golf property analysts

NewsLinks

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BITING THE BULLET

Whole Course Remodeling vs. A Piecemeal Approach

By Greg Muirhead, ASGCA

It's an amazing spectacle; the way pro sports teams maneuver near the end of the season. Playoff contenders trade away long-term projects to get the player that can "make an immediate impact" and propel the team into championships. Meanwhile, teams already out of the race trade away players to better their chances in future years. Golf course owners, managers, superintendents and others also face a decision pitting the short-term versus the long-term. When it comes to remodeling, what should the timeline be? Should the course phase the remodeling process in over time? Or is it better to do it all at once? Increasingly, golf courses are choosing the latter. They're biting the bullet...closing all or a major part of their golf course...and accomplishing all of their remodeling work at once.

More Golfers Need More Courses

The National Golf Foundation reported an increase of 1.5 million new golfers in 1997. The continued growth and increased popularity of golf has prompted the remodeling of numerous public and private courses throughout the country. In the past, with fewer golfers and fewer courses competing to attract golfers, course remodeling was generally limited to small-scale projects, usually involving only two or three holes, or portions thereof. Traditionally, the work was targeted to address only the most severe deficiencies (i.e. flooding/poor drainage, significant lack of turf, safety/liability issues, etc…). Due to budget constraints and less concern over inconveniencing the golfer, remodeling was typically phased-in over a number of years.

Today, the influx of new golfers and a significantly more competitive marketplace has created a new trend in golf course remodeling. Public and private facilities are less frequently phasing-in necessary improvements. Instead, facilities are electing to close the course for a season and institute an 18-hole Comprehensive Remodeling Master Plan.

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Great Bay Golf Course

WHAT'S WITH THE MARKET?

By Larry Hirsh, CRE, MAI, SGA

With the National Golf Foundation and USA Today predicting doom for the golf course industry, what does this mean?

We do know that the REITs have been affected significantly. The two exclusively golf REITs (National Golf Properties NGP and Golf Trust of America GTA) have seen their stock drop from much higher levels but have continued to seek acquisitions. Non-REIT management companies have also to continued an aggressive stance, taking advantage of the less competitive environment and pursuing acquisitions enthusiastically, albeit at more "buyer friendly" prices than earlier in the year. Does this mean the golf boom has gone bust? I don't think so. With professional, multi-course management companies (including REITs) controlling less than 10% of the golf market in the USA and interest rates

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remaining comparatively low, acquisitions will still be relatively easy for those with equity and with the power to borrow. Golf rounds made a significant increase in 1997, indicating continued growth in the game (though 1998 rounds will probably be lower due to El Nino). Club membership appears to be on the rise and there are as many new courses being planned or developed as during the past few years.

It is my opinion that the peak the market reached during the spring and early summer of 1998 will settle back into a more stable market with a continued growth of acquisitions by professional management firms and consolidation of the industry as larger firms acquire the smaller firms, the most significant of those being the absorption of Cobblestone Golf Group by Club Corporation of America and National Golf Properties. While this leaves some experienced golf executives jobless, there is a history of many of them venturing out on their own.

Predominant capitalization rates in the 9% to 11% range as indicated by our investor survey should remain fairly stable with minimal interest rate fluctuations, however income projections on which properties are bought may become more conservative, thus increasing returns. Bargains will be hard to find but high prices that encourage **WOWs** may be a thing of the past. While prices may settle the increasing number of golfers that should grow as baby boomers age and their kids play golf should assure a growing supply of golfers into the new millenium.

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Acquisition Opportunities

Golf Property Analysts is currently marketing the following golf properties for acquisition:

- **Upscale Private Club** at New Jersey Shore location with excellent golf and clubhouse facilities and residential development opportunity. A premiere property in a premiere location with excellent cash flow history.
- **Upscale Daily Fee** facility in Western NY is an 18 hole daily fee golf course facility with extensive banquet facilities and a restaurant.
- **Golf Course Development Site** in Cecil County, MD is a 360 acre tract (nursery site) approved for development of a 27 hole golf course facility.

Please call **Larry Hirsh** at 800-775-2669 for information on any of these opportunities.

REITS and UPREITS: A Legal Analysis.

by
Charles C. Zall, Esq. and F. Michael Wysocki, Esquire*

Last issue, NewsLinks presented an in-depth discussion, or the "ABC's" of REITSs. This issue, we bring to you a legal review of the REIT and UPREIT. The following article has been abbreviated. The complete, unrevised version can be found on our Website at www.golfprop.com

The REIT structure is governed by the Internal Revenue Code, and like most subjects covered by the Code, is extremely complex and difficult to summarize. The REIT law permits the creation of entities that can be owned by a number of persons, and eliminates the "double taxation" incident to the ownership of real estate by corporations. The Law also allows entities to own and operate numerous properties and preserves certain tax benefits normally associated with partnerships, but does not subject the entities to the cumbersome management and tax reporting restraints that make partnerships undesirable public entities.

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In order to alleviate many problems associated with the tax consequences of a traditional REITS disposition of assets the "Umbrella Partnership REIT", or "UPREIT" was created in the early 1990's. According to NAREIT, since 1992 more than 75% of newly created REITs have adopted the UPREIT structure.

In a typical UPREIT structure a limited partnership is formed, usually called the "Operating Partnership," in which the general partner is the REIT. The partners of one or more existing partnerships will contribute either their partnership interests or the real estate owned by their partnership(s) to the Operating Partnership in exchange for interests in the Operating Partnership. Thus, the Operating Partnership is the owner of the real estate, and the limited partners of the Operating Partnership are the former partners of the partnerships that contributed the property to the Operating Partnership. In all other respects, an UPREIT is the same as any other REIT, i.e., with the same management characteristics and tax requirements. The major structural difference is that rather than owning properties directly, the REIT's ownership and control of the properties is indirect through its control of the Operating Partnership.

The principal benefit of the UPREIT, particularly to persons who may be interested in selling real estate to a REIT, is that the UPREIT structure enables a seller willing to accept partnership units in the Operating Partnership to defer federal income taxes which would otherwise be payable upon the sale. The Operating Partnership units are typically convertible on a one-for-one basis into publicly tradable REIT shares, and any tax due from the gain on the sale is deferred until such time as the seller elects to convert Operating Partnership Units into REIT shares. It is customary to negotiate for the right to have the REIT shares, issued upon conversion, registered for public resale so that when the seller elects to convert into REIT shares, he can sell the REIT shares in the public market and realize the cash necessary to pay the tax.

Naturally, there are some risks involved for the seller, most particularly the market risk regarding the value of the REIT shares. Since the Operating Partnership units are exchangeable for REIT shares, a reduction in the value of the REIT shares will trigger a corresponding reduction in the value of the Operating Partnership units. While certain protections can be negotiated, it may not be possible to completely eliminate the market risk. On the other hand, the ability to defer the recognition of gain and the related tax liability may be attractive, particularly to those fortunate enough not to require cash and those who wish to pass the proceeds of the real estate formerly owned by will to their heirs at a "stepped up" basis. If an individual holds Operating Partnership units up to his death, his beneficiaries will take the units at their then current value for tax purposes, and have the same ability to convert the units into REIT shares. Thus, the entire gain on the sale to the Operating Partnership would be avoided, and the beneficiary would pay tax merely on any gain realized after the death of the seller.

Golf course owners can participate in the benefits of an UPREIT transaction by contributing their appreciated partnership interests or properties in return for Operating Partnership units in an exiting golf course UPREIT or a new golf course UPREIT in which they are among the founding principals. As a result, significant tax liability would be deferred. Moreover, the contributing owners will diversify their portfolios by holding interests in the Operating Partnership's many golf courses while being freed of the burden of golf course management and operation. Estate planning benefits may also be available through the passage at death of Operating Partnership units at a "stepped up" basis to the heirs of contributing owners. While the benefits may be great, the contributing owner cannot ignore the issues and risks that accompany all UPREIT transactions.

Contributing partnership interests or property to a REIT or an UPREIT in exchange for REIT shares or Operating Partnership units can require complicated and sophisticated analysis of many aspects of the transaction and should only be undertaken with the advice of competent advisors. Nothing contained herein should be construed as economic, tax or legal advice.

This article was prepared by Charles C. Zall, Esquire and F. Michael Wysocki, Esquire, partners in the law firm of Saul, Ewing, Remick and Saul LLP, Philadelphia, Pennsylvania. Messrs. Zall and Wysocki are members of Saul Ewing's Business Department and Real Estate Department, respectively, and their work regularly involves REIT and UPREIT transactions.

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Why Bite the Bullet?

Some of the benefits that result from of a Comprehensive Remodeling Approach Include:

- Design Continuity: A comprehensive approach ensures that the entire Remodeling Master Plan is implemented simultaneously, under the direction of a single architect and with a consistent design style. On the other hand, phased remodeling, often results in the involvement of several architects and committee chairpersons, each imposing their own opinions and preferences regarding the implementation of, or deviation from, the originally developed Remodeling Master Plan.
- Less Inconvenience of Golfers: By closing the course and implementing a comprehensive remodeling program, golfers are not confronted with the annual disruptions and inconveniences associated with implementing a phased remodeling program. Such as, continuous implementation of temporary tees, greens, drop areas and ground under repair zones, noise and dust from construction equipment, unsightly staging areas and the loss of available parking.
- Selection Of A Qualified Contractor: Given the current golf "boom" and the number of new, 18 hole construction projects available to pursue, top quality contractors are often reluctant to become involved in smaller scale remodeling projects that, in most cases, offer less profit potential. Conversely, a comprehensive remodeling project, essentially the equal of constructing a new eighteen hole course, is quite appealing. The comprehensive approach encourages competitive bidding, amongst several qualified contractors, and thus an overall cost savings for the scope of work to eventually be completed.
- Consistency of Play: A comprehensive remodeling approach ensures the use of identical construction materials for the development of greens, tees and sand bunkers. This typically results in more consistent playing conditions. Greens receive and hold shots in the same way and roll at the same speed. Bunker sand tends to be more consistent as well.
- Eliminates Destruction Of Previous Work: Despite the best planning efforts, phasing of a Remodeling Master Plan can result in the partial, or complete, destruction of a prior year's work. For example, new turf and previously installed cart paths or irrigation components can be damaged while hauling

Considering All Options

These examples represent only a portion of the benefits associated with employing a comprehensive remodeling approach. It is important that a facility complete all desired improvements in a manner that is timely, cost-effective and otherwise appropriate for its method of operation. When possible, the concept of closing the facility and implementing a Comprehensive Remodeling Master Plan should be given strong consideration.

Gregory B. Muirhead is a golf course architect associated with the firm of Rees Jones, Inc. Since joining the firm in 1984, Mr. Muirhead has been involved in projects throughout the United States both for new construction and remodeling existing courses.

Web Site Review

www.golfdesign.org

The home page for the **American Society of Golf Course Architects (ASGCA)** is an excellent resource. As one would imagine, the site contains a directory of members of the ASGCA, as well as a history and description of the organization.

A number of articles of interest written by the members on a wide variety of topics can be found including the article found in this issue of NewsLinks by Greg Muirhead. The Developers Handbook can be found online for those seeking direction or answers to typical problems like "how to select an architect" or "redesigning your course" or "tips for municipalities."

The site also features a cyber bookstore including many books on the subject of golf course design. The site contains an environmental section that addresses a wide variety of environmental issues and relates them to the development of golf courses.

The ASGCA web site is designed and run by communication professionals and it looks like it. Check it out and I'm sure you'll find it a valuable resource if your planning a new course or renovations to an existing facility.

Linking Up By Larry Hirsh

Recently, the question was posed to me; why do golf course deals "fall apart?" Since golf properties are businesses that typically contain large pieces of real estate, one might imagine the typical reasons for deal failures are the same as other real estate deals. This is partially true, but golf courses have their own qualities that can result in discrepancies between buyer and seller large enough to kill a deal.

Several categories of "deal killers." exist including, but not limited to, the following:

- **Physical Issues**
- **Legal Issues**
- **Economic Issues**
- **Market Issues**

After reviewing my own brokerage and appraisal/consulting files and talking with dealmakers and analysts from some of the nation's leading golf course management and acquisition firms, I have highlighted those thought to be the most problematic in the field.

Physical Issues

The lifeblood of any golf course is water. In some areas of the country water for irrigation is a precious commodity and availability, not price, is often the primary issue of concern. A prospective purchaser will need to know the source and price of water for the property.

Environmental problems are often a great unknown. Not only are they usually undetectable by visual observation, but the cost to remedy can often be prohibitive with no alternative solution. Environmental problems can include groundwater contamination from pesticides, petroleum or chemicals; stream contamination from runoff; animal problems or endangered species and many more.

Finally, unknown deferred maintenance, such as deficient mechanical systems, irrigation problems, equipment problems, turf conditions or diseases can be significant enough to split a buyer and seller to the point of no return. Of course, different perceptions of visible items of deferred maintenance, such as worn cart paths, parking lots, roofs, HVAC systems, etc. can also add up to the point of separating buyer and seller.

Legal Issues

Survey issues, such as easements and encroachments often create confusion over what is actually being purchased/sold. We've been involved in properties where tees and greens were actually located on various residential lots throughout the surrounding development. One can only imagine the mess this created.

As with any real estate transaction, clear title is a necessity for a smooth conveyance. And lastly, the most prominent golf course specific legal issue is contingent liabilities, generally member initiation deposits or member's rights.

Economic Issues

Economic issues can be present or future, real or perceived. For instance, we are involved in a deal right now where the buyer feels that the assessment and real estate taxes will nearly double as a result of a pending reassessment to take place in 2000. With no property specific legal protection in place to prevent such an increase (except a jurisdiction-wide maximum 15% tax revenue increase), the buyer is proposing an escrow for future real estate tax increases. Needless to say, the seller is less than excited about this. Stay tuned for results

Inventory, such as food & beverage, pro shop merchandise and other saleable items must be estimated accurately (and left in place) to avoid conflicts. It is not uncommon for sellers to simply take remaining goods after negotiating them into the sale price. Conversely, if a property is to be repositioned or renamed then much inventory may be valueless to the new owner. Conflicts over inventory often cause conflicts that can kill deals.

Market Issues

A critical element in any deal is the buyer's understanding of the marketplace. While most sophisticated buyers exercise their own "due diligence" in researching and analyzing the market, often a market study, feasibility analysis or appraisal, completed by an independent consultant, provides the first view of the market Moreover. an artificially inflated appraisal or overly aggressive assumptions of future growth, and a subsequent unrealistic asking price can scare off many buyers; consequently, a major hindering factor in transactions is the egos of the parties involved. As in any human interaction, if both sides have an insatiable desire to "win" all the time, little will get done that can be solved by compromise.

In our brokerage practice, I've seen firsthand where each of these issues has killed or had the potential to kill deals. As an appraiser/consultant, I also see where these issues ultimately affect value and sale prices. As a seller, I would recommend trying to resolve many of these issues before negotiations begin to reduce your risk to being caught "with your pants down." As a buyer, look for any of these issues to strengthen your bargaining position.

THE PRACTICE TEE

- **Wyncote Golf Club** has retained GPA to provide a market value appraisal for the facility, located in **Oxford, PA.**
- **Sunnybreeze Palms Golf Club** in **Arcadia, FL** recently retained GPA for advisory services to enhance operations.
- **CCG, BlackAcre Capital** recently retained GPA to provide a market analysis for the **Jones Creek Golf Course in Augusta, GA.**
- **The Massachusetts Golf Association** recently retained GPA to provide a feasibility analysis for its proposed facility in **Ashland, MA**.
- **The United States Golf Association (USGA)** recently retained GPA to provide a feasibility analysis for their potential involvement in the **Virginia State Golf Association** Headquarters facility, proposed for the **Richmond,** VA area.
- The owners of **Bulle Rock Golf Club** in **Aberdeen, MD** recently retained GPA to provide market value appraisal services in connection with the proposed expansion of their facilities.
- **Berwind Natural Resources** recently retained GPA to provide a feasibility analysis in connection with the development of a golf course and residential community in **Johnstown, PA**.
- **Wilmington Trust Company** recently retained GPA to provide a market value appraisal of the proposed **Mountain Branch Golf Course** in **Joppa, MD.**

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