This year was a year of contradictions for golf course owners and investors, as both external and internal factors challenged the golf industry. What does this mean to you as a course owner and how should you prepare?

Rounds and Closings
Let’s start with the easy one. Golf utilization and rounds are about the same, year over year, as are playable days. We have not made much headway, but we didn’t lose either. With 2016 rounds up only 1%, and another year of net loss for golf courses nationwide (which seems to be the case every year), at some point rounds per course and price per round must improve. The industry projects approximately the same number of course closings (175) and openings (20-25) as last year, so we are and have been doing a good job getting rid of functionally obsolete and poorly located golf assets, as well as redeveloping assets in great locations with highly developed metros that are worth significantly more as an alternative real estate play. In fact, the Pellucid Report predicts that golf may only need four more years to reach supply equilibrium, much better than predictions just a few years ago.

(Continued on Page 6)
YOUR STRATEGIC DIRECTION IN A TRANSITIONING MARKET

By Christopher Karamitsos  Christopher.Karamitsos@MarcusMillichap.com

What does it mean for a market to be in transition? To what is it transitioning? Are we headed toward a buyer’s market or a seller’s market? What should you do about it? The current state of the US economy and the economic horizon has also elicited some additional questions from leisure property investors of all stripes. Some of the questions we have been asked are: “How will the election results affect the golf market? Are we really headed toward another recession? What affect will all of this have on my asset(s) in the near term?”

The macroeconomic picture is certainly clouded with enough conflicting signals to make answering the aforementioned questions challenging. For example, unemployment is under 5% but the labor participation rate has been in steady decline since 2001 (see Fig 1). GDP has been under 4% since 2014 yet consumer confidence is set to pass through the 100 mark for the first time in 13 years. Interest rates are creeping up but the Dow is hovering around 20,000 points. These factors have worked in consort with a transitioning golf market, to create a scenario whereby the process for devising a strategy for the future is an arduous one.

Looking Back

One should keep in mind that an accurate assessment of any state of the market requires a 6-12-month look in the rearview mirror. Analyzing sales data, our transaction experiences and speaking directly with investors, has helped us to discern a trend that can tell us where the market is and where it is headed. It does little good to know that the average golf course transaction in 2016 was $4.7M without knowing that number represents a 5.85% decline from the previous year. For straight golf acquisitions, transactions are getting smaller by virtue of the year-over-year increase in both the number of $1M-$5M and $1M-$2M transactions. Gone are the major portfolio opportunities and attractive REO deals. The market is currently in the process of transitioning to smaller asset sales with upside. Financing has transitioned as well. The market has gone from no financing available, to available but getting more expensive. That could eventually put downward pressure on pricing but also create a scenario whereby seller financing becomes a better option for both parties in certain circumstances.

Your Direction

Understand that the strategic direction desired for your investments can only revolve around 4 options: buy, sell, hold or refinance. Some owners will still divest in a buyer’s market as well as invest during a seller’s market. Markets in transition tend to provide the impetus for action when that transition is recognizable. Consider for a moment the impact of interest rates. The rule of thumb is that every 100-basis point increase can negatively affect the value of an asset by 9—10%. As alluded to earlier, every indication is that a rise in rates is on the horizon. During Q-4 of 2016, the 10-Year Treasury rose by 60 basis points (see Fig 2). For those who want to take some chips off of the table, this suggests that there exists a window of opportunity to do so while taking advantage of the current economic climate; likewise for the investor looking to grow their portfolio. The cost to borrow money is only getting more expensive. Now is an opportunity to lock in lower rates and maximize cash-on-cash returns from new acquisitions ahead of any significant rate increases in 2017.

What’s to Come

Many investors agree that the results of the presidential election should usher in a more pro-business environment. Slated to occur in the first half of 2017: a reduction of corporate income tax, a reduction in capital gains tax, an overhaul of the Affordable Care Act, regulation reform, wage & hour reform and the repatriation of as much as $3T of corporate capital currently offshore. Recognizing the market realities and understanding the market trends while keeping an eye on macro-economic factors, should form the basis for determining your strategic direction. We look at this information daily—if you need some direction please don’t hesitate to contact us.

![Historical Treasury Rates](image-url)
Throughout 2016, buyer sentiment within the golf industry can be broken up into several distinct groupings based on purchase price. The chart at the bottom of this page summarizes these price-based groupings, including the traits of the properties and characteristics of the people buying them. But first, let’s review two broader observations of the industry’s buyers.

**Traditional Golf Opportunities**

Looking at standalone golf investment opportunities, buyers continue to focus on several key areas. First, **location is key**. For golf this typically means strong demographics (population and income), typically demonstrated by courses in major metros or affluent suburban areas. Being the focal amenity to a high-end residential community is a plus. Secondly, these courses must have strong gross revenue, with a focus on potential profitability from the total income collected. The transactions must be large enough to make the investment (and subsequent returns) worthwhile. Forget looking at acreage, the true “size” of a golf course is the top-line revenue produced. Finally, many sophisticated buyers prefer private clubs over daily fee facilities. This is due to the reliable nature of monthly dues payments vs. the weather-reliant nature of public play. If it rains, your members still pay. Concert Golf has mastered this strategy with their purchase and/or recapitalization of several member-owned clubs, including both White Manor Country Club in Philadelphia and Crestview Country Club in Wichita.

However, golf properties that offer all of these key buying characteristics rarely come up for sale. In previous years, buyers could find discounted REO deals from banks post-foreclosure. In lieu of those REO opportunities, many established investors have turned to negotiating with the members directly to purchase properties. This allows buyers to purchase below market value, as the sellers aren’t actively promoting the asset to the investment community. In exchange, member-sellers get their debts wiped clean and stop member assessments. These deals typically include a promised investment of capital back into the facilities. Although they get a considerably lower price for the property, members can rest easy knowing that an experienced operator will oversee their beloved club for the foreseeable future.

**Redevelopment Deals**

Outside of traditional golf deals, redevelopment opportunities have garnered significant interest throughout 2016. This is especially true for properties with strong demographics near major metropolitan centers due to the lack of development alternatives in these mature, densely populated areas. As important as the property must have a clear path to redevelopment, including appropriate zoning and development plan approval.

For example, in November the City of Boca Raton fielded offers from developers for their 194-acre property of $51 million, $73 million, and $73.2 million. These developers planned to repurpose the golf course site into between 600 and 700 mixed residential units. One of the potential buyers summarized the situation quite clearly, saying that “There’s hardly any raw land left. Golf courses are one of the only opportunities that exist when there is no land left.”

**Buyer Sentiment in 2016**

As detailed in the price range segmentation chart below, 2016 has shown that buyers exist for many types of golf properties. With that said, the year has also demonstrated a certain ambivalence among the investment community. While it’s true that the types of deals previously described can still garner excitement and competition from buyers, that’s largely because those opportunities are becoming scarce. In short, buyers must be blown away by the opportunity – in 2016 this meant well-located assets with strong membership revenue or redevelopment potential.

Buyers also remain disciplined and patient when analyzing potential acquisitions. Even profitable deals listed at 10x EBITDA (10% cap rate) still need upside, otherwise they could be viewed as overpriced. Compare this against stabilized apartments, which regularly sell at 20x EBITDA (5% cap rate). Also, investors are less likely to believe in blue-sky potential, given systemic industry concerns and lower participation rates. Many buyers now doubt their ability to reduce expenses, assuming owners have already cut any available fat. In conclusion, there is plenty of interest from buyers throughout the industry, but also a newfound patience to remain selective in what they purchase. They’re content to wait for a “steal” or “perfect fit”, which are few and far between.
Golf Course Valuation Quandary

Prospective golf course buyers are often confused when attempting to determine the appropriate methodology for valuing a golf course acquisition opportunity. The question that always surfaces is; should the value be based on the assets being acquired or the operating results of the business?

Golf Course Valuations are Complex

Golf course properties represent a unique real estate asset class which typically involve many moving parts. Golf courses are typically sold all-inclusive as a turn-key operation for a lump sum. As Golf Course Advisors, we believe that both the assets and the business are integral parts of the valuation as are several other contributing factors such as: location, population density, demographics, land, zoning, course improvements, vertical structures, amenities and goodwill.

A prudent buyer must be comfortable with the property and the vision that can be fulfilled post acquisition. Consideration must be given to the age and quality of the assets including: golf course features and improvements such as tees, greens, fairways, cart paths, irrigation system, water source, and pump station. Other improvements such as vertical structures, parking lots, electrical and mechanical systems, as well as all furniture, fixtures and equipment must also be taken into consideration. Owned equipment necessary to the operation is generally included as part of the sale with all equipment and cart leases assigned at closing. Owned equipment and golf carts will usually exert upward influence on the purchase price.

Deferred maintenance requiring future capital expenditures must also be factored in. During the valuation process, a buyer must partition future capital expenditures into two distinct categories. Category One includes immediate and/or remedial capital expenditures. These are costs that are necessary to bring the property up to speed to make it competitive within the local market place or repairs that are required to meet local building or occupancy codes. Category Two capital expenditures are typically “wish list” items necessary to fulfill the new owner’s ultimate vision for the property. Category One capex can typically be negotiated as part of the purchase price. However, the costs for Category Two capex are the responsibility of the buyer, since they will be the beneficiary of the improvements going forward.

Financials Key to Performance History

To adequately evaluate a golf course acquisition opportunity, a review of historical and current financial statements (including the profit and loss statements and the balance sheets) will not only provide a view of the business trends, but also assist the prospective buyer to identify the strengths and weaknesses of the current operating model. By understanding the operating history, a prospective buyer will be provided the tools necessary to develop an operation’s pro forma.

Increased competition in concert with declining rounds being played has made maintaining market share more difficult. Subsequently, the better operators continue to succeed while lesser operators continue to struggle. During the past few years we have seen an increasing number of quality assets coming to market. Unfortunately, many of these courses are underperforming operationally, which can usually be attributed to absentee ownership and under-management resulting in underutilization.

Buying Quality Assets Saves on Future Capex

Experienced golf course buyers will always focus their attention on quality assets located in densely populated areas with strong demographics. Under managed assets generally offer immediate lift opportunities. Those with limited amounts of deferred maintenance and few immediate capital expenditure requirements are particularly attractive to buyers. Many of these properties have significant asset value, however poor historical operating performance has driven down their market value. These are ideal situations for experienced golf course operators who can step in with sound business plans prepared to sweep in and gather the low hanging fruit and turnaround the operation. In these situations, the buyer should consider the long term value of the property as an investment.
Following a lengthy campaign, Donald Trump’s presidential election victory could redefine the playing field for the golf investment market. The financing market may face some obstacles this year, for example, the potential impact of recently implemented regulations, increasing interest rates and the potential shift in federal monetary policy, however, these should have minimal impact on the golf industry as a whole. The question is whether or not these changes will decrease the demand for debt. With an incoming presidential administration that many believe will bring about policies beneficial to the overall economy, we don’t think so.

It’s no secret that the cost to finance a golf course, or any other commercial asset, is going to increase this year. What is uncertain is the impact that rising interest rates will have on the golf market moving forward, especially after the Federal Reserve raised its benchmark short-term rate and is predicting three additional increases throughout 2017. While rates have risen as of late, when compared to the historical cost of debt interest rates between 4% and 6% are still considerably low. Also, because interest rates are just now beginning to rise, after dropping to record lows following the Great Recession, it signals the current real estate investment market is resilient enough to handle the changes to come.

The nation’s economy currently stands in its seventh year of a durable but moderate expansion, supporting job creation, wage growth and consumption. A stable 5% unemployment rate and 5 ½ million unfilled job openings point to a tight labor market. So, while the cost to finance a golf course may be increasing, higher borrowing cost are much more manageable in a stimulated, growing economy. Add to that the indicated reduction of taxes and deregulation could give the economy a boost over the short term and increase consumer spending, which will have a positive impact on golf.

In summation, as interest rates slowly climb (but remain lower than historical rates) the demand for debt should not decrease, but all real estate (including golf courses) values inevitably will. This is because higher mortgage payments translate to less cash flow and smaller returns, resulting in a lower valuation. That being said, an improving economy, with job and wage growth, could provide the ammunition needed to combat the increasing cost of loans through increased consumer spending and more disposable income.

| Capital Markets/Course Financing | By Zachary Hadsall | Zachary.Hadsall@MarcusMillichap.com |

### Conventional Bank Loan:
Interest: 5-6.5%, points: 1%, term: 3-10 yrs., amortization: 20-25 yrs., LTV: 60-70%, DCR: 1.3-1.4, loan size: $750,000 and up/ Variable/ floating rates: prime +1.5-2% = 5.25% to 5.75%, term 10 yr., amort. 20-25yrs.

### SBA Guaranteed Loan 7A Program:
Interest: 1.5-2.75% over prime, points: 0%, term: 25 yrs., loan size up to $5M, amortization: 25 years

### Life Company:
Interest: 4.75-5.25%, points: 1%, term: 5,10,15 yrs., amortization: 15, 20 or 25 yrs., LTV: 55-65%, loan size: $750K and up, pure land collateral value is important

### Bridge Loan:
Interest: 9-14% I/O term: 1-2 years, LTV: up to 65%, desire primary markets, cash flowing product

### Hard Money:
Interest: 10-15% including points, term: 1-3 yrs., LTV: 50-60%, usually interest only

### Private Equity:
Interest: 0%, unleveraged IRR: 20%, preferred returns 8.8-12%, LTV: 60-70%, waterfall structure: deal by deal on profit splits

Updated 1/19/2017
2016 was very busy and full of notable accomplishments for the Leisure Investment Properties Group. The golf division closed a record setting 24 transactions, highlighted by the John Wieland Homes golf portfolio of two golf clubs in the Atlanta MSA and one in Charleston, SC. Terence Vanek was the lead agent on these transactions and represented both the buyer and seller for all three. Other notable deals included Deer Creek Golf Club, Tall Grass Country Club and Kiskiak Golf Club sold by Steve Ekovich on behalf of Arcis Equity Partners. They were located in Overland, KS, Wichita, KS, and Williamsburg, VA, respectively. The group currently has eight additional deals under contract and 22 active listings across the country.

With regard to individual accomplishments, both Terry Vanek and Matt Putnam were promoted as the group’s first ever Junior Partners, after demonstrating continued success and commitment to golf advisory services. Steve Ekovich and Chris Karamitsos listed a $70M multi-state portfolio for an institutional client that is generating national and international interest. In June, the group completed its third annual Investor Sentiment Survey. The results, which showed a drop in investor confidence, were published in Golf Inc. Magazine as well as the Pellucid Report. For a full transcript of the survey results, please email Ray Demby, the group’s Head of Research & Analysis.

With the presidential election over but a continued and looming uncertainty about our economic future, the group’s advisors continue to position themselves as a resource to their clients through the strategic advisory program. Our team was also asked to conduct an educational seminar on acquisitions, dispositions and financing for the NGCOA annual meeting in Orlando. But even if you are not of a mind to buy or sell in the short term, the advisory program can provide a snapshot of value for your assets and offer useful ideas through your hold period. Feel free to reach out to one of our advisors for more information.

STATE OF THE GOLF INVESTMENT MARKET (CONT. FROM PG 1)

Media Reports Stores Closing / Golf is Dying

Again this year, the national press seized opportunities to pounce on us with the familiar cry “golf is dying,” fueled by Nike’s exit of the equipment business, Golfsmith’s bankruptcy filing in September and TaylorMade-Adidas Golf’s sale announcement.

First, let’s address Nike. Nike’s equipment business was less than 10% of total revenue, they hadn’t really developed much in the way of new technology for years, and 90% of their golf success was in soft goods. Really, dropping their equipment business wasn’t a damnation on golf, but smart business and a change of course towards their comparative advantage in soft goods.

Golfsmith’s bankruptcy may similarly be misleading. Golf Town, which bought Golfsmith a number of years ago, is the number one category killer for golf in Canada. We have been told Golf Town over-leveraged themselves to buy Golfsmith, so when Golfsmith’s profits sagged, it forced Golf Town into bankruptcy. There was a buyer for Golf Town, but none for Golfsmith. So, Golfsmith went to auction and was purchased by Dick’s Sporting Goods. Dick’s, which laid off 500 PGA professionals in 2015, bought the stores planning only to operate 30 and close 79.

Dick’s already operates its own specialty golf shops, Golf Galaxy, so it’s unclear what their plan is for Golfsmith. Earlier this year, Dick’s won the auction for the intellectual property of bankrupt competitor Sports Authority Inc. with a bid of $15 million. So, Dick’s drops golf in their own store. They own Golf Galaxy as standalone stores. Then they buy 109 Golfsmith stores but only plan to keep 30. If you are confused, we all are, but maybe Dick’s is looking at a chain of stores that are smaller and more nimble, like Golf Galaxy vs. Golfsmith’s alternative big box concept. The general public seems to be looking for smaller stores with high personal touch and club fitting with indoor ranges.
Finally, in May, the media hacks again used the TaylorMade sale announcement to support the tagline “golf is dying”. However, at the time of the announcement, sales at TaylorMade’s owner, Adidas, were up 22%, and TaylorMade’s own sales were up 6%. Analysts said it would be a good time to take a profit.

While at first glance these stories seem to paint a negative picture of the golf industry, when you look at all the background facts (Golfsmith is now owned by Dicks, has less leverage, a smaller number of stores, better economics... Nike should have dropped their equipment line a long time ago... the TaylorMade sale may be good for TaylorMade in the long run) these are not “golf is dying” stories, likely the opposite. In fact, when Acushnet went public and recapitalized itself with $329 million, it showed that investors are not afraid of our industry.

New Third Party Tee Time Provider
GolfNow’s stranglehold on golf course owners seems to be getting a little looser. With the introduction of Golf Pipeline online tee-time joining with CBS Sports Digital, we now have more significant competition for the NBC backed Golf Now titan. Along with EZlinks/PGA Tours Tee off.com and Quick 18, we now have four choices.

What is interesting about Golf Pipeline-CBS Sports, it’s a commission based service, not a barter pricing model like GolfNow, and they have pricing equivalent to what a golf course has on its website, which is what owners have been asking for. To further emphasize GolfNow is not the only game in town, OB Sports dropped GolfNow and is using Quick 18 tee-time reservation system. The more choices golf owners have the better. When Golfnow was the thousand pound gorilla, it was not good for the individual golf owner who had no negotiating strength, and no other choices. Choices for golf owners means better profits in the long run.

The final external influence on golf was the election of Donald Trump.
We now have the first president who own’s golf assets and in fact, has a golf brand that is identifiable. Will that stimulate more interest? We don’t really know yet, but if the president does what he says he will with jobs, incomes will go up and there will be more disposable income to spend on leisure actives and that is good for golf.

The Federal Reserve Raises Rates
The Federal Reserve raised its overnight rate 25 basis points to a range from 0.50 percent to 0.75 percent. This decision reiterates the positive economic outlook for 2017 that could accelerate monetary policy in the coming year. Rising interest rates will remain a significant factor in both the commercial real estate market and golf market that could force asset repricing.

Rising rates will eventually widen the gap in buyer/investor expectations and could eventually slow transaction velocity as investors reassess prospective yields. Buyers are reevaluating acquisition criteria in a rapidly moving capital environment. The performance outlook remains positive for golf, but modest downward pressure on EBITDA multipliers may start to emerge.

How have the median and average golf course values been affected?
It is clear all the news stories, outside influences and sagging golf operations have negatively influenced golf values. Average golf course prices were down 4.78%, the first decline in three years. However, median price was up 5.85%. (Note: We do not report portfolio sales in the averages as they are so large and impactful, they would sway the numbers. So, we did not account for the $135M Oki Golf portfolio sale. We also do not account for golf course conversions since they no longer plan to operate as golf assets.) In the statistical average, is this a one year retrenchment or a trend? We forecasted last year the fact that since most of the golf course distress left the market, there would be a larger number of the $1-$5M priced assets selling vs. larger ones. In fact, that is exactly what has happened.

While overall the average and median are noteworthy, the $1M-$10M tranche is the most important as most golf assets in the US fall into this tranche. The most important measure, median price in the $1-$10M tranche, went up slightly, 4%, while for the reasons discussed above the average in the tranche went down 8%. We don’t know if larger sales will come back to the market in 2017 and lift pricing, but nonetheless, the Leisure Investment Properties Group had our best year ever with 24 closings. Only time will tell if the media, the new president, interest rates and golf course profitability (via more course closings and better choices for third party tee-time reservations) will have a positive or negative affect on golf in 2017. What we do know is it is going to be a fun year with all the external influences on our industry, so stay tuned for our mid-year report.
2016 Sales Activity — The $1M-$10M Investment Tranche

By Kyle Brett  Kyle.Brett@MarcusMillichap.com

The below analysis focuses specifically in the $1M - $10M investment tranche – generally considered the most important subset of golf-specific transaction activity. These values are driven primarily by property fundamentals specific to the business of golf, and therefore most telling towards overall investor sentiment. All sales figures previously presented in the “State of the Golf Investment Market” are derived from analysis of a larger universe of golf transactions, those between $250K—$75M, and therefore differ.

As discussed in the State of the Golf Investment Market article, 2016 saw fewer blockbuster deals and more bite-sized transactions, which led to a decrease in the overall average golf course sale price but an increase in the overall median price. Yet despite the first dip in average golf asset pricing since 2012, the number of annual transactions remained consistent and the “core” data, the $1M to $10M investment tranche, came in about where expected due, in large part, to the 2015 “hangover effect” and an increase in the number of smaller sales. In 2016, the average price of golf course sales within the $1M - $10M investment tranche was $3,360,881, down 8% from 2015’s average of $3,363,985 but very similar to the years 2014 and 2013. That being said, the median price point of this tranche was actually up 4% over 2015, rising from $2,700,000 to $2,800,000. So, while the same proportion of properties traded within this “core” $1M - $10M tranche (68%), a significantly higher portion of them (82.3% compared to 74% in 2015) are trading in the bottom half of this range. We previously forecasted that following the year of the mega-deals and major portfolio sales in 2015, the bulk of available golf course properties would be in the $1M - $5M range, and we were right. 2016 saw more than an 8% increase in the number of transactions between $1M and $5M and a 3% increase in the number of courses sold between $1M and $2M.