CITY OF SACRAMENTO
CALIFORNIA

Office of the City Auditor
Jorge Oseguera, City Auditor

MEMORANDUM

Report # 11-04

Date: September 20, 2011

To: Honorable Mayor and City Council

From: Jorge Oseguera, City Auditor

Subject: Municipal Golf Revenue and Expenditure Analysis

BACKGROUND

At its June 7, 2011 meeting, the City Manager and the Director of Conventions Culture and Leisure (CCL) recommended that City Council approve an intent motion to accept the staff recommendation to pursue contracting out golf maintenance. As part of this consideration, the City Manager informed the Council that CCL was projecting that the City's golf operations would post a $552,000 loss in FY 2010-11 that the City's General Fund would need to absorb. A loss was also projected to occur in FY 2011-12. In response to this information, Council instructed the City Auditor to assess the accuracy of the FY 2010-11 loss and the reasonableness of the FY 2011-12 projected revenue and expenditure data for the City's golf operations.

To conduct our analysis, we gathered a variety of information from CCL and reviewed accounting data from the City's financial system. We worked with both CCL and Finance Department staff to ensure a thorough understanding of the fiscal impact of golf operations. We also gathered and analyzed additional information from both the City and outside sources regarding national, regional and local golf related trends. 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.

Currently most golf services, except maintenance, are under contract with Morton Golf. Per the contract, the City is responsible for the maintenance[1] of golf courses and the Golf Marshal Program.[2] CCL coordinates golf operations for the Haggin Oaks, Bing Maloney, Bartley

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[1] First Tee of Greater Sacramento is under contract with the City for all golf services at William Land Golf Course, including maintenance.

[2] This review focused on the City's related revenues and expenditures and did not include a direct review of Morton Golf's revenue and expenditures.

Cavenaugh and William Land golf courses. The operation of these golf courses is supported by the Golf Fund and, to a lesser degree, by the General Fund.

FY 2010-11 ACTUAL REVENUE AND EXPENDITURES

Our review of the City's golf operation revenue and expenditures confirms that the golf operation revenues were not sufficient to cover its expenditures. As shown in Exhibit 1 below, we found that golf operations expenditures in FY 2010-11 were nearly $530,000 greater than its revenues.

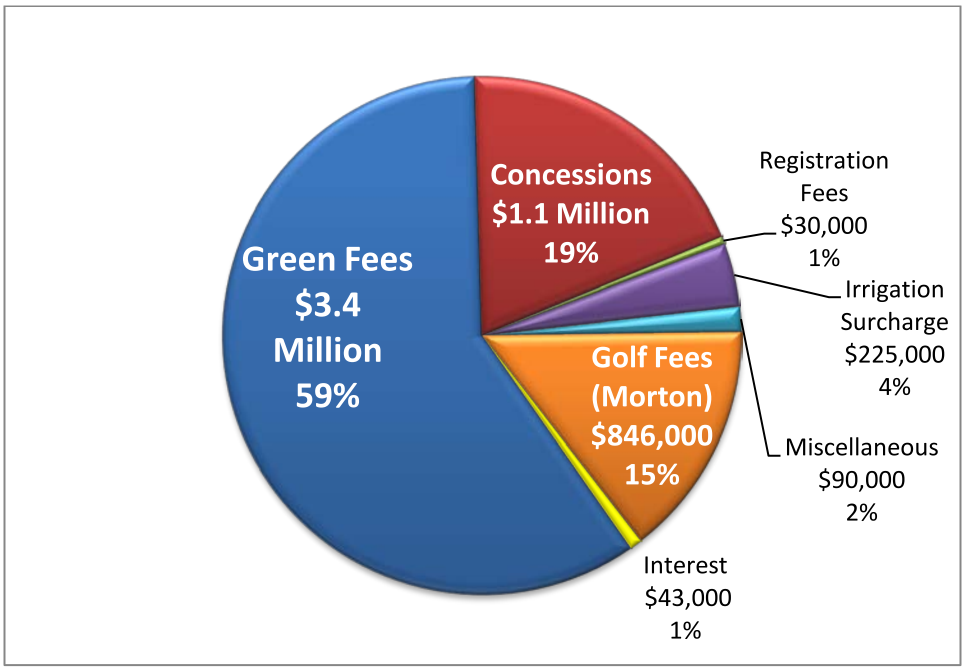
Exhibit 1 – Confirmation Of FY 2010-11 Shortfall

REVENUE	EXPENDITURES	NET REVENUE
$5,740,281	$6,270,199	($529,918)

Source: Rounded City Financial System Accounting Data

As shown in Exhibit 2, golf operations revenue is composed of green fees, concessions, golf fees,[3] irrigation surcharges, registration fees and miscellaneous sources.

Exhibit 2 – Golf Maintenance Revenue Breakout FY 2010-11



Source: Rounded CCL Accounting Data

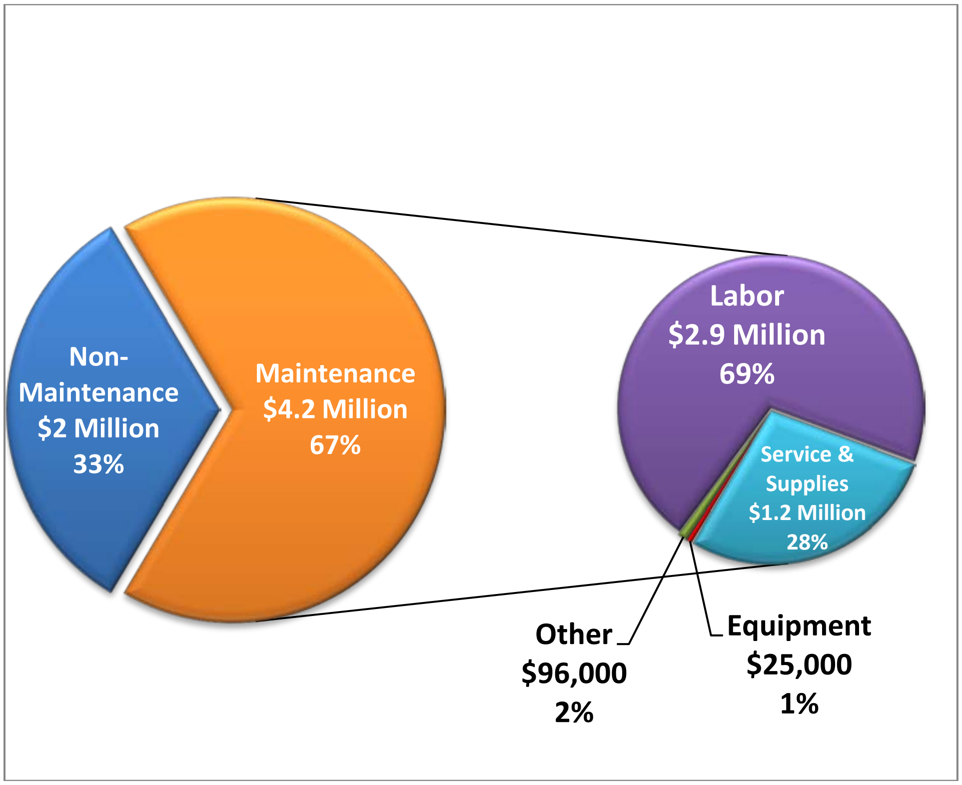
Golf expenditures can be divided into two categories: maintenance and non-maintenance[4] related expenditures. The majority of non-maintenance expenditures can be considered fixed cost as most are set by contract.

[3] Golf fees (Morton) consist of golf related revenue that per the terms of the contract the tenant retains.

[4] Non-maintenance related expenditures are Morton Golf's service fees per its existing contract with the City, debt service payments for outstanding loans and any capital improvement expenditures.

Maintenance related expenditures include the City's labor costs, service and supplies, equipment, and other expenditures. Of the maintenance related expenses, labor makes up the largest share of the expenditures as illustrated in Exhibit 3.

Exhibit 3 – Golf Operations Expenditure Breakout For FY 2010-11



Source: Rounded CCL Accounting Data

GOLF FUND CASH BALANCE

While our analysis does confirm that the City's golf operations experienced a loss in net revenue in FY 2010-11, this loss did not impact the General Fund. The Golf Fund was originally categorized for accounting purposes as an enterprise fund because the golf fees were intended to cover all direct and indirect costs of operating the golf courses. In 2006, the City Council approved changing the Golf Fund from an enterprise fund to a special revenue fund – an optional type of fund that is meant to track revenue, or resources, that are set aside to support a particular program – since the revenue golf was generating was no longer enough to cover its expenditures. At around the same time, the Golf Fund received an internal loan from the City's Risk Fund. This loan helped maintain the Golf Fund's positive cash balance.

Due to the Golf Fund's ability to borrow internally from the City's Risk Fund, the Golf Fund has managed to maintain a positive cash balance over the last six years. Without this borrowing, the fund would not have been able to maintain a positive balance. As of June 30, 2011, the Golf Fund had a cash balance of $724,000 following its absorption of the nearly $530,000 deficit in net revenue in FY 2010-11. Therefore, while the City's golf operations did experience a shortfall in FY 2010-11 as indicated during budget discussions, the shortfall has yet to directly impact the General Fund.

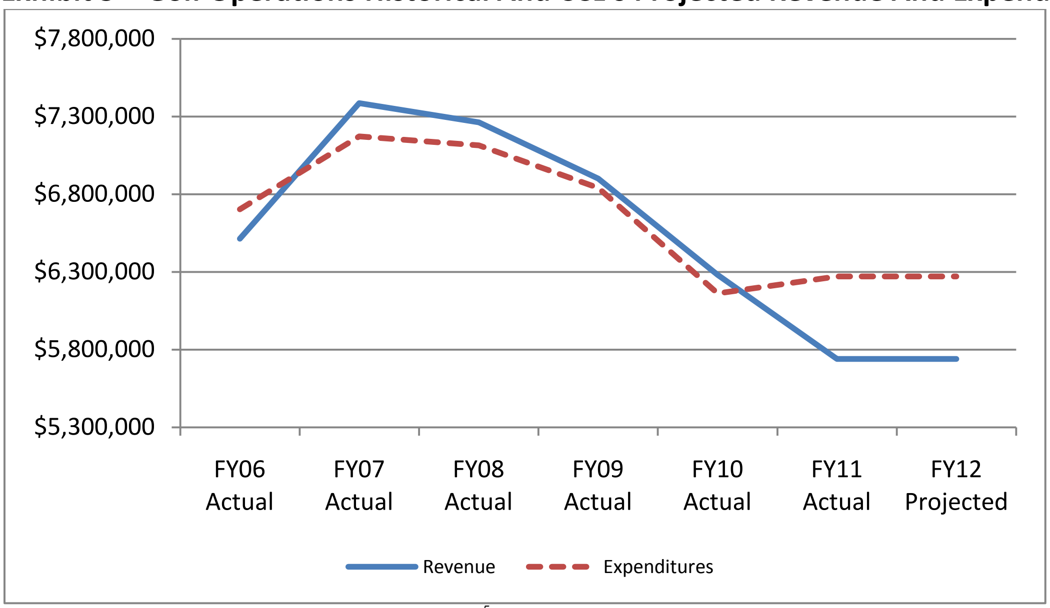
FY 2011-12 PROJECTED REVENUE AND EXPENDITURES

The Administrative Officer of the City's golf operations predicts that FY 2011-12 revenues and expenditures will remain the same as those in FY 2010-11. Based on our examination of national, local, and regional golf trends, we find it reasonable to project that the City's golf revenue will not increase in FY 2011-12.

Exhibit 4 – CCL's Projected FY 2011-12 Golf Revenue and Expenditures

REVENUE	EXPENDITURES	NET REVENUE
$5,740,281	$6,270,199	($529,918)

Exhibit 5 – Golf Operations Historical And CCL's Projected Revenue And Expenditures



Sources: CCL and City Financial System Accounting Data[5]

The Golf Fund's cash balance as of June 30, 2011 of $724,000 includes $135,000 of an unspent restricted appropriation for capital improvement projects related to irrigation resulting in a remaining cash balance of $589,000. Of the remaining $589,000 cash balance, $199,000 are unspent unrestricted appropriations committed to capital improvement projects related to course maintenance and Americans with Disabilities Act improvements. The Golf Fund's remaining cash balance of $390,000 could be used to cushion any cash flow issues that the fund may have throughout the upcoming fiscal year, such as when the fund makes large debt service payments on bond debt. We are not able to predict what the amount of the Golf Fund's restricted or unrestricted cash balances will be at the end of FY 2011-12. Therefore, if future

[5] During our review of the City Budget, we noticed that the amounts listed in the "actual" column for the prior fiscal year were greater than expected. After meeting with Department of Finance staff, it was determined that the prior year actual figures used in the City's Budget documents did not accurately reflect budgetary results. Ultimately, Department of Finance staff determined that the criteria used to report this information from the City's budgetary accounting system is too broad. According to the Principal Management Analyst, the Department of Finance is working with the City's Information Technology Department to resolve this issue as soon as possible. As a result of this discovery with the budget document actuals, we could not rely on these figures to determine the actual revenue and expenditures for the City's Golf Operations. Instead, we compiled actual data from the City's accounting system with the assistance of the Accounting Manager.

City golf operations result in losses that exceed its unrestricted cash balance, the General Fund would likely be impacted as it would subsidize the shortfall.

ADDITIONAL FACTORS THAT COULD CHANGE THE MANGNITUDE OF PROJECTED LOSSES

While we find the FY 2011-12 golf operation revenue and expenditure projection to be reasonable, golf operations revenues could continue to decline or expenditures could increase. In addition, there are other significant factors that could impact the magnitude of a FY 2011-12 net revenue deficit.

The City's Golf Fund currently has two outstanding loans from the City's Risk Management Fund[6] One loan is for capital improvements and was first established in FY 1999-2000 by Resolution 99-682. This capital improvement loan was originally approved in the amount of $3.4 million. The capital improvement loan had an outstanding principal and interest balance of $2.8 million as of June 30, 2011. The Golf Fund has been making debt service payments of approximately $247,000 per fiscal year on the capital improvement loan, but has made no debt service payments on the operating loan. The second loan, first established in FY 2001-02, had a total authorized loan amount of $4 million for golf operations. However, unlike the capital improvement loan, the golf fund has not made any debt service payments towards this loan.

According to both the Administrative Officer and Accounting Division Manager, while multiple plans to begin paying debt service to the Risk Management Fund for the operating loan have been discussed, none have been formally adopted. Repayment terms were not documented when the loan was initially approved by the City Council within Resolution 2002-009. Resolutions 2002-136 and 2002-348, which authorized the additional transfer of funds from the Risk Fund to the Golf Fund as part of this loan, also did not document any terms of repayment. Only the interest rate and total loan amount authorized were ever recorded. The term of the loan, debt service schedule and other pertinent details were not specified and no additional documents were signed by any department heads to secure the loan.[7]

As of June 30, 2011, the Golf Fund's operating loan had an outstanding principal and interest balance of $4.7 million. Assuming the interest rate[8] remains at its average from the last nine years, if the Golf Fund were to begin making debt service payments on its operating loan in FY 2011-12, the annual debt service payment would be about $253,000. As long as the Golf Fund continues to not make debt service payments on its operating loan, the outstanding balance will continue to increase.

In addition to the outstanding operating loan, the Golf Fund also began FY 2011-12 with $224,000 in its capital improvement budget as it did in FY 2010-11. In FY 2010-11, the Golf Fund only expended $30,740 of the $224,000 appropriation. In total, as of the start of FY 2011-12,

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[6]The Risk Management Fund (Risk Fund) is an internal service fund used by the City to account for its workers compensation, general, auto, unemployment, and other insurance programs. The fund activities also include loss control programs such as safety training, ergonomics and emergency vehicle operations center (EVOC) training.

[7] The lack of clear terms for this loan from the City's Risk Fund as well as other related information that has come to our attention in the course of other audits has led our office to conclude that the treatment and operation of the City's Risk Fund should be audited.

[8] Interest paid on the operations loan is set to the current interest rate earned in the City's investment pool, ("Pool A funds").

the Golf Fund had $558,000[9] in unspent capital improvement appropriations. This is due to golf operations not expending all of its capital improvement appropriations in prior fiscal years. While the Administrative Officer of the City's golf operations stated that he does not anticipate expending more on capital improvements in FY 2011-12 than in FY 2010-11, these unspent appropriations are authorized to be spent and could result in greater losses than currently projected.

In Exhibit 6 below, we summarize the impact that the additional debt service payment for the operating loan and any additional capital improvement expenditures could have on the City's projected golf operations net revenue in FY 2011-12. The analysis assumes that revenue remains unchanged during the period.

Exhibit 6 – Impact Of Operating Risk Fund Loan Debt Service And Possible Capital Improvement Expenditures on FY 2011-12 Golf Fund Net Revenue

	Additional Capital Improvement Expenditures	Operating Loan Debt Service	Original FY 2011-12 Projected Expenditures[10]	New FY 2011-12 Projected Expenditures	Original FY 2011-12 Projected Revenue	New FY 2011-12 Projected Net Revenue Shortfall
Scenario 1 No Change	$0	$0	$6,270,199	$6,270,199	$5,740,281	**($529,918)**
Scenario 2 Debt Service Only	$0	$253,386	$6,270,199	$6,523,585	$5,740,281	**($783,304)**
Scenario 3 Debt Service and CIP FY 2011-12 Budget	$224,000	$253,386	$6,270,199	$6,716,845	$5,740,281	**($976,564)**

Source: City Financial Accounting System, Accounting Division Manager, FY 2011-12 Proposed Budget, City Council Resolutions and Auditor Analysis

As shown in Exhibit 6 above, the scenario that produces the least increase in the Golf Fund's net revenue deficit would be if it continued to not pay debt service to the Risk Management Fund for the operating loan and spent a similar amount to that spent in FY 2010-11 on capital improvements.

[9] This amount is composed of all budgeted but unspent capital improvement appropriations from this and prior fiscal years.

[10] The 2011-12 projected expenditures include $30,740 in capital improvements expenditures as well as debt service payments for the capital loan, bond debt service etc.

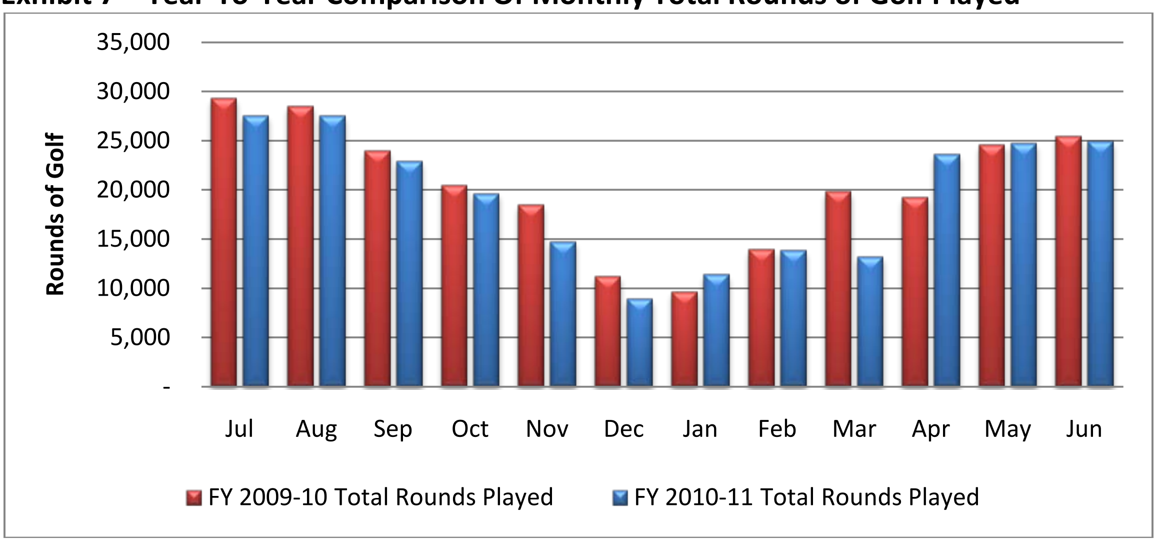
NATIONAL, REGIONAL AND LOCAL TRENDS IN GOLF

Municipal golf courses provide local, affordable, high quality recreation. In many cases, City-owned golf courses are profitable investments that provide a reliable revenue stream for City government. Unfortunately, in recent years, balancing golf course costs with available revenue has encountered many challenges. According to CCL, some of these challenges include the oversaturation of golf courses in the Sacramento area, the overall national and regional downward trend in golf activity, and the impact of an extended economic downturn. These challenges are not unique to the City's golf operations. Other California cities like Mountain View, San Jose, Mill Valley and Alameda are also struggling to operate golf courses that are currently running deficits.

According to the National Golf Foundation's *Golf Participation in The United States 2011* study, the total number of golfers nationwide has decreased from approximately 30 million in 2005 to 26.1 million in 2010. Likewise, according to the National Golf Foundation's *Summary of Rounds Played in the U.S.*, the golf industry has also experienced a decrease in the total number of rounds played from approximately 500 million rounds played in 2005 to 475 million rounds in 2010, or a 5 percent decrease. While the National Golf Foundation projects that there could be a gradual increase in golfers and rounds played over the next ten years, it does not foresee these increases as necessarily leading to proportionate increases in revenues, as aggressive pricing will continue to attract bargain-hunting golfers.

According to the CCL's records, when comparing the total number of golf rounds played in 2010-11 to 2009-10, nine of the 12 months reviewed show a decrease in total rounds played at City courses.

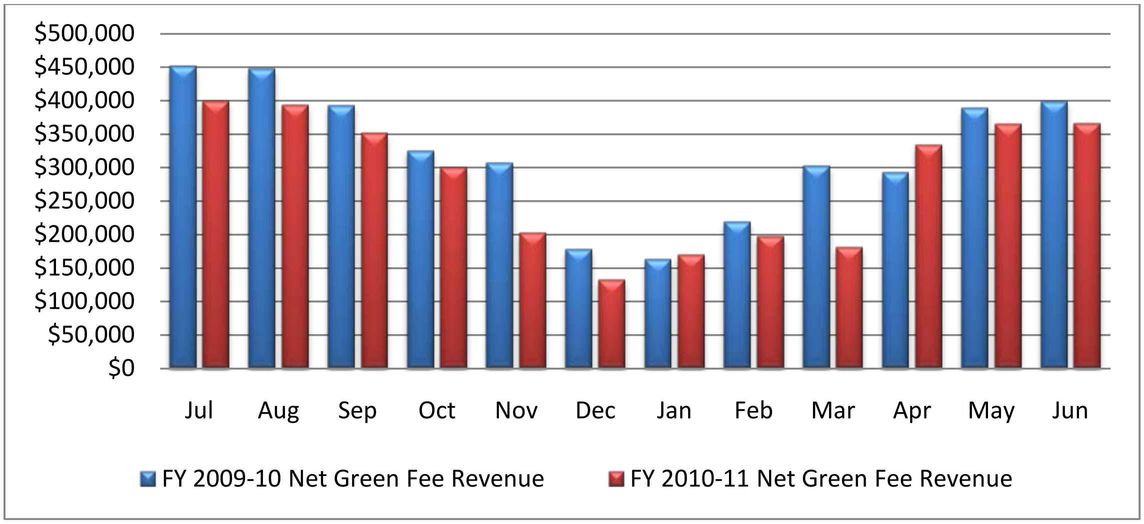
Exhibit 7 – Year-To-Year Comparison Of Monthly Total Rounds of Golf Played



Source: CCL

The City's net green fee revenue has also decreased from the prior years. As shown in Exhibit 8, 10 of the 12 months reviewed collected lower green fee revenue than in the prior year. Overall, net green fee revenue decreased from approximately $3.9 million in FY 2009-10 to $3.4 million in FY 2010-11.

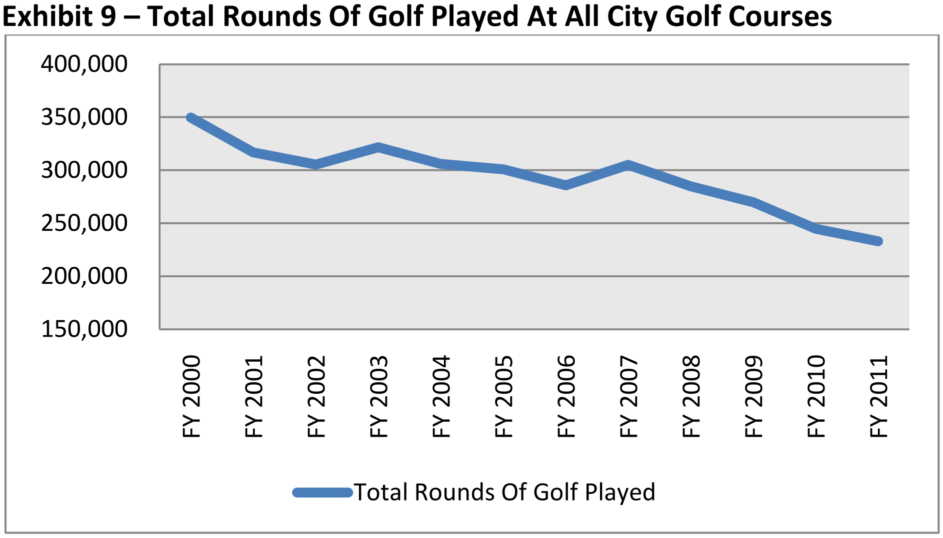
Exhibit 8 – Year-To-Year Comparison Of Green Fee Revenue By Month



Source: CCL

The City's historical information on the number of rounds played on City courses also reveals a consistent decreasing trend in the total number of rounds played. As shown in the following exhibit, the total number of rounds of golf played on City courses has decreased from approximately 301,000 rounds in 2005 to 245,000 in 2010, or a 19 percent decrease. As noted above, during this same period, nationwide, the golf industry experienced a 5 percent decrease in total rounds played.

Exhibit 9 – Total Rounds Of Golf Played At All City Golf Courses



Source: CCL

GREEN FEES

The City periodically conducts a rate survey of other area municipal and privately owned golf courses that allow for public play. The last rate survey was conducted in July 2009. Area golf courses are categorized as either value or premium. Premium courses generally receive a greater level of maintenance than value courses. Exhibits 10 and 11 below display some of the most common green fee types for area private and municipal golf courses.[11] The majority of the City's green fees were in line with other value and premium golf courses in the area.

Exhibit 10 – July 2009 Value Course Average Green Fees

	PRIVATELY OWNED	REGIONAL MUNICIPAL	COUNTY OF SACRAMENTO	CITY OF SACRAMENTO
Standard Weekday 18 Hole	$27.20	$26.22	$26.50	$26.67
Senior Weekday 18 Hole	$20.60	$20.56	$21.00	$21.00
Junior Weekday 18 Hole	$11.60	$11.17	$10.00	$11.83
Cart Fees - Single	$11.20	$14.00	$15.00	$16.00
Cart Fees - Full	$22.40	$27.78	$30.00	$32.00

Source: CCL Rate Study

Exhibit 11 – July 2009 Premium Course Average Green Fees (Including Cart Fees)

	PRIVATELY OWNED	COUNTY OF SACRAMENTO	CITY OF SACRAMENTO
Standard Weekday 18 Hole	$48.79	$43.00	$45.00
Senior Weekday 18 Hole	$38.82	$38.00	$34.50
Junior Weekday 18 Hole	$18.92	$25.00	$20.00

Source: CCL Rate Study

PUBLIC ACCESS GOLF

The Sacramento Bee publishes annually a *Golf Guide* that lists information about the area's courses that are open to the public. By comparing the 2005 and 2011 guides, we noticed that two Sacramento area golf courses have gone out of business, two new courses entered the market, and five courses that were previously private added public play. Overall, from 2005 to 2011, the list of public courses within the guides has grown from 32 in 2005 to 38 in 2011, an increase of nearly 19 percent. This increase in the supply of public courses during a period of decreased demand has likely contributed to the overall decline in the City's golf course revenue.

CONCLUSION

Based on our review of the City's golf operation's revenue and expenditure information, we confirmed that the golf operation revenues were not sufficient to cover its expenditures in FY 2010-11. Also, given the current environment and trends in the golf industry, it is reasonable to predict either no increase or further decreases in 2011-12 golf revenue. The City's Golf operation currently has significant liabilities, some of which are not being reflected in its operating expenditures. Without significantly reducing expenditures or increasing revenue, the City's General Fund will continue to carry the risk of having to subsidize golf operations.

[11] Rates listed reflect some of the common standard rates for area golf courses and do not reflect all rates, specials or discounted promotional prices offered by golf courses.

DEPARTMENT OF CONVENTION, CULTURE AND LEISURE

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MEMORANDUM

Date: September 12, 2011

To: Jorge Oseguera, City Auditor

From: Barbara Bonebrake
Director of Convention, Culture and Leisure

Subject: Response to City Auditor's Analysis of Golf Revenue and Expenditures

The Department of Convention, Culture and Leisure supports the City Auditor's conclusion. The report confirms golf operation revenues were not sufficient to cover its expenditures in FY 2010-11 and the City's General Fund will continue to carry the risk of having to subsidize golf operations if the City continues to provide the golf course maintenance function. The proposal to contract out the golf maintenance will eliminate or severely reduce the risk to the General Fund.

The Auditor's report estimates a cash balance of $724,000 in the Golf Fund as of June 30, 2011. It is important to note that the balance is at a point in time and includes the appropriations for restricted and otherwise needed capital projects as well as cash reserves required for large debt payments due in November and December. Further, FY 2011-12 year-to-date revenues are down 8.5% compared to prior year.

We thank the City Auditor and staff for their comprehensive financial analysis of the City's golf operations.

Cc: John Shirey, City Manager
Leyne Milstein, Finance Director
Doug Parker, Golf Manager