in layoffs and/or reassignments to other City positions or lower wages and benefits to those employees who accept employment with the operator who has the Management Agreement.

Full Self-Operation (Excluding Merchandise and Food and Beverage)

Under the Full Self-Operation Model as referenced in the consultant's report, the owner and operator are one in the same. In this model all functions are provided by the owner/operator including golf course management; maintenance; golf cart rental; driving range operations and possibly lesson services. Typically, merchandise and food and beverage functions are still contracted out.

The primary advantages of the full self-operation model include: retaining full control over the policies, procedures, product quality and golfer experience and maximum participation in upside financial performance. The primary disadvantages of this model include: higher wage and benefit packages for government employees; the absence of "best practices" in revenue generation, and a lack of private industry expertise and knowledge of golf course management and experience in marketing, revenue management, pricing and other support functions.

Under this model, RAP Golf employees would continue to provide the same services as they do now and assuming some new responsibilities such as the operations of the driving ranges. There may be some moderate hiring of new RAP part-time staff.

Current Operating Model for Department of Recreation and Parks Golf Course System

Presently, the management of RAP's Golf Course System is described as a hybrid between full self-operation and a facility lease. This model combines elements of self-operation (reservations, golf starters, greens fees collections, cart operations and course maintenance) with elements of a facility lease (contracting to concessionaires for the operation of driving ranges, food and beverage venues, merchandising and lesson services).

The primary advantages of the current model include: the level of control retained by the City; availability of substantial support from other City entities, and most of the financial benefits accrue to the City. The primary potential disadvantages of the current model include: the absence of "best practices" in revenue generation; bureaucratic constraints which inhibit management's ability to adapt and respond quickly to changing market practices and conditions; multiple providers of services other than the City which potentially can create conflicts and inconsistent service levels, and most of the financial risk is borne by the City.

It should be noted that prior to the commission of, during the preparation of and subsequent to the release of the consultant's report, RAP Golf staff has assumed responsibility for the following operations:

1. On January 1, 2011, RAP began self-operation of the electric golf cart rental operation. As of December 31, 2011, the return of golf cart rental fees was 63% of gross revenue; substantially higher than the 47% received from the previous concession operator. (The concessionaire discontinued operations.)

2. On October 1, 2011, RAP began self-operation of the driving range at the Rancho Park Golf Course. As of March 31, 2012, the driving gross range revenue was 44% higher than the previous concession operator. (The concessionaire did not complete required capital improvements and discontinued operations.)

3. On ~~March~~ October 31, 2011, RAP began self-operation of the driving range at the Woodley Lakes Golf Course. As of ~~December~~ March 31, ~~2011~~ 2012, the driving range gross revenue was 40% higher than the previous concession operator. (The concessionaire discontinued operations.)

The consultant's report states that the current operating model "...is reasonably good in terms of revenue production, although most outside independent analysts believe that there is room for substantial improvement in performance and... the golf director be given greater autonomy and authority to make day-to-day business/operating decisions".

Major Areas of Concern Identified in the Consultant's Report and Input from the Golfing Community

The consultant's report also identified major areas of concern which need to be addressed to have a successful golf course system: importance of investment and planning for capital improvements in golf course infrastructure; lack of expertise in managing golf support functions (i.e. marketing, revenue management/pricing, strategic planning for the use of facilities, customer relations, food and merchandising function); lack of integration of functions, and the financial stability and sustainability of RAP's golf course system under the current operating model. However, the report also noted that the maintenance of the golf courses is good and course level staff is well liked. The positive course maintenance statement was also echoed in the public comments received.

<u>RAP Staff Discussion and Recommendations</u>

RAP staff has reviewed and analyzed the consultant's report; comments received from the golfing community, public, management and other stakeholders, and the financial performance of the RAP Golf System under the current model.

Based upon this analysis and review, it is clear that RAP Golf employees have the expertise to perform well in the day to day functions of operating RAP's Golf Course System and core functions (i.e. maintenance, golf starter operations, golf cart operations, driving ranges, etc.) and are able to perform these functions profitably (Board Report No. 12-124, Status Report on Golf's First Year as a Special Fund Operation and Allocation of Fiscal Year 2010-11 Golf Operating Income). It is recommended that RAP Golf employees be retained and expanded in these roles.

However, the report, as well as input from the various stakeholders, indicates the Golf Division has areas where improvement is needed that could enhance profitability of the Golf System; provide for higher levels of customer satisfaction due to better integration of services, and more effective use of the resources contained in the System. These areas of improvement include but are not limited to: lack of expertise in retail operations (i.e. food services and merchandising); strategic planning for the Golf System; customer relations; revenue management/pricing; marketing (i.e. advertising, market share management, product development, etc.); and capital planning. Staff recommends that a new Golf Division arm (Golf Business Analysis Section), with expertise in these areas, be developed to work collaboratively with Golf line operations to address the areas of needed improvement.

Both Golf line operations and the new Golf Business Analysis Section would report to the General Manager's designated Assistant General Manager. It is recommended that a Request for Information, Request for Qualifications or Request for Proposals be utilized by RAP management to assist in establishing this new Golf arm. Further details would be presented to the Board in this effort.

Based upon information from the consultant and stakeholders, questions arose about the future financial sustainability of golf, the ability of RAP to fund capital improvements and of RAP to respond to changing market needs. RAP staff is cognizant that changes are needed to remain viable in today's competitive golf market, therefore, staff recommends that the Board:

1. Approve a Full Self-Operation Plan for all golf functions by RAP employees except for food services, merchandising, and lesson functions;

2. Approve the establishment of a Golf Business Analysis Section;

3. Conceptually approve the use of contracts, leases or permits to continue operations of food services, merchandising and lesson functions on an interim basis; and,

4. Conceptually approve the use of a Request for Information, Request for Qualification or Request for Proposal to assist RAP management in developing a Golf Business Analysis Section.

FISCAL IMPACT STATEMENT:

There may be impacts to the RAP General Fund in accepting staff recommendations; however, the costs/benefits of those impacts cannot be calculated at this time.

Report prepared by Kevin Regan, Assistant General Manager; James Ward, Golf Manager; Noel Williams, Chief Management Analyst; and Robert Morales, Senior Management Analyst II.