Legislation Details (With Text)

File #:	20-174	**Version:** 1	**Name:**	AGC Management Agreement SR
Type:	Staff Report		**Status:**	Filed
			In control:	City Council
On agenda:	6/1/2020		**Final action:**	6/1/2020
Enactment date:			**Enactment #:**	

Title: Staff Report for a City of San Leandro City Council Resolution Authorizing the City Manager to Enter into a New Management Agreement Between the City of San Leandro and American Golf Corporation and to Authorize the City Manager to Terminate the Existing Lease Agreement between the City of San Leandro and American Golf Corporation

Indexes:

Code sections:

Attachments: 1. 10.A. American Golf Presentation

Date	Ver.	Action By	Action	Result
6/1/2020	1	City Council	Received and Filed	

Staff Report for a City of San Leandro City Council Resolution Authorizing the City Manager to Enter into a New Management Agreement Between the City of San Leandro and American Golf Corporation and to Authorize the City Manager to Terminate the Existing Lease Agreement between the City of San Leandro and American Golf Corporation

SUMMARY AND RECOMMENDATIONS

With the City's intention of selling a portion of the 9-hole golf course to Cal Coast as part of the proposed Shoreline development project, the recommended action terminates the existing Lease Agreement between the City and American Golf Corporation (AGC), which currently runs through November 14, 2024 (in addition to the option for two additional 5-year extensions, if mutually agreed upon). If authorized by the City Council, the existing agreement would be replaced with a new Management Agreement.

BACKGROUND

The Marina Golf Course was originally built in 1963, while the Tony Lema Course and Everett Rooney Driving Range opened in 1983. Prior to November 1997, these recreational amenities were operated and maintained by the City, and at the time, at a loss to the City. There was significant need for capital improvements to enhance the quality of play and to improve the golfing experience, but with no identified funding source. The City issued a Request for Proposals and seven firms responded. A subcommittee of three councilmembers and two golfers from the public reviewed the proposals and narrowed the field of interviewees down to three firms: AGC, Arnold Palmer Company, and Senior Tour Players.

The general terms of the 1997 Lease Agreement are:

- 20-year term (to commence after completion of Phase III work, which was November 15, 2004) + two 5-year extensions if mutually agreed to;
- AGC to spend $8.1M on renovations including the double-deck driving range and improvements to both courses (plans to include clubhouse renovations were deleted after unexpected additional costs associated with the course renovations);
- Creation of Golf CIP account - 4% of revenues (green fees, cart fees, and driving range fees) with City and AGC each contributing 2%;
- Minimum rent of $750K annually, or 75% of the average total annual rent paid for the previous 3 years, whichever is greater;
- Escalating percentage rent from years 1-10, with the current rate of 30% on golf revenues and 6% on clubhouse revenues.

Subsequent Lease Agreement addendums included the following:

- 2006 - Agreement for AGC to purchase the City's reclaimed water (essentially at the City's cost, with a 2% annual rate increase);
- 2010 - Addition of cell sites at the driving range, with agreement that all cell site revenues would be deposited into the Golf CIP account; and
- 2019 - Temporary waiver of payment for reclaimed water.

To date, the City has received more than $17M in golf revenues since AGC began operating the courses under the 1997 lease.

Analysis

It is noted that the golf industry nationwide suffered a downturn starting in 2006 (from the high at the time of the Lease Agreement), with more than 1,550 public and private golf courses having gone out of business since that time, and overall participation and golf revenues declining throughout the country. Monarch Bay Golf Course has not been immune to the downturn in golf, as total net golf revenues have varied from a high of $1M in 2011 to less than $650K in 2016. Since 2016, net revenues have begun to increase, and last year's revenues exceeded $1M for the first time since 2011.

Under the current Lease Agreement, AGC is responsible for all costs associated with operating the two golf courses while paying the City 30% on gross golf revenues plus 6% on clubhouse revenues. Below is a recap of the past seven years of golf revenue, expenses, the City's percentage rent and AGC's net. Both revenues and expenses have increased over this period, with expenses outpacing revenues by approximately six percent. As a result of the current lease structure, the City golf rent revenues are up 17% over the seven-year period while AGC's net revenues are down more than 47% (including five straight years of losses). These significant declines are emblematic of why the majority of golf courses throughout the country are now being operated on a management basis rather than on a lease basis, as golf operators are simply not making enough net revenue to justify a lease agreement - a major reason for the closure of more than 1,550 golf courses since 2006.

Year	2013	2014	2015	2016	2017	2018	2019
Revenues	$3,089,601	$3,001,054	$3,341,796	$3,152,101	$3,225,840	$3,472,004	$3,578,005
Expenses	$2,186,986	$2,266,979	$2,641,979	$2,507,759	$2,535,615	$2,639,407	$2,559,329

EBITDAR*	$ 901,170	$ 734,075	$ 699,982	$ 644,342	$ 690,225	$ 832,597	$1,018,676
City Rent	$ 800,042	$ 797,797	$ 830,379	$ 818,563	$ 877,015	$ 946,655	$ 965,573
AGC Net	$ 101,128	$ (63,725)	$ (130,397)	$ (174,221)	$ (186,790)	$ (114,058)	$ 53,103

*EBITDAR = **E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation, **A**mortization, and **R**ent costs

Seven-Year Recap

- *Gross Revenues* +11%
- *Expenses* +17% (Bay Area CPI over +25%)
- *EBITDAR* +11.5% from 2013 value (-28.5% at lowest point in 2016)
- *City's share* +17% from 2013
- *AGC's share* -47% (five straight years of losses between 2014 and 2018)
- *City's share of 7-year EBITDAR* +109%
- *AGC's share of 7-year EBITDAR* -9.3%
- AGC invested $9M in property from 1997-2002
- AGC/City (through Golf CIP fund contributions) invested $1M+ in property improvements between 2005-2018
- Rental rate is at maximum allowed under Lease Agreement (30% on golf/carts/range plus 6% on food/beverage/merchandise/lessons)
- Hourly wages have increased from $8/hr. to $14/hr. (75% increase)

Conversion to a Management Agreement

The Shoreline Development purchase and sale agreement approved by the City Council earlier this Spring for a portion of the 9-hole Marina Golf Course automatically reopened the lease agreement between the City and AGC. AGC has proposed terminating the lease and entering into a management agreement for the remaining years of the lease term. The City and AGC have engaged in good faith negotiations and have proposed an agreement which would pay AGC an annual fee of $150,000 to operate and maintain the two courses and associated amenities.

The City's golf consultant, who has over 40 years' experience in the management and oversight of municipal golf courses, assisted staff by overseeing the current lease agreement. For the negotiations of the management agreement he conferred with various municipalities and experts in the golf course operation industry, and well-respected golf course consultants. Based on the City consultant's research, staff believes that a lease agreement with any credible golf operator is not feasible and at this time a management agreement with the current operator is the best course of action available to the City. It maintains continuity of operations, and historical knowledge that will be useful for the Shoreline development's construction.

Below are major points for the conversion from a lease agreement to a management agreement:

- Conversion to a management agreement structure is consistent with the recent directions of many municipal golf courses upon the expiration of lease agreements;
- The City will assume greater risk;
- The City will have control over the operations at Monarch Bay;
- The City will assume responsibility for all operating expenditures; and,

- The City will be responsible for funding major capital improvements.

While there are other experienced municipal golf operators throughout the country, staff believes remaining in partnership with AGC is beneficial to the City because of the following:

- The 23-year partnership between AGC and the City resulted in an experienced operator familiar with Monarch Bay, which staff believes is advantageous to the City;
- Will provide for a seamless transition (from lease to management) for the golfing community;
- AGC is regarded as one of the most successful golf operating companies in the country with 40+ years' experience operating 500+ courses; and
- AGC is an industry leader in controlling expenses and producing EBITDAR.

AGC will continue to operate Monarch Bay Golf Club, with no change in the day-to-day operations of the facility. AGC will continue to commit its resources to all facets of the business from its El Segundo, California corporate headquarters. AGC's core economies of scale will also continue to accrue to the benefit of the City's bottom-line.

Legal Analysis

The City Attorney's Office assisted with the negotiations of the management agreement. The City Council should note that the City is retaking the risks associated with operating a golf course. The lease agreement transferred all risks to AGC, but also allowed AGC to receive the majority of revenues. Under a management agreement, the City will retake all revenues, but also all of the risks to operate the facility. As part of the management agreement, AGC will procure the proper types and amounts of insurance coverage, the costs of which will be paid by the City as an expense of the facility. Therefore, although entering into a management agreement carries increased risk, such risks are offset by insurance that covers the City, indemnity for AGC's sole negligence or willful misconduct, and the flexibility to allow the Shoreline Development to proceed as quickly as possible.

Fiscal Impacts

Under the current lease agreement, all golf revenues go directly to AGC, who then pays the City monthly rent plus annual contributions towards the Golf CIP fund. Under a management agreement, all golf revenues received by AGC would be deposited into a City account. A separate joint banking account would be established and be funded by the City from the revenue deposits, with draws to the joint account made to cover AGC's monthly operating expenses as well as monthly installment payments for the management fee.

The existing and separate Golf CIP fund would remain, although AGC would no longer be required to contribute to it under the management agreement. Prior to the onset of the Shelter in Place (SIP) order and temporary closure of both golf courses, the Golf CIP fund had a balance of just under $500,000. The City and AGC agreed to waive rent payments and cover the minimal staffing/maintenance of the course during the SIP from the Golf CIP fund, at an estimated cost of $70,000 per month. If the proposed management agreement is approved, staff will develop a new 5-year CIP proposal for future City Council consideration (the previous CIP projects list covered 2015 - 2019).

Based on the initial Annual Plan provided by AGC (Appendix B of the management agreement), the City is anticipated to realize a net profit of $715,056 for this initial plan period (June 1, 2020 through June 30, 2021). This anticipated net revenue amount is approximately 26% less than the City's share of 2019, which was $965,573. The difference in projected revenue is due in part to the fact that under the existing Lease Agreement, AGC was exempt from the City's Living Wage Ordinance (the 1997 Agreement was in existence prior to adoption of the Living Wage Ordinance), and under the management agreement, living wage would apply (approximately $130,000 difference). Additional factors include the static management fee ($150,000) to be paid to AGC, whereas in the past several years AGC operated at a loss. Staff also estimates approximately $55,000 more for insurance costs. The difference between rental income of $965,573 the City received under the Lease Agreement and the anticipated net profit from golf course operations of $715,056 will have an anticipated negative impact of $250,000 on the Shoreline fund.

Although AGC worked hard to maximize golf revenues, including the addition over the past few years of Foot Golf and Disc Golf on the 9-hole course, it is anticipated that over the next 2-3 years, as the 9-hole course is closed for reconstruction, net revenues will temporarily decline. Plans are in place to offer 9-hole play at a reduced rate on the Tony Lema course during the interim construction period, but the overall number of players is anticipated to temporarily decrease.

PREPARED BY: Debbie Pollart, Director, Public Works Department
David Sams, City's Golf Consultant