OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item: CITY OF SAN DIEGO'S FIVE-YEAR GOLF OPERATIONS BUSINESS PLAN

OVERVIEW

The Golf Operations Business Plan lays out a five-year plan for the operation, maintenance and capital improvement of the three golf complexes owned and operated by the City of San Diego. The Business Plan proposes significant changes to the way that City golf courses are run, including changes to the fee structures, allocation of tee times, and how tee times will be made available to the public. The Business Plan also lays out a long-term capital improvements plan, and proposes guidelines regarding special use of the City's golf courses, such as tournaments, photo shoots and filming, facility rentals, and other special projects.

FISCAL/POLICY DISCUSSION

Despite the numerous changes proposed by the Business Plan, the two areas of primary concern are green fee increases and tee time allocation. In fact, the majority of the changes proposed in the Business Plan may be categorized under one of these two issues. This report focuses on these two issues, beginning with the Business Plan's proposal to increase green fees.

The Torrey Pines clubhouse project, while still included in the long-term capital plan, will not be approved concurrent with the Business Plan. The Business Plan expressly states that construction of the clubhouse will not begin before FY 2009, and that additional City Council will be required prior to the implementation of this project. Since the focus of this report is the Business Plan, the Torrey Pines clubhouse project is not addressed. However, it should be noted that the fee increases proposed in the Business Plan are projected to generate sufficient revenue to fully fund the clubhouse project if ultimately approved.

Finally, additional analysis by the IBA may be done as necessary in the future before the Business Plan is considered by the full City Council.

GREEN FEE INCREASES

An integral part of the Golf Operations Business Plan involves green fee increases at each golf course. Green fee increases over the past few years have been minimal, and have not kept pace with the increase in operational costs. The Business Plan recommends increasing resident green fees to cover the cost of operations and maintenance (O&M), while the recommended increase in non-resident green fees more closely reflect market demand, and will cover the cost of capital improvements.

Overview

The fee structure at each course is multi-tiered, with different fees charged for residents and non-resident, and for weekends and weekdays. Discounted fees are charged for twilight rounds, or rounds that might not be completed due to darkness, and separate fees are charged for junior golfers. The Business Plan uses the resident weekday green fee as the benchmark upon which all other fees are determined. For instance, the rate for resident weekend play at the Balboa Park 18-hole course is 125% of the resident weekday fee, while the rate for non-resident weekday play is 150% of the benchmark rate. A table showing the relative breakdown between different rates can be found on page 29 of the Business Plan. While the relative difference between rates at a given course is determined by market demand and/or relevant benchmarking, it should be noted that all rates are tied to the benchmark, meaning that if the resident weekday rate increases, all other rates increase as well. Likewise, and perhaps more significantly, non-resident rates cannot increase unless the resident rates increase as well.

Fee-Setting Philosophy

IBA Report 06-11 stated that resident fees should not be higher than the total cost per round, and should not be lower that what is necessary to maintain self-sufficiency. These guidelines generally define the upper and lower limits of acceptable resident fees based on the requirement that the golf system remains financially self-sufficient. Furthermore, the IBA has suggested that the total cost per round, which includes capital improvements and debt service costs, should be considered the benchmark or "fair" rate for residents. In a hypothetical situation where there was no non-resident play on the City's golf courses, this is the rate that residents would have to pay in order for golf operations to remain self-sufficient.

In reality, of course, there are non-residents that play golf on the City's courses at a rate that is often much higher than the cost per round. This raises a basic philosophical question – should the City use the "extra" revenue from non-residents (i.e. the portion of the non-resident fee that is above and beyond the cost per round) to offset a portion of the benchmark residential rate?

On one hand, if the "fair" resident rate as described above is not offset by non-resident rates, then the Golf Course Fund is likely to amass a surplus over time. While an unreasonably large surplus may indicate that resident rates were set unnecessarily high, there is nothing intrinsically wrong with maintaining a moderate surplus. A reasonable build up of fund balances may actually be prudent, as such balances might be used to enhance customer service, increase maintenance, accelerate the timetable for needed capital projects, more aggressively pay down debt, or even offset anticipated future rate increases.

On the other hand, setting resident rates as low as possible has a greater risk factor in that it is predicated on the accuracy of revenue and expense estimates. For instance, if non-resident play unexpectedly decreases, or if the total number of rounds played does not meet expectations, the Golf Fund will likely end up with a deficit. In addition, it is very difficult to predict expenses in outlying years. The Business Plan attempts to set rates for a five year period, and it is unknown how salaries and wages or the cost of materials will rise over that time. Finally, capital expenses vary dramatically from year to year, making it impossible to use one year's capital budget as the basis for rate setting. While it may be possible to average out capital costs over time, projecting capital costs over even a five-year period is speculative at best, and cannot account for emergency capital repairs.

While either one of the options described is the preceding paragraphs may be viable from a financial perspective, the optimal solution is likely somewhere in between.

<u>Balboa Park</u>
The Business Plan proposes to increase resident rates in order to bring them more in line with the per-round cost of operations and maintenance (O&M). Resident rates are proposed to increase moderately in FY 2007, and then increase minimally over the next four years. The larger increase in FY 2007 is proposed in order to "catch up" with the increases in O&M costs over the last several years. Non-resident fees are proposed to increase minimally in all years in an attempt to generate more play by non-residents, who are charged rates closer to the market rate.

The Balboa Park complex currently operates in a deficit status, as the courses are unable to generate sufficient revenue to cover all expenses. While this may partially be due to the fact that rate increases have not kept pace with increases in O&M costs, the Balboa complex is also in need of significant capital improvements in order to remain competitive. However, there is currently insufficient market demand by non-residents to be able to fund the required capital improvements with non-resident fees. As a result, needed capital improvements are being subsidized by non-resident play at Torrey Pines.

<u>Mission Bay</u>
The City of San Diego assumed control of daily operations at Mission Bay in 2003. Since that time, numerous improvements have been made to the course. However, the

course is still in need of additional maintenance and capital improvements. Since the rates currently charged at Mission Bay are identified as being on the high end for comparable courses, only minimal increases are proposed for the resident rates. The Business Plan does recommend, however, the implementation of a non-resident structure as is done with Balboa Park and Torrey Pines. Additional improvements to the course should increase non-resident demand – and non-resident rates – over time. In addition, the Business Plan proposes to increase rates for the Mission Bay driving range in an effort to reap greater benefits from this valuable asset.

<u>Torrey Pines</u>
The Business Plan proposes modest annual rate increases for residents on the North course, and minimal increases in resident rates on the South course until FY 2010. When Torrey Pines was awarded the U.S. Open, part of the agreement was that resident rates on the South course could not increase, other than to adjust for price increases, until the year after the Open. As a result, resident rates are proposed to increase significantly in FY 2010. It should be noted, however, that this increase is warranted within the context of the Business Plan's staged fee-setting strategy by aligning resident rates with the operations and maintenance costs per round.

Non-resident rates are increased more aggressively on both the North and South courses, more accurately reflecting true market demand. IBA Report 06-11 stated that non-residents should be charged the market rate, and that the market rate should be defined as the highest rate that can be charged while still achieving the targeted number of non-resident rounds. While the proposed rate increases for non-residents do appear to bring rates closer to a true market rate, it is possible that there is still capacity for even higher rates given current market demand. While it is difficult to know *a priori* exactly what the market will bear, it is recommended that non-resident demand be closely monitored to determine whether further rate increases are warranted.

The final item of note regarding the proposed rate increases for Torrey Pines is that Friday rounds are charged at the weekend rate. Higher weekend rates reflect greater demand for golf on those days, and in this sense, it may be appropriate to charge weekend rates on Fridays if it is determined that a higher demand exists on those days. However, Fridays are currently charged at weekday rates at both Balboa Park and Mission Bay. It is recommended that whatever policy is ultimately adopted be adopted on a system-wide basis in order to achieve consistency among the three golf complexes.

<u>Cost Per Round Calculation</u>
The estimated cost per round calculated in the Business Plan for each course relies on several assumptions, but overall the methodology appears to be sound. While the IBA has suggested that the total cost per round should be the benchmark for setting resident rates, the calculations in the Business Plan do not include capital improvement costs, and therefore reflect only operating and maintenance costs per round.

The cost per round is essentially derived by estimating the total operating cost for each course and then dividing it by the projected number of rounds played in FY 2006. The challenge of this calculation is in estimating the total operating cost for each course. Calculating the estimated operating cost for each golf course was a multi-step process. The first step was to identify which portions of the Golf Division's budget are directly attributable to each complex, and then allocate indirect or "Division-wide" expenses such as Division management and support. Once the total operating budget for each complex was derived, the next step was to determine what portion of that cost was attributable to each course within the complex. For instance, the total operating cost at Torrey Pines was estimated to be $6.25 million. The second step in the process was to determine how much of this cost was attributable to the North and South courses, respectively.

The primary concern with the cost per round calculations is that they are based on the FY 2006 budget instead of actual expenditure data, which is the result of audited financial statements being unavailable for the last three fiscal years. While the budgeted data used in the calculations are probably close enough to get a relatively accurate picture of the cost per round, it is recommended that these calculations be revised with actual data once it becomes available.

<u>Low Income Fee Waiver</u>

The Business Plan proposes to eliminate the senior rate and in its place implement a Low Income Fee Waiver (LIFW), which would provide a 50% discount for all residents that meet income qualifications. The rationale behind this proposal is that some seniors live on fixed incomes, and increasing or eliminating the senior rate could place an undue burden on those who cannot easily increase their income. The Business Plan recommends that 10% of projected rounds be allotted to residents who quality for the LIFW.

However, because the LIFW is available to any resident who meets the income qualification, regardless of age, it is unclear how many seniors will benefit from this proposal. In this sense, it appears that a LIFW may not be the most appropriate policy instrument with which to provide seniors a discount. While granting access to residents who might otherwise be unable to afford to play golf at the City's courses is an admirable policy objective in itself, it should not be confused with the separate policy objective of providing a discount to seniors who may be living on a fixed income. The LIFW should be reconsidered as an appropriate substitute for the senior rate.

TEE TIME ALLOCATION

The second major component to the Golf Operations Business Plan is the allocation of tee times at Torrey Pines. Torrey Pines is host to the PGA's annual Buick Invitational, and has been awarded host of the U.S. Open in 2008. Such world-renowned professional tournaments have helped Torrey Pines gain the reputation as being a world class golf facility. Torrey Pines is also cherished by San Diego resident golfers, who have enjoyed the courses' natural beauty and challenging play for many years. Overall, Torrey Pines is one of the premier golf facilities in the country, and there are simply not enough rounds available to accommodate all those who wish to play.

Overview

The Business Plan has made a valiant attempt at balancing the demands of the various stakeholders, while placing an emphasis on increasing the number of rounds available to the daily public golfer. Currently, various stakeholder groups are allocated a certain number of rounds per month. These groups include the Lodge at Torrey Pines, the Torrey Pines Hilton, the Torrey Pines Club Corporation (TPCC), and the Torrey Pines Men's and Women's clubs. In addition, a substantial number of rounds are set aside for the numerous tournaments that are held at Torrey Pines. After the allocations to these groups and tournaments are made, the remainder of the golf rounds are available for the daily public golfer.

The Business Plan's stated intent is to realign the allocation of tee times to allow greater access for the daily public golfer. In order to increase the number of rounds available for the daily public golfer, the Business Plan has proposed that the number of rounds allocated to each of the stakeholder groups be reduced and made available for the daily public golfer. At the Natural Resources and Culture Committee meeting on March 8, 2006, TPCC announced that they would voluntarily forego their previous tee time allotment. In addition, the Business Plan has proposed that it be made illegal to resell tee times for a profit, eliminating a current practice whereby tee-time "brokers" purchase tee times at the rates charged by the City and then resell them at higher prices. This is discussed in greater detail below. The Business Plan states that if all the recommendations are adopted, over 15,000 additional rounds will be made available on an annual basis for daily public golfers.

Resident vs. Non-Resident Play

Another challenge regarding the allocation of tee times is determining how many rounds are played by residents and how many by non-residents. The City Council has adopted a policy stating the 70% of all rounds at Torrey Pines should be played by residents, while 30% should be available for non-residents. In the past, it has been difficult to monitor this policy because the resident/non-resident breakdown within each defined user group was unclear. To address this, the Business Plan aptly categorizes the different user groups and analyzes the composition of each group to determine the relative share of residents and non-residents. For example, composition of the tournament golfers group is assumed for the purposes of the Business Plan to be 75% non-residents and 25% residents. In this way, golf operations staff can determine the percentage of total rounds allocated to tournament golfers that it attributable to non-residents. This methodology is employed for all user groups.

It should be noted that the tee times previously allocated to TPCC were categorized as non-resident rounds. While the decision by TPCC to forgo their allotment of tee times is certainly commendable, it did not result in additional rounds allocated for resident play. Being constrained by the 70% resident – 30% non-resident split, the rounds freed up by TPCC were reallocated as additional rounds for non-resident daily public golf or advance purchase. One possibility would be to consider all tournament rounds non-resident rounds, since the tournament rates for all golfers are based on the non-resident rate, regardless of whether a tournament golfer is a resident. This would allow approximately 3,400 of the annual rounds freed up by TPCC to be allocated for resident daily public golf.

Equity of Tee Time Allocation

One concern regarding the Business Plan's proposed reallocation of tee times relates to the equitable distribution of the times themselves. While the proposal increases the *number* of rounds allocated for the daily public golfer, it does not ensure that the actual times at which these rounds are played are equitably distributed. While the Business Plan clearly states that each round of golf that is begun counts as a round, regardless of whether the round is actually finished, it must be recognized that certain tee times are preferential to others, particularly true with respect to twilight rounds. Under the proposed allocation of tee times, nearly all of the twilight rounds are allocated to the daily public golfer. In order to maintain an equitable distribution of tee times, particularly in regard to the 70% resident – 30% non-resident split, all tee times should be proportionately distributed across all user groups. It should be noted that a more equitable distribution of tee times is somewhat constrained by the various leases and agreements that are currently in place. However, to the extent that these leases and agreements can be revised, a more equitable distribution of tee times is encouraged.

Advance Reservation System

The Business Plan proposes to implement an advance reservation system at Torrey Pines that will allow resident and non-resident golfers to reserve tee times up to 90 days in advance. For the privilege of this service, non-resident will be charged a $35 service fee, and residents will be charged $25. This system will allow resident and non-resident golfer to reserve tee times further in advance, providing a greater opportunity to secure a desired tee time. This is particularly important for non-residents, who may be especially keen to booking tee times in advance for the purposes of vacation planning. This system will also allow Golf Operations staff to more closely monitor and enforce the 70% resident – 30% non-resident split. The IBA supports implementation of the advance reservation system, and encourages consideration in the future of implementing the system at all of the City's golf complexes once economically viable.

Tee Time Brokers

Currently, a number of brokers purchase tee times at City rates and then resell them to the public at a higher price. While some of these tee times are sold to residents, the majority are sold to non-residents, who may be unaware that they are purchasing tee times from a private business instead of the City. The Business Plan states that the experience and cost associated with obtaining tee times from brokers often fails to meet customer expectations, and requests that it be made illegal to profit from the resale of City tee times. The City Attorney's Office has supported preparation of an ordinance to this affect.

While the IBA agrees that private entities should not be able to profit off of City assets, the mere fact that brokers can profit from reselling tee times indicates that non-resident prices are set well below the market value. The closer non-resident rates are to market value, the lower the profit margin would be for potential brokers. The City could significantly reduce the impact of brokers by setting non-resident rates as close as possible to market rates.

CONCLUSION

The Golf Operations Business Plan has laid out a fee-setting strategy whereby resident rates are intended to only cover the cost of operations and maintenance, while non-resident rates, aimed at being set closer to the market rate, will pay for all capital improvements. While the IBA does not necessarily support a fee structure that is set on the basis of "who pays for what," and while it may be possible to charge lower resident rates and still maintain the financial integrity of the golf system, the approach to setting fees that is stated in the Business Plan appears to strike a reasonable balance between providing reduced rates to residents and having all golfers pay their fair share.

In addition, the Business Plan's approach to identifying distinct user groups and allocating tee times among competing interests is commendable. The additional tee times that have been re-allocated for the daily public golfer should provide increased access to Torrey Pines for the general golfing public, while the implementation of an advance reservation system will allow residents and non-residents greater ability to secure desirable tee times in advance.

Overall, the IBA supports the Golf Operations Business Plan, with the following suggestions:

Green Fee Increases

1. Consider unlinking the resident rates from non-resident rates to preclude the requirement of coincident rate increases.

2. Revise cost per round calculations once actual data is available to ensure that the proposed fees are in line with operations and maintenance costs.

3. Maintain consistency among all courses with respect to the days charged the weekend rate.

4. Reconsider the use of the Low Income Fee Waiver as a replacement for the senior fee.

Tee Time Allocation

1. Consider all tournament rounds as non-resident, thereby freeing up additional rounds for residential daily public golf.

2. To the extent possible, amend current leases and agreements to allow for a more equitable distribution of tee times.

3. Conduct annual reviews of the rounds played to ensure that 70% resident – 30% non-resident policy is being effectively implemented.

Finally, the golf operations staff should be commended for the dedicated effort and thoughtful approach that went in to the preparation of the Business Plan. Municipal golf, particularly at Torrey Pines, is an important, emotionally charged subject for many people, and proposing changes to the status quo is a risky endeavor. The golf operations staff has done an admirable job in balancing the competing interests and concerns of the various stakeholder groups, while at the same time developing a long-term vision for the success of the entire golf system and putting together a comprehensive strategy achieving this vision.

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