With commercial real estate confidences up, is golf close behind?

BY STEVE EKOVICH

The golf industry tends to look at golf through a very small window in the clubhouse. We tend to think what is happening to us is unique and that we are the only ones that have to deal with the type of issues we are faced with. That could not be further from the truth.

Most people in golf become blinded by their passion for golf and forget it is an investment vehicle. As we know it today, golf is not unlike other investment vehicles that have the same characteristics as a hotel, apartment, office or industrial building. It has a revenue stream, expenses that service and help create that revenue stream, in many cases debt service and NOI/EBITDA. Consequently, it is in competition with the other investment classes for investment dollars.

So is golf behind the wave or in front of the wave? Non-core real estate like golf, self-storage and hotels tend to lag behind core commercial assets. They tend to go into the recession later and come out later.

Apartments, office and retail went into the financial meltdown long before golf, so as they emerge today we may not be far behind. Before we look at golf value, we need to look at other asset classes. The fourth quarter National Real Estate Investor Magazine/Marcus & Millichap Investor Sentiment Index showed that despite economic and political headwinds in the summer and fall of 2011, Investor sentiment remained at an all-time high for the last four years. The latest NREI/Marcus & Millichap Investor Sentiment survey shows only a slight decline in investor sentiment from the height of 164 that was recorded in the second quarter of 2011. It is important to note the current investor sentiment matches the 142 recorded in the fourth quarter of 2010, which at the time represented the highest level the index had achieved since the survey began in 2004.

COMMENTARY

Investors have remained relatively steadfast despite being bombarded by a wave of macroeconomic and political troubles, including the ongoing debt crisis in Europe, the political logjam in Washington and the downgrade of the U.S. credit rating.

Despite the Dow Jones Industrials hitting 13,000 for the first time since 2008, 73 percent of respondents agree that commercial real estate offers favorable returns relative to other investment classes.

In addition, only 8 percent say it would be better to invest in the stock market compared to 71 percent who do not agree with that assessment. Apartments are currently the hot investment class and are selling at pre-recession yields. Every core asset class and some non-core classes are seeing tremendous buyer activity so far this year.

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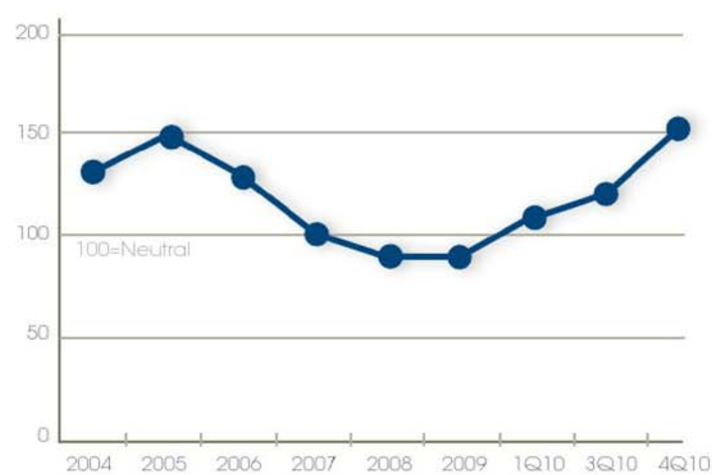

So what about golf?

We recently completed a study for Bloomberg News. The research indicates that the median price of a golf asset through 2010 was almost half of what it was in 2006 (See chart on Page 12). However, in 2011 the median sale price went up. The caveat is that the data was not complete and full sales reporting is always six months behind, so the increase in the median could be an aberration and prices could go down further.

If you look at the average price (the mean average), the mean is down in 2011 (again we don't have final data), but the percentage was only 2.5 percent, which tends to indicate we may have leveled off and are at or near the bottom.

By drawing some conclusions from both the median and the mean average, one would say the turnaround has happened, or at the very least we are at the bottom and the turnaround is right around the corner. It is true there are still a lot of foreclosures to come to the market, but it is also true in the last two to three years there have been a lot of foreclosure sales.

When you break down what drives golf values, you see there are only three real drivers of value: revenue/EBITDA, financing and investor demand. So while we surely haven't seen revenue and EBITDA go up, we know financing wasn't really available. So was it more money chasing properties that could have caused the values to go up?

Sam Zell, the real estate billionaire, said interest rates go up when employment goes up.

"The reality is that increased economic activity combined with increased interest rates is basically bullish for real estate."

Zell is telling us in golf, that as the economy goes, as employment gets better and as properties get leased up, there is more discretionary income and, consequently, golf rounds and revenue will increase. In addition to a strengthening economy, there are a number of things that we believe will help golf values catch the wave from a pure investment stand point as well as from an operation standpoint.

	# of Sales	Average Price	% Change	Median Price	% Change
2006	91	$7,326,883	n/a	$4,500,000	n/a
2007	93	$6,778,325	-7.49%	$3,500,000	-22.22%
2008	101	$5,757,172	-15.06%	$3,300,000	-5.71%
2009	87	$5,089,742	-11.59%	$2,900,000	-12.12%
2010	98	$4,963,674	-2.48%	$2,450,000	-15.52%
2011	80	$4,842,956	-2.43%	$3,000,000	22.45%
TOTAL	**550**	**$5,809,616**	**-33.90%**		

Investment factors: why these factors will help increase golf values

Debt: The ability to finance creates a higher rate of return called cash on cash and that will stimulate golf asset values. We have sold golf courses for premium prices because the seller would carry back financing. This allows the buyer to put less of their equity into one investment and raises the return on equity.

Investor demand: The more investors chase after apartments and offices and retail, the more the margins are squeezed and the more the cap rates in golf will attract opportunity funds, private equity, private investors and others.

Buying at below replacement cost: When you buy below replacement costs, developers can't afford to build, so buyers have barriers to entry. When building a new course costs more to build (a moderate cost would be $6 million), it attracts investors to acquire existing courses, driving values up.

Interest rates are low: When interest rates are low, you can afford to pay more for an asset because the hurdle rates (rate of return investors need to receive) are lower. It is all about the cost of capital.

Buying at the bottom of the market: No one can predict the top or bottom, but we do know when we are around the bottom. What you don't want to do is buy at the top the market or on the way down. The research suggests that we may be establishing a new bottom. Many of the sophisticated buyers have been trying to acquire assets at one times gross revenue or below and have made a few purchases. However, they are now being beat out on a more consistent basis by more competition for deals.

Paradigm shift: The corner drug store is gone and put out of business by CVS and Walgreens. The corner hardware store is a dinosaur, replaced by Home Depot and Lowes. The proliferation of equity clubs, with guys that treat the golf business like a boys club, is also a dinosaur. (There will always be top end equity clubs that will not be in financial trouble, but they are the exceptions.) So too will be gone for the most part the mom and pop owner who is over leveraged, undercapitalized, using yesterday management techniques with deteriorating properties. Eighty percent of golf is controlled by private individuals, not owners whose core competencies are in golf. The companies with multiple assets in an area, with well-capitalized owners with a plan and change in business strategy with professional management will survive. The rest will sell to multiple course owners with course competencies in golf or shut their doors.

Closing of courses: For the next four to eight years, we will continually see net losses in the number of courses, and that will be good for all golf owners and operators as functionally obsolete, poorly located and rundown courses will close and the land will be recycled. All of these factors above will combine to raise golf values. Is it today, tomorrow or has it already come? Only time will tell, but the antecedents of a rise in value are in place.

So is golf catching the wave? You decide. We have presented the evidence. However, we predicted in our Semi Annual Golf Investment Report, released in January, this would be a turnaround year for most golf courses in revenue and rounds. Some people said we were crazy. Only time will tell, but we are waxing our surfboards. ●

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