

The Fine Balance in Golf Lending

Owner-operator funding provides an option when private-equity clubs face hard times

By Peter J. Nanula

Until 2008, the golf-lending market had remarkably been stable for the previous 15 years, with two reliable lending sources for mortgage originators and their golf-club clients. One source was local banks, which provided refinancing or capital-improvement financing mainly for private country clubs, based on personal guarantees or a strong base of affluent members who could assess themselves to make debt-service payments. The other source was national golf-specialty lenders that made acquisition loans to buyers of golf properties with plans to improve the financial performance of those properties.

The economic stability in the golf-lending world was not to last, however, and many clubs soon found themselves balancing on a knife-edge.

The repercussions of the economy's crash in 2008 were manifold, but they had a specific effect on the golf industry. The second category, golf-specialty lenders, had largely gone away, resulting in a major decline in funding by previously golf-oriented institutions like Textron Financial Corp., Capmark Financial Group (formerly GMAC Commercial Mortgage) and GE Capital.

Meanwhile, the ability of private-equity or member-owned golf and country clubs to secure financing through local banks also had been markedly curtailed because these clubs usually did not have historical financials that would support a loan or a strong personal guarantee, meaning an acquisition loan was unlikely to be made.

Decline of liquidity

These factors meant the departure of some \$2 billion in liquidity from the golf-lending market. This also meant that when existing golf-specific five-year term loans matured,



banks were often not available for takeout financing. This led many clubs to sell or seek new investors to pay off their debt.

This is not an isolated issue within the U.S. golf market. About 2,500 of the country's nearly 4,000 private golf or country clubs operate according to an equity or member-owned model. Some sources estimate that as much as 50 percent of those clubs face problematic debt levels. These figures may come as a shock to some lenders. Many local banks holding

Continued >>



Peter J. Nanula is chairman of Concert Golf Partners, an owner, operator and all-cash buyer of private golf and country clubs. Concert Golf specializes in recapitalizing member-owned clubs carrying too much debt, converting them to nonequity status, and maintaining the clubs as fully private. Nanula is the former CEO of Arnold Palmer Golf Management. Reach him at pnanula@concertcapital.com or visit concertgolffpartners.com.

<< Continued

golf-club loans assume they are in good shape because payments are being made on a current basis.

Lenders must understand the underlying financial health of a private club to be able to definitively make that assessment, however. Today's private-club market is in a precarious position. A private-club development boom from 1990 to 2005 resulted in marked oversupply in multiple markets. Competition for members is understandably fierce.

In this environment, even slight member attrition can result in an operating loss at a seemingly stable private club. To cover that operating loss, a club's board of directors often raises dues or assesses the members to cover the shortfall. In today's oversupplied market, however, any increase in dues above market levels results in member attrition. Assessments at a private club, regardless of their relation to market levels, are typically met with 3 percent to 5 percent member attrition.

Marked attrition means there are fewer members to support the club's operations the following year. Before long, the lender can see significant erosion in the loan value. Timing is important. If the club loses members on a net basis for two consecutive years, the bank could see a 50 percent to 75 percent loss of principal. If the bank moves quickly when it recognizes the decline, however, a lower write-down, perhaps 10 percent to 20 percent, will be necessary to exit the loan.

Case study

The Country Club at Woodmore in Mitchellsville, Maryland, is a good example of just how quickly things can go south. This establishment, featuring an Arnold Palmer signature-designed course, received a \$6 million bank loan in 2006 so the member-owned club could rebuild its older clubhouse. The remodel was successful, but then the 2008 financial crisis hit. Some members left the club, and the board assessed the remaining members to cover the debt-service payments, which prompted more members to leave, according to a media report. This is a

pattern that is repeating itself across the private member-owned club sector today.

After several years of discussion about lowering payments, extending maturities and other restructuring strategies, the lending bank decided to sell its Woodmore loan to a dedicated owner-operator of private clubs, which secured it in 28 days, bought the club from the members — converting it to nonequity status — and immediately embarked on a capital-improvement program that resulted in more than 100 new members.

Today, Woodmore is a stable and thriving non-equity private club, no longer member-owned. The bank was satisfied with the quick, discreet closing, not to mention its exit from a long-problematic situation. Had the bank acted when the club's challenges first surfaced instead of waiting several years, however, the 60 percent write-down it took on the loan could have been much smaller.

Owner-operator benefits

Well-capitalized owner-operators are rare, but they are important for originators and lending banks to seek out because they are ideal potential buyers of troubled private golf-club loans. They are equipped to see the club's situation from both sides.

First, they understand the importance of acting quickly. Member-attrition situations can rapidly spin out of control. Enormous amounts of principal and dozens of members can be lost in a matter of weeks. By moving quickly to buy loans, such buyers effectively serve the lender and the newly purchased golf property.

Next, they are discreet. Lack of discretion may become a double-edged sword. The lender has nothing to gain by publicizing its loans gone bad. Similarly, private clubs do not want it known that they are refinancing or experiencing financial challenges — their brands are built on prestige and privilege.

Golf-specific owner-operators also bring something else to the table: Expertise in golf management and operations. Private-equity clubs are traditionally managed by boards that include professionals such as dentists and insurance executives — people who

aren't club-management specialists. In many cases, the civilian leadership of private clubs contributes to their financial instability and poor management. Banks and clubs are best-served when buyers of golf loans can deliver efficient, profit-driven operations post-transaction.

Changes

Today's private-club market is clearly in transition, but not because of an overt failure of the private-equity-club model. Instead, it's because of diversification of club products and categories resulting from a series of economic realities: an oversupply of private clubs, a recession that forced many of them into debt, and the subsequent flight of banks from the sector.

Another development of significance to lenders holding golf loans: Private-club members emerged from the economic downturn with adjusted tastes and expectations.

The old private-club model is hardly facing extinction, however. The most prestigious private golf clubs in America have historically been private-equity clubs, and that is unlikely to change. What is changing is the perceived social status that historically went along with the exercise of voting power and membership exclusivity.

There have always been trade-offs inherent to the private-equity model: Such clubs are obliged to assess members each year for capital improvements, but many shy away from making tough choices about assessments, resulting in improvements that didn't take place and a deteriorating infrastructure.

Before 2008, many private-equity clubs made this model work, despite these challenges. After the recession, with many markets oversupplied, the private-club market experienced something of a perfect storm — and those trade-offs became difficult for many clubs to bear. Over the past three years, many private clubs have gone semiprivate, transitioned to private non-equity status, or given up the ghost and sold, often to eager home developers.

Continued >>

<< Continued

Some private-equity clubs weathered this storm, while others are fighting their way back into the black, retrenching when it comes to the capital expenditures too long deferred. These clubs tend to occupy the top of the market. Others, however, are going the opposite direction, opening their doors to public golfers.

The clubs that choose to remain private but want to get away from the private-equity model and its inherent vulnerabilities are the ones exploring the private nonequity model that golf-specific owner-operators offer. This model is increasingly suited to the current financial climate in the golf industry. Debt and declining membership rolls have made the private nonequity option more attractive, especially when the alternatives are often bleak. This isn't the systemic failure of the private-equity club segment. It is the natural diversification of a segment that has been through the wringer and is coming out the other side.



Some private golf clubs simply won't make it on their own, but many are suitable for the nonequity conversion model, provided a well-capitalized owner-operator is found to purchase the loan and retire the debt. Commercial mortgage originators and the banks holding loans in private-equity golf clubs must understand the current market climate and be ready to act swiftly when a private club starts to lose members and neglect its infrastructure. Cultivating relationships with golf-specific owner-operators who buy troubled loans can take the sting out of the knife-edge that too many private clubs find themselves balanced upon. ■