GBAS
GOLF BUSINESS ADVISORY SERVICES

Back of the Cup

A NEWSLETTER CONCERNING THE BUSINESS OF GOLF

The Challenges of New Golf Development

Over the past ten years near 50 golf courses have been developed and opened around Australia with approximately three quarters of these courses being part of a residential and/or resort development. As at January 2010, 27 of these courses were ranked in the country's top 100. Many of these courses were conceived in strong economic times, with bullish projections for the performance of both the residential and golfing components.

The motivation for this article stems from the publicity the industry has received from the financial struggles and closures (and re-openings) reported by a number of new courses only opened within the past ten years - St Andrews Beach, Kennedy Bay and The Cut in WA as three examples. From where I sit, such publicity doesn't do the industry any good at all. Be it from a funding perspective (bankers remember failures), or from a potential new member perspective at another course with a similar membership structure (news about members getting burned with no recourse travels fast) or from a club perspective, who are possibly considering a merger with a new development, a discussion about "bankability" with potentially already resistant members is a diffcult one to have! Simply put, development failures that make the headlines are not good for the industry.

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The unfortunate reality being experienced at many of the courses built in the past ten years is that there is still a decent degree of financial pain being felt and there could well be more negative news on the 2010 horizon. As we begin a new decade I therefore thought that I would share with you the mistakes made and being made at some of these courses, what has been learned from these developments and what is now required for new golf and residential developments to be financially successful in this market, hoping to keep golf, at least in course development terms, out of the headlines.

Will another 50 courses be built over the next ten year period? At the risk of upsetting our course architects, I think not, but I am sure they, like their US brethren who have also experienced a dramatic slow-down in work, accept that a healthy industry, with good news surrounding new developments is what we'd like to be seeing. If you read on however you can decide for yourself as the challenges in doing so are outlined.

The reason for building – $$$$ from real estate.

"…other than club relocations, it is likely that only residential based golf will be built, not for golf but for the real estate dollars attached....."

As identified above, of the last 50 or so courses built, less than 25% (only 11) of these courses were "golf only." A few of these were due to club relocations, some were club course extensions. Only a handful were genuine, new to market stand alone public access golf courses. The politics of club relocations unfortunately ensures that they take far longer than first envisaged (if at all) meaning that the actual timeline from concept, to proposal, to construction and physical relocation can be a very long one - just ask the Sunshine, Croydon, Waverley and Eastern Golf Clubs.

On the standalone side, there has been one obvious success in this market, that being

Barnbougle Dunes. It too however was far from a certain winner in its early days and was a pure cash investment. I was fortunate to see the original proposal and marketing scheme behind the development and said to the young entrepreneur trying to bring the course to reality at the time, your approach can only be - simply build it and hope they will come (and they thankfully did). It was just not possible to do any type of research work that would support the development as there was nothing in Australia to compare it with. A raging success in remote Tasmania? One would have thought highly unlikely, but in this case, fortune did follow the brave.

The likely reality, given the current climate and some of the struggles reported in the last ten years, other than club relocations, it is likely that only residential based golf will be built, not for golf but for the real estate dollars attached. That said, for these new courses with real estate to have a chance at success, there are a number of hurdles that they will still need to jump.

They are:

- Location and market depth – both project scale and required lot pricing dictate that new golf/real estate projects will need to be accessible to Australia's current major population/employment centres. In order for the necessary market depth for real estate to exist, only certain areas will likely be suitable for development.
- Land size, value and project scale – the amount of land required to undertake a development that yields a feasible project is considerable and therefore the capital commitment required at the project front end is very high. The increasing value of and scarcity of land demands that a unique formula be adopted in order to create a feasible project and one must have a lot of cash to spend.
- The cost of tightening planning laws – tighter laws around planning legislation is resulting in longer, more demanding rezoning timeframes, which therefore require more skilled inputs and greater resource investment at the project front end. These timeframes impact a project's feasibility, particularly if a project becomes politically unpopular.

So what determines feasibility?

Successful golf course development within a real estate community is not only about real estate premiums. There are a number of key variables to consider and it is the interaction of these variables that will determine ultimate feasibility.

The key variables in the residential/golf equation are:

- Size of land - The smaller the piece of land, the higher the average lot premium will need to be as there is less land available to extract the necessary required value from.
- % Useable land - The higher the useable land figure, the higher the average lot premium will need to be as golf land could be used for residential land. (Golf gives up residential profit.)
- Lots per hectare - The lower the average lots per hectare the higher the average lot premium will need to be as there are fewer lots available to extract the necessary value from. Lots per hectare will be influenced by what the market is demanding.
- Golf course size - The size of the golf course will determine the level of average lot premium required, on the basis that the golf land can otherwise be used for residential purposes.
- Exit strategy - In the current market there is very thin demand for golf course assets and sale cannot be guaranteed.

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The golf course construction challenge

But let's assume that the hurdles above can be jumped and the formula above still produces a digestible number. The first or next challenge to be faced is the cost of golf course construction as the cost of modern day golf course construction can be a significant one. From a cashflow perspective it is very intensive in the early phases with little income able to be achieved from a new course until almost full completion.

Data available from one third of the courses opened over the last ten years reveals that the average cost of construction for these projects was around $15 million over an average two year construction period. That said one really good one, suitable for its market, was delivered for less than $5 million, though that number is still a significant one.

Adding to this cost, the planning permission approvals and required timelines can also impact project momentum. For some, full golf course opening has been required before sales of any residential lots can commence or timing of other assets before future stages can be released.

These handcuffs have placed significant strain on cashflows and developer patience with the new golf assets which in the early years have made considerable operating losses, this being the next lot of challenges.

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The Clubhouse Construction Challenge

The first component is the clubhouse and its cost. These buildings have traditionally come at a significant price, averaging over $7 million to construct, with some exceeding $12 million. That said one really good one, very appropriate for its market, was delivered for less than $1 million.

Other than cost to develop, and despite being the obvious focal point for the new "community", the mistakes made and other challenges around new clubhouses have included:

- Traffic flow - the new communities have not provided enough regular demand (or golfers) from within to generate sufficient traffic/revenues flows to cover the fixed operating overheads and staffing requirements.
- The newly built golf clubhouses have been one dimensional, with limited other non golf or community facilities included.
- "Member only" space, if deemed necessary, was too separate and lacked atmosphere.
- The built retail space has been overly generous for the sales generated.
- Food and beverage pricing hasn't encouraged regular visitation.
- Infrequent community events have occurred around the clubhouse facility.
- Cost efficiencies have been difficult to achieve given building layout and the services offered.

"…In some cases membership was restricted to residents only (crazy, particularly when there were few initial residents who were golfers!)……"

The Golf Operations Challenge

The final challenge in the golf development challenge is the financial performance of the golf operations. Over the period discussed I have seen nearly 50% of the profit and loss statements from these courses and there are still significant losses ($500k+ per annum) being experienced by many. Operational losses incurred in the first three to five years of operation have ranged from breakeven to over negative $1.6 million per year! The reasons for these results have included:

- Insufficient membership demand - Many of the courses built in the last ten years were built in markets that already had reasonable levels of supply. It was a case of we (the new courses) are coming whether you like it or not. All this did was fragment the local market and ensure that the new course wouldn't be supported by the existing local club.
- Course was simply too hard to play on a regular basis. We want to score our handicap

if we play well. What chances are you of returning if you are bashed up?

- Poor membership structures - In some cases membership was restricted to residents only (crazy, particularly when there were few initial residents who were golfers!) Others opened up as a private club, not readily accepting interested public play, designed to protect the real estate buyer - but they then quickly complained about golf's performance.
- Initial membership pricing – didn't reflect market, was based on cost to deliver, not perceived value.
- Insufficient, repeatable rounds demand - The public went there once or twice, played it, didn't return frequently enough. At many the number of rounds played actually declined in year two, not increased. The goal should not have been 20,000 golfers twice a year, but 5,000 golfers eight times a year. With a good strategy such an outcome is much more achievable.
- Expense hungry F&B departments with minimal staff efficiencies able to be achieved.
- Course maintenance budgets that didn't reflect the green fee being paid. Playing surfaces should have a direct correlation with green fees.
- High headcounts within Administration with too narrow skillsets.

So what will a new course need to be successful?

Based on what has been seen in the last ten years, the following is a list of what will be required for new golf operations to initially be feasible and sustainable over a longer term:

- Today's reality dictates that any new built course will always be a mixture of members and guests. They will never be fully private so best accept it from the get go.
- An immediate membership base, in excess of 600 members on day one, growing to over 1,000 as soon as possible.
- A course that is fun to play for all level of golfer, not too hard with ball gobbling rough, with few "tricked up" greens.
- Genuine, sustainable rounds demand from the public (not just been there played it once, not going back, see comment above).
- Total annual rounds in excess of 40,000 per year, being a good, balanced mix of member and public and group play.
- An average green fee above $70 (ex carts).
- Decent levels of cart hire.
- Member and community support for day to day food and beverage.
- External food and beverage function demand from day one.
- Operations efficiency through pro shop, F&B and administration.
- A great marketing pitch that resonates loudly with the consumer.
- Course maintenance budgets in line with green fee pricing (no point spending money on maintenance it if is not returning itself through the membership or green fee.)
- Multi skilled management with accounting and marketing ability.
- Minimal debt (minimal interest cost below the EBITDA line).

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The extent to which the above challenges are solved and the above needs met will determine the ultimate success of the development of "new" golf from a development perspective. One might start out by thinking it is the total development return that matters, but, based on what has been seen in the last ten years, the individual performance of the golf asset does and will quickly matter to those paying the bills.

About Golf Business Advisory Services (GBAS)

Jeff Blunden
Managing Director of GBAS

GBAS is an independent advisory company offering dedicated, professional advice to the golf industry and is Australia's leading provider of golf industry advisory services.

Offering unrivalled experience and industry insight, our approach is grounded in research with a belief that data analysis always reveals the insights required to drive your business.

Specialist services offered by GBAS include:

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- Market research
- Asset oversight
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- Asset valuation
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If you have a need in the golf industry GBAS is able to provide you with all of the necessary knowledge and experience required to help ensure you achieve your goals.

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