

Strategies For Making a Golf Course Work In Your Community

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WHY GOLF MAKES SENSE IN RESIDENTIAL MPCs

- Increased Earnings
- Lifestyle Amenity
- Planning Solution



Understand the Economics

- 99% of the time- golf as a stand alone development investment, doesn't work financially.
- For golf to work financially, 1/2 - 2/3 of the total costs required to develop, construct, furnish, fixturize and equip the golf amenity (including the clubhouse, pool, tennis, fitness etc.) must be absorbed by the surrounding real estate (not much different from absorbing other infrastructure costs, such as streets and utilities).
- Members rounds are trending down.
- Golf membership capture rates are trending down.



FIRST QUESTIONS

- What is the target location?
- What is the target audience?
- What is the exit strategy?
- What is the project schedule?



Project Feasibility

- Physical
- Legal
- Financial
 - Market Analysis – What is a market?
 - Market Position
 - Economics/Cash Flow
 - Realistic Return Analysis
 - Cost-Benefit Analysis



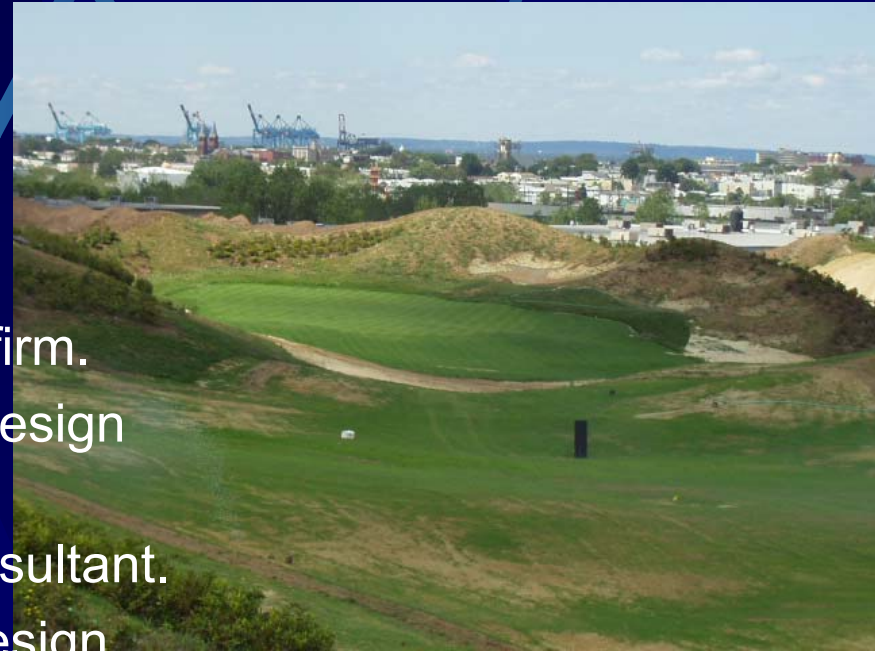
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Formulate the correct pricing plan

- Private -- Initiation
Deposits/Initiation Fees and Dues.
- Daily Fee -- Greens Fees.

Professional

- Retain an experienced law firm.
- Retain an experienced engineering firm.
- Retain an experienced golf course design company.
- Retain an experienced irrigation consultant.
- Retain an experienced clubhouse design firm.



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Other

- Engage an experienced golf course construction company.
- Hire the golf course superintendent early on.

Establish a mandatory membership plan (Private Club)

- Reasons
- Logic
- Examples, including daily fee golf course community.



SECOND QUESTIONS

- Have you analyzed the market?
- Have you aligned the residential and the club components?
- Have you executed the exit strategy?



Initial Legal Organization of the Process

Documentation Required

- Flow Chart of Transaction
- Organizational Chart for Parties
- Identification of Conditions Precedent for Closing
- Who Drafts the Documentation?
- Utilization of Phase I Due Diligence Information in Drafting Phases
- Identification of Lender Requirements



Initial Organization of the Process

Utilization of Letter of Intent

- Critical Components of a Letter of Intent
- Business Issues vs. Legal Issues. What Should be Included?
- Avoid Generalization Traps
- Provisions for Lender and Financial Issues
- Hidden Costs Gained or Lost in Letter of Intent



Evaluation of Structures to Develop, Own/Manage Amenities

Critical Issues in Determining Type of Structure

- Flexibility of Structure to Adapt to Market Conditions
- Control of Facilities During Project Sales Period
- Long-Term Quality and Value to Residential Lot Purchaser and Member
- Legal Requirements to Protect Subsequent Owners and Lender
- Sale of Amenities to Members or Third Party at Later Dates
- Exit Strategy



Evaluation of Structures to Develop, Own/Manage Amenities

Types of Structures to Own/Manage Amenities

- For-Profit Corporations - Usage Rights to Facilities
- Not- for-Profit Corporations – Advantages and Control Issues
- Homeowners Associations
- Lease/Option Structures and Conversion Rights
- Limited Partnerships and Related Ownership Vehicles
- “UDIs,” Resort/Club Ownership and Other Club Ownership Models

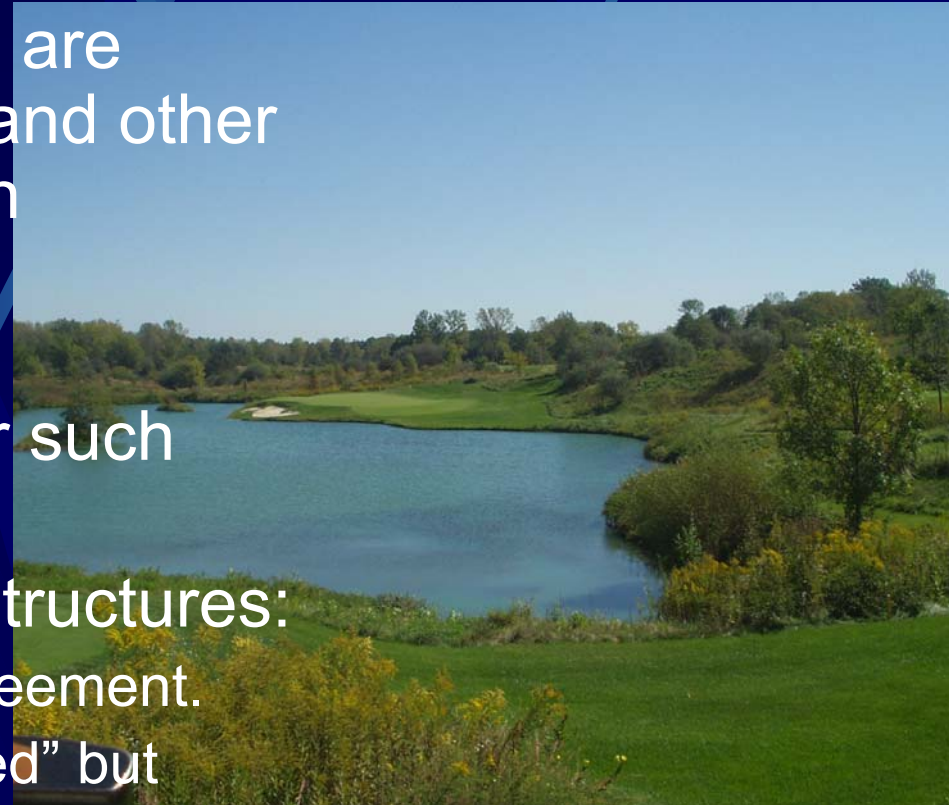
Taxes - Advance Planning is the Key

- After-the-Fact Tax Structuring is Usually Disastrous
- Primary Areas for Tax Planning:
 - “Excess Costs” of Amenities – generally 50% - 67% of Amenity Costs
 - Methods of Accounting for Lot or Home Sales
 - Structuring to Enhance Probability of Conservation Easement Tax Benefits



Excess Costs of Amenities

- Issue: Lot/home sales revenues fund such costs, but costs are capitalized in golf course and other amenity assets resulting in “phantom income”.
- IRS vehemently contests allocations to inventory for such costs.
- Two possible alternative structures:
 - Two-entity cost sharing agreement.
 - Sale/leaseback to “controlled” but “unrelated entity”.
 - Each is very fact specific, thus upfront planning is required.



Structuring to Enhance and Protect the Value of Amenities

Separation of Amenities and Real Estate Product

- Establishment of Long-Term Relationship Between Developer, Homeowners Association and Club
- Identification of Specific Rights and Obligations of the Club Owner
- Establish Structure and Proper Documentation for “Exit Strategy” for Amenities



Structuring to Enhance and Protect the Value of Amenities

Amenities - an Integral Part of Project Master Plan

- Type of Amenities Required by Marketing Plan
- Interrelationship Between Sale of Residential Lot and Amenity Facilities
- Common Goals and Requirements
- Initial Development Obligations vs. Long-Term Operation and Ownership
- Combined but Separate Status of Improvements, Lots and Facilities



Select an experienced Golf Management Company

- Engage early on.

Formulate the correct positioning plan

- Properly align the golf amenity with the residential product.
- Private versus daily fee?
- Implications of golf course designer selection.

Be prepared to internally finance the sale of Golf Memberships

- Examples

Carefully contemplate your exit strategy

- Examples



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Properly invest and appropriately reinvest in course and clubhouse infrastructure

Remember

- As the golf goes -- so goes the real estate!
- As the real estate goes -- so goes the golf!



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Methods of Tax Accounting

- Issue: Lot/Home developers are generally subject to “long-term contract” accounting rules.
- Percentage of Completion Method (PCM) is primary method which can require income recognition prior to closing as you incur costs of construction/development.
- Completed Contract Method (CCM):
 - No income recognition until 95% complete even if you close on a sale.
 - “Home Construction Contract” required.
 - Current developments with the IRS.
- Review contracts to delay binding contract status.

Conservation Easements – An Option for YOU?

- Issues: Qualification, Valuation, “Inventory”
- Developer Issues:
 - Quid Pro Quo
 - Valuation: Are you truly giving up value?
 - Definition of FMV
 - “Inventory” Classification of Land
- Planning to Avoid Inventory Classification
 - Acquire conservation property in separate entity
- Current IRS and Legislative Developments

Other Tax Planning

- Cost Segregation for Depreciation
 - New Construction – 2005 last year for any potential Bonus Depreciation
 - Purchase Price Allocations
 - Renovation projects – documentation of prior costs abandoned (depreciable and nondepreciable)
- Current IRS and Legislative Developments
 - Will the new Section 199 Deduction benefit real estate developers?

COMMON INGREDIENTS FOR SUCCESS

- Customer/Concept/Execution Alignment
- Realistic Schedule and Budget
- Superior Execution



Membership Issues - Impact on Structure of Amenities

Equity vs. Nonequity Clubs

- Ownership of Facilities by Members and Conversion Rights
- Usage Rights and “License to Use” Facilities - Nonequity Club
- Assessment Obligations and Capital Calls in Equity Clubs
- Control of Amenities, Types and Numbers of Memberships - Nonequity Facilities
- Initiation Deposit vs. Initiation Fees

Membership Issues/Impact on Structure of Amenities

Types of Memberships and Impact on Structure

- Transferability of Memberships - Control of Subsequent Sales
- Lot Ownership Restrictions
- Social vs. Golf, Tennis, Athletic and Other
- Recallable Memberships
- Nonresident and Associate Memberships
- Members' Rights of First Refusal or First Offer Rights
- Other Memberships



Membership Issues - Impact on Structure of Amenities

Board of Governors vs. Board of Directors

- Board of Directors' Responsibility
- Advisory Role of Board of Governors vs. Board of Directors
- Liability and Indemnification of Board of Governors vs. Board of Directors
- Responsibility for Member Discipline
- Subsidiary Boards, e.g., Men's Golf Association, Women's Tennis Association



Membership Issues/Impact on Structure of Amenities

Membership Agreements Between Club and Developer

- Reserved vs. Priority Memberships
- Waiting List and Preferred Rights
- Developer-Salesman Memberships
- Membership Caps and Other Restrictions
- Club Bylaws and Rules and Regulations



Membership Issues/Impact on Structure of Amenities

Club Owner's Liability for Fraud or Misrepresentations by Developer's Sales Force

- Common Problem: Misstatement of Rights of Club Members to Induce to Purchase Lot/Home
- Reasonable Approval Rights Over All Sales Literature
- Meetings With Developer's Sales Staff
- Insurance for Misrepresentations Carried by Developer



Due Diligence Process - One Key To Savings

Why Due Diligence? Why Incur The Costs?

- Identification of Development Issues
- Identification of Actual Assets Being Acquired
- Status of Assets Utilized in Club Operation
- Determining Existing and Potential Liabilities
- Exposing Important Issues
- Identifying Agreements and Permits Required
- Ability to Retrade the Initial Business Terms



Future Sale of Amenities For Enhanced Value

- **Proper Structure and Documentation to Establish Rights and Obligations**
 - **Establish Membership Rights for Future Lot Owners**
 - **Preserve Water Supply for Club**
 - **Create Easements Required for Club Operations**
 - **Protect Overall Aesthetics of Project and Amenities**
 - **Diminishes Homeowner/Member Disputes/Litigation**
 - **Establish Method for Future Growth**
 - **Provide Vehicle to Resolve Control Issues/Disputes Between Parties**



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Future Sale of Amenities For Enhanced Value

- Separate Structure For Orderly Transfer of Property to Third Party
 - Assist in Due Diligence Process
 - No Commingling of Assets/Contracts
 - Clear Assignment of Contract Obligations/Rights
 - Title/Survey Issues Easier to Resolve
 - No Cross Liability for Lot Sales Representatives
 - Establish Post-Closing /Long-Term Relationships Between Parties



Value – Of What?

- Real Estate
- Going Concern
- Memberships
- Obligations
- Restrictive Covenants
- Investment Value or Market Value



“Golf is a game that needlessly prolongs the lives of some of our most useless citizens.”

- Bob Hope



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