REITs and golf: A happy marriage

By LAURENCE HIRSH

The latest factor contributing to the boom in the golf course industry is the Real Estate Investment Trust (REIT). In order to most accurately measure the REIT's impact on the golf course industry, a little background information is in order.

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A REIT is defined by The National Association of Real Estate Investment Trusts (NAREIT) as "a corporation or business trust that combines the capital of many investors to acquire or provide financing for all forms of real estate." It acts kind of like a mutual fund for real estate. In order to qualify as a REIT under the Internal Revenue Code a corporation or trust must:

- be a corporation, business trust or similar association;
- be managed by a board of directors or trustees;
- have shares that are fully transferable;
- have a minimum of 100 shareholders;
- have no more than 50 percent of the shares held by five or fewer individuals during the last half of each taxable year;
- invest at least 75 percent of the total assets in real estate assets;
- derive at least 75 percent of gross income from rents from real property, or interest on mortgages on real property;
- derive no more than 30 percent of gross income from the sale of real property held for less than four years, securities held for less than one year or certain prohibited transactions;
- pay dividends of at least 95 percent of REIT taxable income.

REITs were created to provide investors with the opportunity to participate in the benefits of ownership of larger-scale commercial real estate or mortgage lending, and receive an enhanced return, because the income is not taxed at the REIT entity level. This means that a diverse range of investors can realize investment opportunities otherwise available only to those with larger resources. This opportunity first became available when President Eisenhower signed the real estate investment trust tax provisions into law in 1960. The basic provisions of this law remain unchanged, although there have been a number of improvements to the law over the past 30 years.

The REIT industry has benefited from tax reform initiatives enacted in the 1980s. These initiatives eliminated the incentive of tax-sheltered real estate vehicles and promoted a return to the fundamentals of capital formation and investment in real estate for income and appreciation. A tax change in 1986 allowed REITs to manage their properties directly, and a 1993 change removes a significant barrier to pension plan investment in REITs.

There are more than 300 REITs operating in the United States today. Their assets total in excess of $61 billion. More than 80 percent of these trade on the national stock exchanges:

- New York Stock Exchange - 147 REITs
- American Stock Exchange - 42 REITs
- NASDAQ National Market System - 12 REITs

In addition, there are dozens of REITs that are not traded on a stock exchange.

The first golf property REIT (National Golf Properties) was formed in 1993 by acquiring much of the assets of American Golf Corporation. Since that time five other major REITs have entered the golf course business or been formed to do the same. These include:

- Golf Trust of America (exclusively golf);
- Patriot American Hospitality (hospitality);
- Starwood Lodging (hospitality);
- Meditrust Corporation (acquired Cobblestone Golf Group);
- Presidio Golf Trust (by Arnold Palmer Golf Management Company).

Performance of the Golf REITs can be measured, but with caution because their history is so short. National Golf Properties (TEE) has risen steadily from

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around $20 per share in December, 1994 to a high of $35 in June, 1997 and has since settled back into the $30-$32 range since February, 1998. Golf Trust (GTA) is the only other exclusively golf REIT with any history and it's only about 15 months old being initially offered at around $21 per share and rising to approximately $32 per share as of May 2, 1998. As of January 12, 1999 National Golf Properties is trading just under $28/share and Golf Trust is trading at 26 3/8.

Presidio Golf Trust never got off the ground, becoming a casualty of the volatile stock market in mid-1998 and Meditrust announced plans to sell Cobblestone in late 1998. Reportedly, there are as many as six finalists in the bidding to acquire Cobblestone in a process which should be completed in the near future.

GTA and NGP have performed admirably but to date only control a total of 150 courses along with another 100 or less owned by the other REITs. One would assume that with 16,000-plus courses in the United States alone that this is only the tip of the iceberg.

As previously mentioned, REITs are required to return 95 percent of their revenues to stockholders. This comes form the operating leases and rents established partially based on acquisition prices. In a competitive market, this means higher prices and thus, increasing rents to support the acquisition prices. An interesting byproduct of this requirement is that in many instances, existing ownership sells to the REIT and then has the opportunity to 'lease back' the operation. Accordingly, existing owner/managers have the unique opportunity of 'cashing out' and exercise their knowledge of the property, the market and clientele to continue the business growth and continue their opportunity to make a living.

In some cases, this creates a 'partnership' with the lessor (REIT) which may ask the lessee (seller) to accept stock in the REIT as part of the sale proceeds. This can be good or bad, depending on the stock market.

While it may seem that all courses are attractive to REITs, that is not always the case. Most REITs are not interested in proposed construction or in recently opened properties with little or no operating history. REITs are typically interested in properties with positive historical cash flow that can be more accurately projected into the future. This, along with the importance of the potential lessee's ability to meet rental payments would seem to indicate that REITs are typically only interested in properties which are generating positive cash flows, have been well positioned and are in markets with strong future prospects.

Why are REITs paying so much for golf courses? This is a question I often hear.

First and foremost, REITs (and other golf course buyers) are 'paying so much' for courses because there are more buyers with substantial funds in the marketplace than ever before. This creates keen competition that when combined with favorable interest rates, numerous lenders (compared to 10 years ago) and the continued growth of golf logically and naturally produces upward pressure on golf course values. Additionally, some REITs are cash buyers, meaning there is no debt service in the equation and thus the ability to pay more and make the cash flow grow over time.

In conclusion, what REITs mean to the golf course industry is that there has never been a better time to sell a golf course. As an appraiser, I have seen transactions I never thought possible. As a broker, I have had a buyer offer to pay my commission rather than wait for the seller to list property just so the buyer could get first crack at the property. Golf courses are in the mainstream of the real-estate investment world now and higher quality management and the growth of the game have made Wall Street and the rest of the investment community look at golf much differently (and more positively) than 10 years ago.

Of course, with all this optimism comes a word of caution. Where does this stop? We all know that real estate (like all

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Forecaddies

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D'Alene. "Five hours a round is the norm at resort courses. Here, it's 4:17 a round. With forecaddies, we don't need marshals out on the course. They move play along."

The Seaview program is run by Caddie Masters Enterprises of Fairfax, Va. Caddie manager Kieran Bell said the forecaddies serve a variety of purposes.

"The forecaddies certainly affect speed of play," he said. "They have a local knowledge of the course. They go out ahead of the foursome to spot balls so you eliminate a lot of time spent hunting for stray shots." The caddies also give yardages, rake bunkers, clean clubs, fix ball marks and read greens.

Bell said the Seaview program "is the first time forecaddies have been marketed to a great extent." He added that feedback from players has been positive. The club has rating cards that golfers fill out concerning the performance of their forecaddie and that 90 percent of the ratings have been excellent.

When Seaview went to a cart path only rule on its Pines Course, officials worried about speed of play. The forecaddies have eliminated that fear, said Bartley.

"We were worried that the cart path only rule would add three quarters of an hour to rounds on The Pines Course. But with the forecaddies, the average round has not gone up significantly."

Beyond the speed of play issue, Bartley said the forecaddies have brought smiles to the resort's maintenance crews.

"The maintenance people are kissing my feet," he said with a chuckle. "Having forecaddies raking bunkers and fixing ball marks on greens really has improved course conditions on a day to day basis."

Bartley said Seaview adopted a mandatory forecaddie program for several reasons.

"We wanted to make the program an added plus for golfers here. And, it just wouldn't have worked had we allowed golfers to an option. What if the foursome ahead of you didn't have a forecaddie and you did. It would have made for some uncomfortable moments on the course."

Seaview toyed with the idea of installing laser yardage finders in its golf carts. "But that just didn't fit with what Seaview is. We wanted a person dealing with the customer and that's what the forecaddies do for us."

Bartley said that while he has fielded some complaints about mandatory use of forecaddies, the vast majority of comments have been favorable.

"I've had a few people say they didn't want a forecaddie because they weren't comfortable having somebody watch them play," said Bartley. "But the majority of people have enjoyed the experience."

Bartley said some 1,200 people were interviewed for the Seaview program with 275 hired.

"The biggest challenge we have is maintaining a consistency among our caddies."

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businesses) goes in cycles. With such a low percentage of golf courses under professional management, it would seem that there are many opportunities. Can the golf boom go bust? Some say when the economy slows down the leisure dollar will be the first affected. This is tempered by those that note the extended period of time needed to add to the supply of golf courses where there aren't now enough. Nobody knows. If you're a golf course owner looking to sell, examine any proposals carefully and make sure it's right for you. If you're a buyer in the golf course market, plan on competing with 'the big boys.'

Meditrust

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they got confusing to the market and analysts. They were initially a health-care REIT, then they started buying hotels, then they bought this golf company. So they have these three different businesses operating within Meditrust right now. The stock market is saying 'Get out of the health-care and golf business and go back to being a core, middle-market hotel company."

Meditrust plans to sell up to $1 billion of assets, including Cobblestone and Santa Anita, to pay down about $525 million in debt, the *Union-Tribune* reported.