IRS gives managers of munis a break on tax-exempt bonds

By PAUL H. JOHNSON

The Internal Revenue Service (IRS) has solved the second-greatest problem facing companies which contract to manage government-owned golf courses that are financed with tax-exempt bonds.

Even the IRS is powerless to deal with inclement weather, however, it has done the next best thing by lengthening significantly the permissible period that management contracts may cover without jeopardizing the federal tax exemption for interest income that investors earn on government-issued bonds used to finance the courses (the governmental borrower typically insists on maintaining the tax exemption qualification because it lowers by as much as a third the interest expense for the project).

Paul Johnson

The new rules are effective for management contracts entered into, modified or extended on or after May 16, 1997. Current contracts may be renegotiated to reflect these more liberal provisions.

The National Golf Foundation estimates that 2,541 of the 15,703 golf courses in the U.S. are owned by governmental units, as well as approximately one in seven of the courses now under construction. Although precise numbers are not available, many are financed through issuance of tax-exempt bonds by the governmental course owner.

Since 1986, management contracts have been severely constrained by the following four requirements:

1) Compensation must be reasonable and cannot be based upon net income.

2) Variable compensation cannot exceed half of the total compensation.

3) The contract term, including renewals, cannot exceed five years.

4) The contract must be cancelable, without cause or financial penalty to the owner, after three years.

These 3- and 5-year provisions have forced management companies and course owners into short-term thinking which necessarily has led to higher fees and inefficiencies occasioned by having to change managers at least every five years.

The new rules will be a boon to owners by fostering greater certainty for longer

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Wall Street taking a serious interest in management & learning center firms

By BUD LEEDOM

On an August day in 1993, an event took place that signaled a new era in the golf real-estate industry. The event merged corporate involvement in golf real estate with Wall Street capital. As the first few shares of National Golf Properties (NGP) crossed the ticker tape on the floor of the New York Stock Exchange, the golf real-estate market came of age.

Today golf real-estate investors have two developing segments within the golf real-estate market to chose from: golf courses and golf practice centers.

Corporate involvement in courses and practice centers has grown in separate and distinct stages. As of Oct. 5, 1996, the National Golf Foundation listed 15,447 existing U.S. courses, with 551 under construction. Within this growing golf course market, corporate consolidators first made their presence known.

American Golf was already an established and successful course owner/operator prior to spinning off its golf course holdings into National Golf Properties in 1993. NGP has grown steadily from 47 courses in 1993 to 115 today. NGP purchases courses that are poorly managed and marketed. Although acquisition deals are increasingly harder to come by, NGP purchased a record 34 courses in 1996, including 20 owned by then competitor, Golf Enterprises. NGP is the largest publicly traded owner of courses and second overall to privately held Club Corp. of America (CCA). CCA owns and operates 240 courses.

While NGP has successfully implemented its acquisition strategy and grabbed the attention of institutional investors and market observers, it is the equally dynamic management side within the business that has emerged more quietly.

Following the acquisition of a golf course, NGP immediately and almost exclusively hands over management responsibilities to its former parent, American Golf, through a triple net lease. This operational side of the course business is where substantial growth has taken place in recent years and where many

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Bud Leedom is publisher of Golf Insight & Investing*, a San Diego-based newsletter which covers the corporate and investment world.*

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If you're a golf course superintendent, then you probably do.

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While effluent water is "safe" for irrigation it still contains a high level of nutrients. Sitting in your irrigation pond this water can quickly explode into an algae farm. If you're pumping unfiltered effluent, imagine having to remove and clean every clogged sprinkler head on the course. Now imagine doing it every month.

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Leslie comment

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distance has gone up — so that in 1987 or '88 the pole position was 210-211 mph, and we had several horrific wrecks.

"So NASCAR's sanctioning agency came back with the restrictor plate. This year the pole position was 189 mph. And it has made the sport better."

In golf it would make the Merions, Pinehurst #2s and Medinahs play the way they were meant to be played for the pros. The lesser hitters among the population — which is 99-plus percent of golfers — would retain the long-distance balls which, after all, only help us regain the yardage lost to ball roll because of today's heavy irrigation.

Now that Nicklaus, Crenshaw, Griffiths and I have weighed in on this subject, perhaps some of the heavy hitters in the industry will come forward and push for the less-juiced Tour ball.

• • •

"The limbo pole is probably as low as it can go." That according to GCSAA Immediate Past President Bruce Williams, speaking about the care of turfgrass on golf courses. He was joining Ben Crenshaw in a press conference prior to Crenshaw's acceptance of the GCSAA's Old Tom Morris Award. Crenshaw agreed with Williams, adding: "Without a doubt, the most important person on the golf course is the person who takes care of it."

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So, you'd like to be a golf course architect? Dana Fry, new partner of Mike Hurdzan (see story page 44), would not dispell any of the aura of the job. Fry determined that since he couldn't make a living on the Tour, he'd find another job in the industry, and circumstances led him into design. "To this day," he said, "I've never had a 'job.' My life is a continuous adventure, from one place to the other."

Tax-exempt bonds

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periods of time, which should lead to more efficiency by reducing manager turnover and fees — and by encouraging managers to make capital expenditures whose value extends beyond the short contract term. The manager benefits from a longer contract term (up to 15 years) and more stable projected compensation. Additionally, the new rules permit a one-time productivity reward which will not disqualify the contract if it provides a stated dollar amount based upon revenue increases or expense reductions (but not both). As an example, the manager may be rewarded upon attaining a desired benchmark, such as a number of rounds played.

Three compensation/term formulas permitted under current law continue to be permissible:

1) At least half of the total compensation is a fixed, periodic sum (a stated dollar amount for a specified period of time) with a maximum 5-year term that is cancelable after three years without penalty or cause.

2) Per-unit compensation (for example, a stated dollar amount for each round played) with a maximum 3-year term that is cancelable after two years.

3) Unlimited variable compensation (based upon a percentage of either revenues or expenses) during the initial start-up period for the facility which cannot exceed two years and must be cancelable after the first year.

The new rules permit two longer periods, but limit their value by requiring a higher percentage of total compensation that must be fixed and periodic:

1) Fifteen years with 95 percent of the total compensation as a periodic, fixed fee.

2) Or 10 years with at least 80 percent as a periodic, fixed fee.

Importantly, neither of the longer terms requires the cancellation-without-penalty clause at the end of the third (or second) year contained in present law. Also, it remains permissible to increase the fixed fee automatically according to a specified, objective, external standard, such as the Consumer Price Index, which is not linked to the output or efficiency of the property.

While current contracts may be renegotiated to reflect these more liberal provisions, the period that the contract has actually been in force must be reflected in determining the maximum remaining term of the contract. For example, a contract that commenced two years ago cannot be extended for more than 13 years. Parties to management contracts now will be able to select whichever of the five compensation formulas that best suits their circumstances.

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