Specialty CRE Property Financing Requires Specialized Underwriting

There are ample opportunities for developers and brokers to tap the golf course niche, but these professionals need to be aware of special considerations.

BY JERRY SAGER

By all accounts, specialty commercial real estate (CRE) properties - such as golf courses - appear to be quite attractive. Aside from the affinity for the game of golf itself, the asset class presents opportunities for both brokers and developers.

The segment is open to broker originations, as there are over 16,000 golf courses in the U.S. For residential developers, golf course construction provides an opportunity to build an amenity that can boost real estate development and residential home sales.

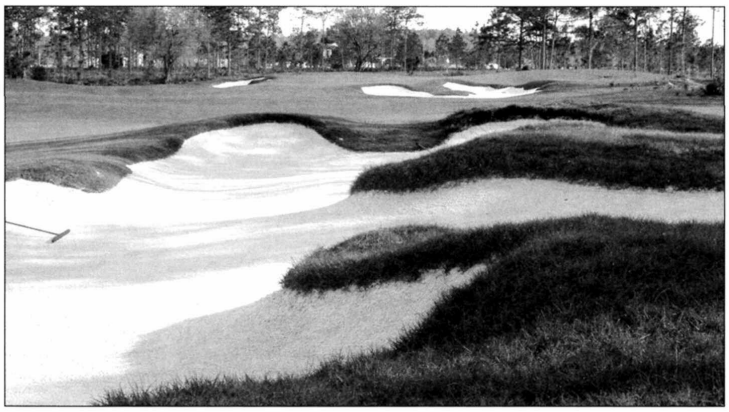
However, lending to any specialty CRE property segment requires specific knowledge of that particular marketplace, the operating business models employed and the risks involved. As a result, the underwriting practices found within single-market lending institutions often differ from typical CRE property underwriting.

The process for golf course construction loans, for instance, offers an illustration of the detailed due diligence and tight underwriting procedures that must be implemented when working with certain high-risk asset classes.

It is no surprise that lenders are cautious when presented with a request for a golf course construction loan. Ensuring thorough due diligence on these specialty property loans can be challenging. With risks as broad as an owner's lack of retail business experience to uncertain water sources and insect problems, it is no wonder why many lenders do not jump at the notion of adding golf course loans to their portfolios.

Specialized financial sources that understand the nuances of nonstandard properties can minimize the risks involved and avoid the hazards that many lenders confront when evaluating these loan requests.

Because a specialized lender is being asked to make a loan that many other financial sources probably would not - or one which does not fit general lending practices - its depth of knowledge of operations and properties must be comprehensive. In the golf course financing realm, specialized lenders often possess broader knowledge than the course owners themselves. This asset class is so specialized that lenders should even know enough about various turfgrasses and turfgrass diseases to be able to anticipate any potential risk to the real asset itself: the dirt.



The Concession, Sarasota, Fla.

Loan terms

In the case of a golf course construction loan request, the lender is effectively being asked to lend on raw land that does not have a realized value until it is a developed operation. For golf course construction loans, the loan-to-value is generally adjusted downward - lower than that common to commercial building construction loans and often even lower than that of other segments of the hospitality market. The required debt service coverage ratio of the operation is usually in the 1.25 to 1.35 range and higher.

The underwriting process must include an evaluation of project construction costs, the project development team and the future operating retail enterprise (i.e., private club, daily fee or semi-private golf course). A lender for course construction will seek to assess both the future operating potential and value of the completed project.

The actual depth of the process is variable and can be affected by many factors, including the borrower's prior experience developing or managing golf course operations, how far along the project is, how detailed the business plans are, how complicated the project is (golf courses projects including residential components are more complex) and how leveraged the loan will be.

The assessment is quite different than that applied to traditional commercial construction projects, where value is often created through the construction and lease-up process. To additionally minimize risk, the lender will need to verify that proper course operating practices have already been implemented or are planned in order to ensure the course's successful and profitable operation.

A specialized lender's due diligence process includes requests common to construction loan financing but additionally will require documentation pertinent to the actual construction and operation of the golf course. These items fall into the same general categories that would be applied to many specialized loan markets but are specific to a golf course's operation. While an underwriter evaluating a retail or office construction project may focus on leasing and tenant credit, a lender that specializes in golf course loans will be more interested in learning about the type of operation (daily fee, semi-private, equity), the rate and rounds of play projections, or membership structure.

The review

The review for a golf course construction loan would typically include:

- The facility. Course statistics (course yardage, pars, hazards, etc.), course routing plan, details regarding structures such as a clubhouse, maintenance buildings and cart storage, food and beverage operations, and pro shop operations.
- Financial projections. Detailed projections of revenue sources, including membership fees and dues, greens fees, cart fees, food and beverage, and pro shop. On the expense side: details of turf maintenance expenses, payroll and benefits, equipment leasing costs, departmental expenses for food and beverage operations, and the pro shop.
- Management and staff. Resumes for all key operating staff, including details about their prior experience managing courses, and the management firm's proposal, if applicable.
- Permits and approvals. Culinary and irrigation water sources, all zoning and permit approvals, and wetlands, environmental, archeological, endangered species and geotechnical investigations.
- Construction documents. All construction documents, such as drawings, specifications and bid packages.
- Contracts. Agreements and resumes for all parties involved, including the golf course architect, clubhouse architect, irrigation designer and builder, and other consultants. Also, the agreements and resumes of all contractors, including those working on the course, clubhouse, and roads and parking. Construction and performance bonding information, as well as easement and liability insurance, must also be obtained.

Sometimes reading a green perfectly to make par can be a fairly straightforward challenge compared to determining whether a golf course operation is a viable lending opportunity. When underwriting a deal involving a specialty property, it is important to keep in mind that many high-risk classes require specialized expertise and a true knowledge of the working business. ●

Jerry Sager is managing director of First National of America, a lender that specializes in supplying funds for the acquisition, construction, expansion and refinancing of golf courses. He can be reached at (908) 604-4700 or jsager@firstna.com.

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