New Internal Revenue Service rules may not ease management constraints with public agencies

By RICHARD J. THORMAN

Richard Thorman has more than 25 years of golf-related residential and resort experience. His projects have included planning, financing, development, construction, marketing and operational bottom-line responsibility for major golf companies.

Several articles have recently been published which indicate that the new IRS ruling (Revenue Procedure 97-13) will stimulate golf management companies and public agencies to enter long-term agreements on projects financed by tax-exempt municipal bonds. Superficially, the new rules may lead one to the above conclusion. However, real-life experience may demonstrate that the new rules don't help the situation at all. In several recent negotiations between cities and management companies, the companies determined that the new ruling did not create an environment that was more favorable than what existed under the 1986 rules.

Historically, under the 1986 rules, management contracts for golf facilities financed by tax-exempt municipal bonds could not be written for longer than five years. Additionally, the city or agency involved could cancel the contract after the third or fourth years without a financial penalty.

This creates two adverse effects. One, management companies do not want to invest funds and resources and build up the business at a golf course that could have the contract canceled at the end of year three and/or face a municipal bid process at the end of year five. Two, the city might be able to sell the bonds either quicker or at a better rate if the investors knew that the management company was involved for the long term.

Extending the term of contract to fifteen years, as provided by the new rule, might seem to be the answer. Upon close examination though, the rule calls for 95 percent of the fee to be based on a fixed periodic fee and not tied to profits or gross income of the golf course. Therefore, only 5 percent of the fee can be tied to incentives. Cost of living increases are allowed.

Economics 101 says that investment is based on risk vs. reward. The reasons management companies are willing to invest funds and resources in golf projects are based on what they see as an upside reward which accrues due to increases in gross and net profits based on marketing and management skills and the growth of a potential golf market. When the management company is forced to receive 95 percent of the fee on a periodic fixed rate either the city or the management company will be on the losing end.

In order to produce an acceptable return, a 15-year fixed fee, the management company will have to establish a fee which includes the projected acceptable return.

The pitfalls are obvious. If the golf course does not produce up to the hoped-for projections, then the city is paying too much. If the golf course produces more than the projections, then the management company is not rewarded for its efforts. The only management companies that may be happy with the situation created by the new ruling, may be "custodial" in nature.

One approach to creating mutually beneficial longer-term agreements, may be for the city and the management company to look at taxable public bonds plus private funding by the management company. Normally, taxable municipal bonds may cost only 135 to 150 basis points more than the total cost of the tax-exempt bonds and the taxable municipal bonds do not carry the restrictive management "term/fee" provisions required by use of the taxable municipal bonds. Under this "public-private investment" approach, the city would issue the taxable bonds and the management company would invest private funds as a partner. With the management company investing as a partner, the amount of funds borrowed by the city should be substantially less than if the city were to fund the golf course using only tax-exempt bonds. Therefore, the cost to the city should be substantially lower and the management company will have a long-term contract and a major incentive in making the project a success.

Due to the above, cities need to carefully examine the best approach to financing a golf course to achieve the best funding source(s) for each particular situation.

USGC merges

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Duane Marchant, Golf Ventures chairman, president and CEO, will remain a member of the board of directors and assume responsibilities as vice president/ Western region. At Eising, Golf Ventures will change its name to Golf Communities of America Inc., and its corporate headquarters will be relocated to Orlando.

"We're looking at several acquisitions," Stanchina said. "We have our (USGC's) six courses plus three of Golf Ventures and the potential for acquisition. Everyone is going the other way (golf-only facilities), but this is the way for us to go."

Oppenheim will act as a financial advisor for the merged firm and assist the company in obtaining additional capital to fund its growth objectives. The transaction is expected to close in November.

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