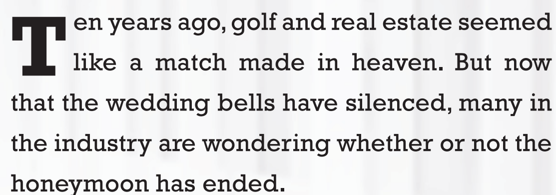
Despite a real estate slowdown, course owners and operators like Barton Tuck have outlined blueprints for continued growth, albeit at a more deliberate pace than that of recent vintage.

On the Rocks

After more than a decade of bliss, is the marriage of golf and real estate heading down a bumpy road?

By Ray Tennenbaum



Ten years ago, golf and real estate seemed like a match made in heaven. But now that the wedding bells have silenced, many in the industry are wondering whether or not the honeymoon has ended.

If nothing else, the relationship between golf and real estate is decidedly more complicated than it was a decade ago. What's more, if the last few years of golf's flattening growth and retention rates weren't bad enough news for the industry, the residential real estate bubble burst this spring. With lenders' purse strings tightening as the golf industry struggles to recover from course overbuilding during the 1990s, the tough times may be far from over.

For proof of golf and real estate's current rocky relationship, you need look no further than your daily paper. Stories of courses around the country being sold or foreclosed appear almost daily, and more often than not, the article reads the same: Local golf operator sells his course to a developer who plans to convert the land into housing complexes or commercial real estate developments. Truth is, even a "good" real estate market is sometimes bad for golf. After all, who would argue with an operator who opts to sell his course because he's located in an area where rising property values offer more profitable uses for a 175-acre piece of land than running a golf course? But given the need to bring new players into the game, the consequences seem particularly painful for the industry when the displaced golf course is the type of beginner or lower-fee facility that often serves as a training ground for younger or less-affluent players.

"It tends to be the older courses and the more affordable courses (that get sold)—what a friend of mine calls the 'bunny slopes,'" says Jim Koppenhaver, president and founder of Pellucid Corporation, an Illinois-based consultancy for the golf industry.

To Koppenhaver and many observers, the erosion of lower-end golf courses is part of a lamentable pattern that began with the golf course building boom of the 1990s, when developers built upscale daily fee courses at a pace that gave little thought to long-term impact. This, in turn, has led to what

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Most observers believe housing developments will remain integral components of new course projects, but aren't likely to be the only amenity.

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Koppenhaver deems "a vicious cycle," one in which the newer supply of premium daily fee facilities gets passed down from owner to owner.

"A guy builds a course for $7.5 million, and he needs to get a $75 green fee to keep it open," Koppenhaver explains. "He can't get that, so he sells it to somebody for $6 million. Now, they try to operate it, and they need a $60 green fee to do that but they can't run it there. So, they sell it a third time for $5 million, and finally it can run as a $50 green fee course."

If only that were the end of the story. In fact, it's just the beginning of the downward spiral for that operator, as well as others in the area. According to Koppenhaver, that owner's attempts to survive often destroys the local pricing structure because he has to engage in widespread discounting to generate rounds and revenue, a practice that devalues the entire market.

"Meanwhile, that price pressure keeps beating on everybody else, who formerly were successful operators in the market, but now they're having to price-compete," Koppenhaver adds. "But, unfortunately, nobody wants to take back that $7.5 million, two-year-old golf course, and it doesn't get plowed under—it just continues to reincarnate itself in the marketplace. It's a very painful process."

To be fair, all is not lost in the union of real estate and golf. Barton Tuck, a veteran golf course and real estate developer based in the Carolinas, believes the industry is poised for a rebound. "A lot of people think we're at the bottom of the trough, and I can't disagree with 'em," says Tuck, who also owns a handful of daily fee courses. "Last year, our business was up about 8 percent in rounds and about 15 percent in revenue, so we had a pretty good year last year."

Yet even Tuck's optimism is somewhat tempered by the vagaries of the current business climate. For instance, Tuck points to two daily fee courses near Dulles (Virginia), which are on pace to do a combined total of between 77,000 and 79,000 rounds this year—a rate that Tuck says "has been pretty steady for a while." What's changed, however, is the price and, by extension, the club's profits.

"In 1999, we were getting $90 a round; today, we're averaging $60 a round," Tuck says. "That affects borrowing because the banks lend on an income stream, and when you're playing 80,000 rounds and you're getting $30 a round less, that's $2.4 million. Theoretically, those courses are making less money and worth less than what they once were."

DISLOCATION, DISLOCATION, DISLOCATION

In some areas of the country, development of single-family home subdivisions featuring centerpiece golf courses has slowed to a crawl—or simply stopped. Meanwhile, many struggling courses in sold-out developments are changing hands, or even facing the prospect of closure. In extreme cases, operators of these types of facilities have approached (or are considering approaching) local

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governments to purchase the course in what can be viewed as, in effect, a bailout. This phenomenon illustrates a potential return of what Koppenhaver refers to as the "charter" of municipalities: providing affordable golf.

If nothing else, regional slowdowns are helping to govern course construction as a whole. Some builders say their own involvement in course construction is limited, but it's pretty clear that real estate development has driven the building of golf courses in recent years.

"It has certainly been the trend," observes Jim Mendelson, managing director of golf lending and new product development for GE Commercial Finance Real Estate. "The vast majority of golf courses that have been built over the last four to five years have been part of single-family home subdivisions or resort communities. There are very few standalone golf courses being built these days that aren't part of another development."

Even still, the numbers haven't always added up. Mendelson, who lends investment capital to companies that often purchase these courses once build-out is complete, contends that course profitability is rarely part of the original developer's master plan.

"Many (single-family home developers) build a golf course as an amenity to sell homes, and they justify the cost of the golf course because they get a premium for those lots that are on the course," Mendelson says. "Or, they simply get a more rapid sell-out because the home is part of a 'name designer' golf course, part of a golf course community. I don't want to say they don't care about the economics of the course, but I think it's a secondary motivation for building the course."

Understandably, there are inherent deficiencies with an operating plan that, shall we say, is formulated with expectations to lose money (or at least isn't concerned with making it). For instance, suppose a real estate developer builds a course for $10 million, and then sells the facility to an operator for $5 million after the community has reached build-out. The buyer may think he got a good deal because, in essence, he purchased it for half of the original price. But the devil is often in the details—or between the lines.

"Two things happened," Koppenhaver says. "No. 1, the developer sold $25 million worth of lot premiums, so his $5 million loss on the golf course

BURSTING THE HOUSING BUBBLE MYTH

EVERYONE HAS HEARD THE RECENT TALK OF A HOUSING BUBBLE. BUT, IF YOU LOOK AT THE CURRENT CONDITIONS pragmatically, you'll see that five of the seven elements that drove the hot market in recent years are still in place. What's more, the absence of one of the elements—an extremely volatile stock market—is actually a good thing. Given this context, let's evaluate the conditions that created the hot market:

- Interest rates are still the lowest, on average, that they have been in 50 years.
- Hordes of baby boomers are still moving through the marketplace, with money and a desire to have more and better of everything.
- Supply and demand will always be present, just at different levels across various markets. Temporarily, there are markets where, because of recent investor and "flipper" sales, current inventory is high. But demand will continue.
- The stock market is no longer as volatile as it was during the hot market, and investors and flippers are on their way out. Investors, for a time, seemed to be very good for the housing market. They created extra demand, which allowed the real estate industry to increase supply and raise prices. But the demand was artificial, and the houses that investors purchased ultimately became competing inventory. Eventually, the supply of new homes outpaced real demand, and that's part of what has caused the housing market to cool.

Given this dynamic, many investors are now desperate to liquidate their "inventory," and are willing to sell homes for any price that's greater than what they paid months or even a few years ago. This devalues the new homes that builders are trying to sell at today's prices, especially when those homes are in the same communities where investors have inventory. As soon as investors' remaining inventory is sold, the market will begin to stabilize. And, if the stock market remains stable, consumer confidence will increase.

- Immigration to the United States is still on the rise and will only continue to increase, and home buying is a priority for immigrants. A University of North Carolina-Chapel Hill study estimates that 80 percent of all first-time homebuyers in 2010 will be immigrants.
- E-mail, online databases, Blackberries, remote desktop access and other technical conveniences still allow people the freedom to live far away from work. Newer devices and capabilities continue to make it easier to work away from the office, and more people are working from home. So, this trend will continue.
- The press continues to sensationalize things—and always will. Now, instead of raving about a hot market, the media is touting a cooling market, which is contributing to the slowdown.

In reality, there is no housing bubble. Most markets are not bad—they're simply returning to normal after a long period of what former Federal Reserve Chairman Alan Greenspan called "irrational exuberance," which created the perception that the thing to do was buy a new house (or two or three or more).

By Bob Schultz, MIRM, CSP. Shultz is a new home sales and management expert, and is the author of two best-selling books, "The Official Handbook for New Home Salespeople" and "Smart Selling Techniques."

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wasn't really that big of a deal because he got 25 (million) in his pocket. He's already ahead 20 (million), and he gets to move on to the next piece of dirt."

The challenge, of course, is for the new owner to operate this high-end golf facility profitably in an area that, most likely, can't support the premiums needed to maintain the course. "So, the guy who bought it at 50 cents on the dollar who thought he got a good deal realizes within a year or two that he can't operate it profitably at $5 million dollars," Koppenhaver adds.

Granted, just how dire the golf-real estate relationship currently is depends on whom you ask—or, perhaps more importantly, where you ask. Take southeast Florida, where thousands of empty condominiums and scores of single-family homes have flooded the market. The untrained eye could easily draw bleak conclusions from a market where absorption seems to have disappeared and where it's taking months for developers to sell out their projects.

But for observers like Jerry Sager, president and CEO of First National of America, these tales of woe are often self-inflicted. The blame, he contends, rests squarely at the feet of lenders.

"I think many times lenders become so excited about this or that project that they lose sight of what they need to stay focused on as a lender and they don't do their homework," Sager says. "Therefore, they have transactions that aren't so good. There are cycles in residential real estate; it's simple Keynesian economics: There's supply, and there's demand."

On the other hand, there are places like Texas, where the real estate picture looks particularly distressed at first blush. Here, Sager says there are properties that First National has underwritten which "have exceeded their projections, up to and including today."

So, in a nutshell, is the golf real estate market on the skid? Yes. And no.

"I guess—if you look across the continental United States—yeah, it's probably off a couple of percentiles and, yeah, absorptions are down," Sager admits. "But if you did your homework as a lender and you have the right developer, guess what? You have a really good loan and a really good opportunity for everyone to make money.

"But if you don't do your homework and you make bad decisions, then you can brush off your bad decisions by saying, 'The real estate market is in the crapper and that's the problem,'" Sager adds. "It's not the fact that we as a banking group made a bad decision, it's that the entire real estate world is bad. Honestly, that's not the case."

Meanwhile, Henry DeLozier, vice president of golf operations for Pulte Homes, takes an analytical view of the real estate marketplace. "We've been hearing for five years that the bubble was about to burst, and all it did was continue to grow and grow and grow. It has now burst, and there's obviously a recalibration within the market. But that's also part of a healthy business cycle."

From this perceived negative, DeLozier extracts a positive. "The benefit is that there's a winnowing process, where folks who were attracted to golf—or to residential development with golf—have vacated the market, and the people and the companies that are left are those who consider it to be one of their primary businesses."

In other words, these developers—unlike the "turn and burn" mentality of some builders in recent past—are in the golf business and strive to make a profit at it. What's more, DeLozier says consumers "have become extremely aware that there are good bargains to be found, so there's now a new growth in interest, which will eventually become

Real estate slowdowns aside, many homebuyers still aspire to own a house on a golf course.

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a growth of demand. And that, too, is a healthy part of the cycle."

As for the overall "sky is falling" mantra that has seeped into the market? Here, DeLozier takes a dry perspective on some of the frenzy. "I guess the other observation I would make for the benefit of golf course owners is that if I'm a golf course buyer, it's kind of in my business interest to cause a sense of panic in the marketplace. Golf course owners need to be savvy enough to understand the influences on their business."

IS GREEN STILL GOOD?

So, what does the future hold for golf courses as a real estate amenity? While the course may still be the centerpiece of the community, most everyone agrees that the trend is toward golf as one of several options, rather than as the only offering.

"I think that the baby boomers, who are getting ready to retire, are going to be different from the last generation that retired, who played golf five days a week or even seven days a week and lived in Florida or Arizona," says Dave Richey, vice president of Toll Brothers' golf division. "I think the people that will be retiring for the next 10 to 15 years are going to have golf as one of the many things they do. It may not be the only thing they do."

In response, Toll Brothers and other developers are equipping their clubs and communities with such non-golf amenities as fitness centers and spas. "All the good clubs that I see are not taking that lightly," Richey says. "You know, you spend $9 or $10 million building a golf course, then you build these people a 1,000- or 2,000-square-foot fitness facility, and you want a thousand people to jam into it—it won't work. You've got to spend a little bit more."

Richey expects operators and developers—at least those who want to give buyers what they truly want—will be "spending a little bit more" on such offerings as indoor and outdoor pools, outdoor exercise lawns for yoga, small cafes and other "lifestyle" amenities.

While amenity packages are evolving, one thing that hasn't changed is the perceived enhancement that a home on the fairway makes to a home's value. Quite simply, golf course living continues to command a premium.

"It varies considerably by market, but golf-related residential property is quite popular," says DeLozier, noting that golf lots are typically valued at 9 percent above the base value of standard lots in a golf community. "People like the open space, the fresh air and the fulfillment value that comes with owning a home on a golf course. A lot of people have simply aspired for years to own a home on a golf course."

Aspirations aside, some observers predict a re-emergence of the classic model of the equity club—perhaps one that anchors a residential development—as the industry approaches the end (or beginning, depending on your perspective) of a real estate cycle that has witnessed the struggle of upscale daily fee facilities. If nothing else, chances are developers will be more discerning when building courses to sell real estate with little regard to the golf product.

"If you sell the golf course, it's almost like you're selling a heart," says Tuck, who is currently devoting his efforts to two carefully plotted North Carolina projects centered around Tom Fazio designs: Forest Creek Golf Club in Southern Pines and Bright's Creek Golf Club near Hendersonville. "You better make sure you're selling it to someone that knows what they're doing. If they run that golf course into the ground, you're going to run your subdivision into the ground, too.

"It's a dangerous thing to sell your heart to somebody."

Ray Tennenbaum is a New York-based freelance writer.

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