



CITY AUDITOR 345 6th Street, Suite 100, Bremerton, WA 98337-1873 & Phone (360) 473-5369

February 13, 2020

To Audit Committee Members:

Leslie Daug, Audit Committee Chair and Council Member
Deborah McDaniel, Audit Committee Vice-Chair and Citizen Member
Lori Wheat, Council Member
Darryl Riley, Citizen Member
Dennis Treger, CPA

Re: Golf Mountain Golf Club Review

Dear Audit Committee Members:

This report contains information concerning the history of Gold Mountain Golf Club and the recent Request for Proposals (“RFP”) solicitation and response. A comparison of significant differences between the expiring and proposed golf course management agreements is included in Exhibit A (end of report.)

GMGC HISTORY

GOLD MOUNTAIN GOLF CLUB HISTORY

In 1966, the president of the Puget Sound Naval Shipyard Golf Association and others asked City Council to consider having a municipal golf course in Bremerton. At that time, local golfers were going to Tacoma to play. Several location options were discussed, including watershed property, and it was agreed that the City would engage a professional to advise the City on which location would be most suitable.

William Sherman and Associates provided site options to the City in early 1967 which included Watershed Lands, State School Lands, Holiday Hills on the Brownsville Highway, an area south of Kitsap Lake, beyond the Airport, and Sinclair Heights. Several options had potential complex land arrangements or the terrain was not suitable for golf. Ultimately, the Watershed Lands were selected for the golf course development.

The Cascade Course at Gold Mountain Golf Club (“GMGC”) was designed by Ken Tyson and opened in 1971. A small clubhouse was also constructed. The Cascade Course is an 18-hole course with yardage up to 6,707 from the longest tee.

A second 18-hole course, the Olympic, was opened in 1996. This course was designed by John Harbottle III, and has yardage up to 7,152 yards. The Olympic Course has hosted several championship events, including the NCAA Men’s Regional Championship in 2015, the U.S. Junior Amateur Championship in 2011, the NCAA Men’s West Regional Golf Championship in 2008, several University of Washington Husky Invitationals, and the 81st U.S. Amateur Public Links Championship in 2006.



GMGC UNDER SCOTT ALEXANDER

Scott Alexander was contracted as the Golf Professional at GMGC beginning in 1984 and resigned 28 years later. When Mr. Alexander was first hired by the City, he reported that people in Seattle did not know about GMGC. When he left in 2012, people from all over the country and internationally came to play the course.

Mr. Alexander has been credited with much of the success of GMGC under his leadership, including being a driving force behind the building of the acclaimed Olympic Course and newer clubhouse at the complex, transforming the Olympic Course into one of the top-rated and most affordable courses in the country, and with bringing highly successful national tournaments and regional championships to Bremerton. As reported in the Seattle Times, Mr. Alexander is generally credited with leading GMGC to its national reputation.

The contracts with Mr. Alexander provided that he would be compensated a percentage of the greens fees, plus he operated the pro-shop, restaurant and cart businesses as his own. Under this arrangement, Mr. Alexander owned the financial gains, losses and risks associated with the pro-shop, restaurant, and cart businesses.

Amidst a downturn in the golf industry and a recession, GMGC operations sharply declined in 2010, and remained in a slump through 2012. In early 2012, Mr. Alexander decided to discontinue operating the golf course and submitted notice to the City that he would not renew his contract set to expire December 31, 2012. According to Mr. Alexander, although he loved the golf operation side of the business, half of his income was from the cart business which only required five percent of his time. Although he exited the golf operations, Mr. Alexander continued his cart business which he still operates today.

MANAGEMENT AGREEMENT WITH COLUMBIA HOSPITALITY, INC. - HISTORY

In 2012, CHI was managing the City's Kitsap Conference Center and expressed interest in managing GMGC, although they had never managed a golf course. Without issuing an RFP, City Administration¹ selected CHI to manage GMGC. Other golf management companies and individuals that requested a chance to bid the job were not given the opportunity.

On October 3, 2012, Bremerton City Council waived the request for bids procurement requirement and approved the sole source golf management agreement with CHI in a 6 to 2 vote. In Resolution No. 3181, dated October 3, 2012, City Council explained its authorization of a sole source contract and entering into direct negotiations with CHI based on CHI's experience with managing the Kitsap Conference Center since 2003, the City's good working relationship with CHI, and anticipated benefits from combining the finances, marketing and other resources with the operation of the conference center.

In the audio recording of the October 3, 2012 Council meeting, the dissenters, then Councilmembers Greg Wheeler and Adam Brockus, stated the reason for voting against the sole source contract was because the contract did not go out for bid.

Following a transition agreement, the initial term of the golf course management agreement was three years, from January 1, 2013 through December 31, 2015. In summary, the agreement provided that CHI would manage and operate GMGC for a base management fee

¹ Administration was led by Mayor Patty Lent from 2009 through 2017



of five percent of the facility’s gross revenue plus an incentive management fee of 20 percent of net operating income in excess of \$600,000. In addition to the base management and incentive fees, the City agreed to pay CHI central service fees² for accounting and other services provided by CHI. The capital reserve set-aside³ was set at four percent.

Bypassing the RFP process again, the term with CHI was extended one year through December 31, 2016 via an amendment signed in September 2015. This first amendment decreased the capital reserve set-aside from four percent to three percent of revenue, which increased the basis for computing the incentive management fee. Notably, it appears CHI calculated the capital reserve set-aside based on three percent from 2013 through 2015 when it was supposed to be calculated at four percent. Although the calculation was incorrect, it did not result in an overpayment of the incentive management fee because net operating income was not sufficient to generate such fees in those years.

The first amendment also increased the incentive management fee from 20 to 40 percent of net operating income in excess of \$500,000 (versus the previous threshold of \$600,000) – significantly increasing the rate of compensation while significantly lowering the bar to achieve the incentive fee. Apparently in exchange for the more generous incentive management fee, a debt service guarantee was added to the agreement, whereby CHI agreed that if the facility’s net operating income was insufficient to cover the facility’s annual debt service obligation⁴, CHI would compensate the City the difference.

Bypassing the RFP process again, a second amendment was fully signed in December 2016 that extended the term an additional three years through December 31, 2019.

GMGC FINANCIAL OPERATIONS

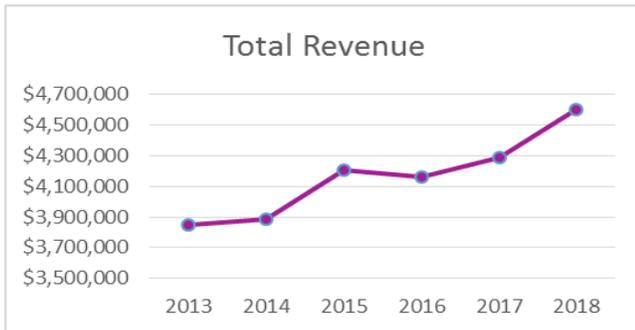
The following charts reflect GMGC operations under CHI management. As shown, all revenue sources and operating income have increased throughout the period that CHI has managed the facility:



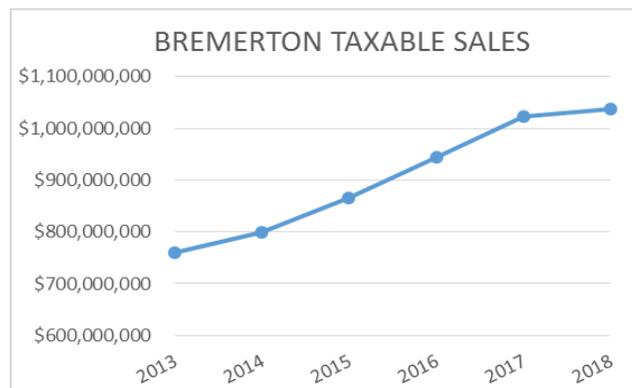
² The contract provided CHI could charge the City an undefined “reasonable profit” on the central service fees although CHI states it bills the City at cost with no profit.

³ The capital reserve set-aside is a reserve account used for purchasing or replacing capital assets. It is also deducted in determining net operating income, which is the basis for computing CHI’s incentive management fee.

⁴ From 2015 through 2018, net operating income was sufficient to cover the annual debt service obligation. Thus, CHI never paid anything in terms of the debt service guarantee, while the City paid an additional \$70,000 in incentive fees from 2016 through 2018 in exchange for CHI bearing the risk that operating income would be insufficient to cover debt service.



The local economy as measured by Bremerton Taxable Sales was also positive from 2013 through 2018, as shown in the graph below. Thus, GMGC performed well during a good economy throughout CHI's management.



The contract states CHI can charge the City for accounting, human resources training and development, public relations, employee relations, payroll processing, information technology and other related services. These costs are referred to as Central Service Fees in the contract. The contract does not appear to specify what charges, if any, should be included in the base management fee.

Central Service Fees have increased over time from \$8,100 in the first year of the contract to over \$100,000 in 2017 and 2018. The degree to which Central Service Fees have increased is somewhat surprising as economies of scale are addressed in the contract; thus, as CHI's portfolio has grown, one could reasonably expect the allocated Central Service Fees would decrease. CHI states additional costs were incurred as revenue grew and the additional costs were passed on to the City.

Based on a review of the income statements, it appears the individual categories charged to the City have also increased: the first year only Public Relations costs were charged to the City, with Corporate Accounting, Corporate Office Support, and Corporate Human Resources being added over time, as shown below:



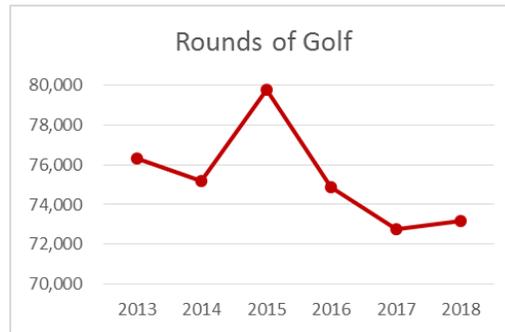
Description	Central Service Fees Charged to Gold Mountain Golf Club					
	2013	2014	2015	2016	2017	2018
Public relations	\$ 8,100	\$ 12,176	\$ 12,079	\$ 13,510	\$ 12,000	\$ 6,000
Corporate accounting	-	30,000	30,000	40,333	55,000	55,000
Corporate office support	-	-	2,064	3,318	7,200	8,000
Corporate human resources	-	-	-	12,980	31,704	31,704
Total	\$ 8,100	\$ 42,176	\$ 44,143	\$ 70,141	\$ 105,904	\$ 100,704
Growth		420.7%	4.7%	58.9%	51.0%	-4.9%

Shawn Cucciardi, CHI Golf President, stated public relations is an allocation of expenses related to a national public relations firm that manages all of CHI’s social media and public relations. The accounting in 2013 was performed onsite at GMGC so the corporate accounting charges replace accounting payroll at GMGC. The accountant’s salary is allocated between GMGC and Kitsap Conference Center. Corporate office support is a marketing manager allocation.

Total fees paid to CHI were initially approximately \$200,000 per year and have grown to almost \$400,000 per year. Their fees have averaged 37.5 percent of operating income before fees. The remaining operating income is used by the City to pay the fees, debt service, depreciation, insurance, etc. The table below summarizes all fees charged by CHI through 2018 for management of GMGC:

Year	Paid to Columbia Hospitality			
	Base Mgmt Fee	Incentive Fee	Centralized Service Fees	Total
2013	\$ 192,256	\$ -	\$ 8,100	\$ 200,356
2014	198,685	-	42,176	240,861
2015	206,765	-	44,143	250,908
2016	207,193	18,168	70,141	295,502
2017	214,515	53,298	105,904	373,717
2018	229,903	68,678	100,704	399,285
Total	\$ 1,249,317	\$ 140,144	\$ 371,168	\$ 1,760,629

One metric that decreased from 2013 through 2018 is rounds of golf (while at the same time golf revenue increased.) At your request, additional review could be performed to understand why golf revenue increased while rounds decreased.



Feedback provided by certain individuals in City leadership during my review included high praise for Daryl Matheny, the GMGC general manager who has been with the course since 1988. Feedback also indicated folks seem pleased with the operating performance of GMGC under CHI’s management. Some complaints were raised in terms of certain process problems, such as capital purchases by CHI without proper approval, and some cash handling practices; however, feedback was positive overall concerning the golf course and CHI, with no serious concerns noted.

DEBT SERVICE

Shown below is the bond amortization schedule for payments from 2019 through 2028, when the debt service will be retired. This debt was incurred to build the Olympic Course and new clubhouse.

Year	Principal	Interest	Total
2019	\$ 320,000	\$ 116,230	\$ 436,230
2020	325,000	109,670	434,670
2021	330,000	102,195	432,195
2022	340,000	93,450	433,450
2023	350,000	83,590	433,590
2024	360,000	72,915	432,915
2025	375,000	60,315	435,315
2026	385,000	47,190	432,190
2027	405,000	32,175	437,175
2028	420,000	16,380	436,380
Total	\$ 3,610,000	\$ 734,110	\$ 4,344,110



GOLF INDUSTRY

PARTICIPATION

Golf participation is a core measure of golf’s vitality. The following statistics are based on data compiled by the National Golf Foundation (“NGF”), which tracks how many people play the game and their demographic composition.

The NGF reports that in 2018, an estimated 24.2 million Americans played golf on a golf course and another 9.3 million participated exclusively in off-course golf activities at places like driving ranges, indoor golf simulators, or golf entertainment venues like TopGolf and Drive Shack where golfers and non-golfers hit micro-chipped golf balls at giant dartboard-like targets on an outfield from an establishment typically equipped with a bar and restaurant.

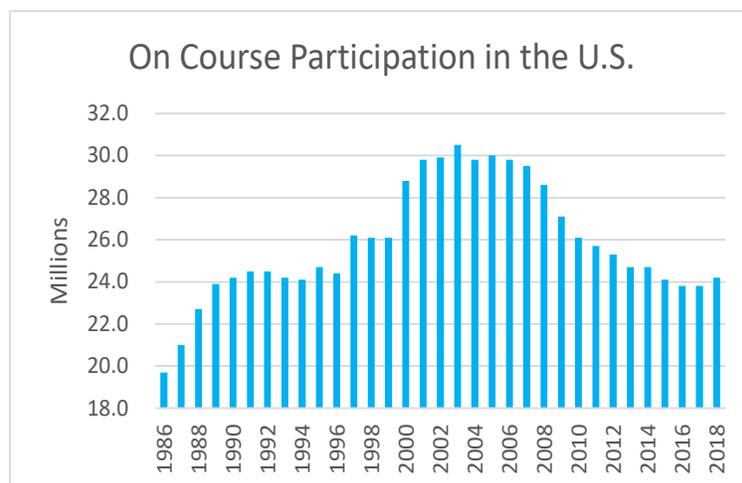
Of the 24.2 million Americans that played on a course in 2018, an estimated 2.6 million played for the first time. 2018 was the industry’s fifth straight year with more than 2 million beginners. Prior to the past two years, the previous recorded-high of 2.4 million was set in 2000, when Tiger Woods was at the height of his popularity.

Young adults (18-34 year olds) is the sport’s biggest customer age segment, with 6.1 million on-course participants. This segment averaged 11.6 rounds of golf in 2018.

Women account for approximately 24 percent of all U.S. golfers. In 2016, women golfers played an average of 13 rounds of golf while men played an average of 21.3 rounds.

There were 4.2 million golfers age 65 and over in 2018. NGF expects this number to increase as the balance of Baby Boomers, the youngest of whom are 54, cross this milestone. As they retire, they are expected to continue to positively impact rounds for the next decade. Golfers who were 65 or over played an average of 36 rounds of golf in 2018.

NGF research finds that although the sport has not yet returned to pre-Great Recession levels, golf is experiencing a recent stabilization in on-course participation, with a new support level around 24 million golfers. The table below shows the participation level from 1986 through 2018:





GOLF COURSE SUPPLY

According to the NGF, at the end of 2018, there were 16,693 golf courses at 14,613 golf facilities in the U.S, with 2,515 (17.2 percent) of the facilities owned by a municipality. 75 percent of the facilities are open to the public with the remaining 25 percent private.

Prior to 2006, there was a 20-year expansion cycle where U.S. golf course supply grew by 44 percent. Since 2006, there has been a cumulative contraction of eight percent, which has been disproportionately concentrated in value-priced courses (less than \$40 greens fee).

According to NGF, investment in golf courses remains significant with major course renovations replacing new construction as the focus of investment. Approximately 1,200 major golf course renovations have been completed since 2006, representing an estimated total investment of \$3.5 billion.

12.5 new courses (measured in 18-hole equivalents) opened in the U.S. in 2018; and 27 courses reopened after being temporarily closed for major renovation.

GOLF REQUEST FOR PROPOSALS

SUMMARY

The current Gold Mountain Golf Club (GMGC) management agreement expires December 31, 2019. For the first time in GMGC's 49-year history and as directed by Mayor Greg Wheeler, the City used a competitive process to procure golf management services. An RFP was issued on June 4, 2019 by the City's new Contract Administrator, Melinda Monroe, who also managed the process.

After receiving responses to the RFP, Ms. Monroe formed a Proposal Review Committee⁵ ("Committee"). The Committee performed significant due diligence to gain assurance that the selected management company has the knowledge, experience, and resources to manage GMGC at the same or better level and quality of service currently provided.

Toward that end, the Committee diligently performed a thorough review and evaluation of the proposals, conducted two rounds of interviews, checked references, reviewed contracts and toured other golf courses managed by RFP respondents, performed analytical procedures and other due diligence deemed appropriate.

The Committee believes that the results of its due diligence provide a reasonable basis for its recommendation to Mayor Wheeler that Columbia Hospitality Inc. ("CHI"), the City's current golf course management company, be selected to continue managing GMGC.

⁵ The review committee included Melinda Monroe, Mike Riley (Finance Director), Jeff Elevado (Parks Director), and Steve Mutek (Parks Operations Manager).



2019 RFP SOLICITATION AND RESPONSE

A legal notice of the RFP was published in the Seattle Daily Journal of Commerce⁶, a daily publication that is frequently used to advertise certain RFPs, and was posted on the City’s website. The City received five responses to the RFP: two companies that had inquiries but did not submit proposals, and three companies, listed below, that submitted proposals:

1. Columbia Hospitality, Inc. (“CHI”), the City’s current management company;
2. CourseCo, a strong contender that specializes in municipal golf course management; and
3. XUDE Hospitality, a hospitality company headquartered in Florida that is “dedicated to creating and enhancing long-term partnering opportunities in the hospitality industry.”

For personal services greater than \$20,000, Municipal Research and Services Center (“MRSC”) recommends (but there is no requirement for) sending the RFP to at least six firms, which was not done in this instance. Although the proposal response rate may be lower than expected, the City administration believes the process attracted sufficient qualified bidders and competitive offers.

RATINGS, FEES AND ESTIMATED OPERATING REVENUE & EXPENSES (PROFORMAS)

The golf course proposal review committee was most impressed with CHI and CourseCo, each receiving a 91 percent rating based on experience, interviews, and references.⁷ However, there were significant differences between these two respondents in terms of their proposed fees (compensation) and projected operating expenses for the golf course.

In terms of the initial proposed fees, central service fees, and projected revenue and expense, CourseCo’s proposal package was a better deal for the City by approximately \$106,215 in the first year, as summarized below:

Description	2020 Projections		CourseCo
	CHI	CourseCo	Less CHI
Total revenue	\$ 4,760,031	\$ 4,784,591	\$ 24,560
Contract expenditures excluding management fees	3,874,101	3,954,618	80,517
Management fees	297,172	135,000	(162,172)
Revenue less all contract expenditures	\$ 588,758	\$ 694,973	\$106,215

The table shows the following:

1. CourseCo projected the golf course would have \$24,560 more revenue in 2020 than projected by CHI.
2. CourseCo projected the golf course would have \$80,517 more in 2020 expenses than projected by CHI.

⁶ Based on discussions with a golf course management company, when a municipality issues an RFP, the management companies typically receive an email invitation to bid. The lower than expected response to the RFP may be a result of not inviting golf management companies to bid.

⁷ After XUDE Hospitality received a 74 percent rating, XUDE was no longer considered for selection.



- 3. CourseCo’s proposed management fees⁸ were estimated to be \$162,172 less than CHI’s in the first year of operations at \$135,000 compared to CHI’s management fees totaling \$297,172.

CourseCo’s proformas had insufficient detail to determine whether their revenue and expense projections were reasonable: to the extent the projections were inaccurate, the difference between CourseCo’s and CHI’s proposals could be greater or less than presented in the table above.

DECISION TO AWARD CHI

The City’s due diligence showed it had two capable and qualified candidates, CourseCo and CHI. The City performed research including site visits of other Washington golf courses managed by CourseCo and it appears CourseCo is a reputable vendor that manages some high quality courses, including Palouse Ridge which is rated in the top 10 golf courses in Washington.

In its decision to recommend awarding the contract to CHI, the golf proposal committee included other considerations such as the risk that a new vendor may not maintain the quality of the course, the cost and staff time needed for a transition, potential response by golfers and vendors, many of whom have praised CHI, and the risk of losing key personnel such as the general manager or superintendent. Because the City administration has been pleased with the performance of CHI, it decided to use the RFP process to negotiate better terms with CHI.

Fees – CHI Proposed and Negotiated

In its written proposal, CHI proposed to maintain its current fee structure with a base management fee of 5 percent of revenue plus an incentive management fee of 40 percent of all net operating income in excess of \$500,000.

During negotiations, CHI reduced its base management fee to 4.25 percent of revenue, plus a reduced variable incentive management fee that increases as net operating income increases. The table below summarizes the rates at which the incentive management fee is paid:

Net Operating Income Range	Rate
\$600,000 to \$650,000	20%
\$650,001 to \$700,000	25%
\$700,001 to \$750,000	30%
Greater than \$750,000	40%

The table below compares CHI’s fees under the expiring agreement with the proposed agreement:

⁸ Management fees includes base management fees and incentive fees, and excludes central service and accounting fees.



Description	CHI Contract		Difference
	Expiring	Proposed	
Assumptions based on 2020 proforma:			
Revenue	\$ 4,760,031	\$ 4,760,031	-
Net operating income before fees and capital reserve	1,028,729	1,028,729	-
Base management fee	\$ 238,002	\$ 202,301	\$ (35,701)
Incentive management fee	59,170	7,205	(51,965)
Total fees	\$ 297,172	\$ 209,506	\$ (87,666)

As shown, based on 2020 projected revenue and net operating income, the proposed contract reduces CHI's fee compensation \$87,666 in 2020 compared to the compensation CHI would have received under the contract expiring at the end of 2019. While the total difference between CHI and CourseCo started at \$106,215, including compensation and projected operating results, the difference was reduced by \$87,666 to \$18,549 through negotiations.

In addition to the base management and incentive fees, CHI will continue to receive Central Service Fees. The new contract specifies a fixed amount that will be charged for Central Service Fees, plus a growth factor not to exceed four percent per year.⁹ Year One Central Service Fees total \$100,708, which equals the 2018 fees. Please refer to the chart on Page 5 of this report for a summary of CHI's Central Service Fees from 2013 through 2018.

Fees – CourseCo Proposed

CourseCo's proposed fees included a base management fee of \$135,000 per year and an accounting fee of \$21,600 per year, each adjusted annually by Consumer Price Index¹⁰ beginning in Year 2. The offer also proposes that if net operating income is less than \$600,000, the base management fee will be reduced by the shortfall up to \$50,000.¹¹ The proposed incentive fee is 15 percent of net operating income in excess of \$650,000.

CourseCo stated it does not allocate corporate expenses (like Central Service Fees) to the individual properties; however, because proformas submitted by CourseCo show higher operating expenses, it is unclear whether some similar services could be provided at the property (rather than through the corporate office) resulting in higher direct expenses charged to the golf course.

⁹ Seattle-Tacoma-Bellevue Consumer Price Index for all urban consumers has grown an average of 2.1 percent for the past 11 years, which is the full term of the proposed contract including renewal options.

¹⁰ The Consumer Price Index has averaged approximately 2.1 percent the past six years.

¹¹ The chart below ignores this provision since it is uncertain what the threshold might have been set at in 2013. By ignoring this provision, the CourseCo fees could be overstated by up to \$50,000 per year.



CONCLUSION

As noted in my October 17, 2018 report on the Kitsap Conference Center, utilizing a competitive bid process gives the City an opportunity to evaluate the qualifications of different vendors, helps ensure services are provided at a competitive rate, and gives the City a better opportunity to see what other contract terms could be available to the City. It also gives other vendors a chance to compete for the City’s business.

The RFP process resulted in two qualified bidders, which provided the City a strong position for negotiating favorable contract terms. The process also provided the City with valuable insight on competitive fee structures and fresh ideas to consider for promoting GMGC. Although the process involved a lot of staff time in terms of drafting the RFP, reviewing proposals, interviewing bidders, performing due diligence, and planning for and participating in contract negotiations, the resulting competition was good for the City and led to an estimated \$88,000 cost savings for the City in the first year.

GMGC is a special City asset that Bremerton golfers and non-golfers alike are proud of, and rightfully so. The table below recaps data presented in the August 2019 issue of Cascade Golfer and shows how GMGC ranks in Washington:

Description	GMGC Course Ranking	
	Olympic	Cascade
Best public course in 2019	4	
According to experts only	4	
Ladies choice	2	
By Region - The Peninsula	1	8
By price \$45 and under		2 (\$45)
By price under \$100	1 (\$70)	

While working on this review, it was clear that City staff is committed to selecting a management company that will maintain this special asset as a top rated championship golf course. A comparison of significant contract differences is shown in Exhibit A and a list of documents reviewed for this report is shown in Exhibit B. Please contact me if you have questions or need additional information.

Sincerely,

Jennifer L. Sims CPA/CFF, CFE
City Auditor

- cc: Mayor Wheeler
- City Council
- Jeff Elevado, Parks and Recreation Director
- Mike Riley, Finance Director



EXHIBIT A

Comparison of Significant Contract Differences

Contract Item	Expiring Contract	Proposed Contract
Term	Initially, three years plus successive automatic two-year renewals	Five years plus two successive automatic three-year renewals
Base Management Fee	5 percent of gross revenue	4.25 percent of gross revenue. First year cost savings for the City is expected to be \$35,701.
Incentive Management Fee	40% of net operating income > \$500,000	Variable. Refer to Page 10. First year cost savings for the City is expected to be \$51,965.
Capital Replacement Reserves	3 percent of gross revenue	4 percent of gross revenue
Debt Service Guarantee	Included	Omitted



EXHIBIT B

Documents Reviewed

1. [MRSC personal service purchase recommendations](#)
2. [Kitsap Sun Article dated May 15, 2012](#)
3. [Cascade Golfer August 2019 issue, Top 10 Best Public Courses](#)
4. [Sole Source Resolution and Management Agreement with CHI](#)
5. [Amendment No. 1 to Management Agreement with CHI](#)
6. [Amendment No. 2 to Management Agreement with CHI](#)
7. [GMGC Profit and Loss Statements prepared by CHI](#)
8. [2020 Consolidated Operating Budget for GMGC prepared by CHI](#)
9. [GMGC Debt Amortization Schedule prepared by Mr. Riley](#)
10. [Kitsap Conference Center Audit Report dated October 17, 2018](#)
11. [CourseCo proposal for operation of GMGC dated July 1, 2019](#)
12. [CHI proposal for operation of GMGC dated June 28, 2019](#)
13. [National Golf Foundation Statistics](#)
14. [Draft Golf Course Management Agreement currently under consideration](#)