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Three options for a municipal golf course: Leasing vs. management vs. self-operate

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I was recently hired by a New England town to provide consulting services relating to their municipally owned golf course. The property was being leased and it was coming due, so they needed to explore their options. They had one of three options; they could either self-operate, which means run the course themselves; hire a management company; or lease the property to a golf operator. Most towns do self-manage, this occurs when the municipality wants total control and flexibility with the operation. It allows a town to use town employees, set pricing, establish policies and procedures and make capital improvements. However, this option will also expose them up to the most potential downside if operated poorly, as many towns are actually losing money on their golf operations. They are often poorly operated and inefficient because employees lack the expertise or resources. Funds are often co-mingled with the general fund so there is often less accountability and changes in personnel hurt the consistency of the product being offered. It is often hard to analyze the true profitability of the operation because certain functions might be difficult to allocate, like snow removal, or garbage pick-up. Since these are town functions, they are often done by town employees and not expensed directly to the golf course.

Next, they could hire a professional golf company under a fee arrangement. The town would have to pay about $100,000 to $120,000 a year for the expertise of a professional golf operator. The town would be entitled to the profits. These agreements tend to provide more flexibility to the town, and more control, however they would require some oversight. The town would work with the golf company to establish budgets, hiring procedures, operating policy, while balancing the motives of a for-profit operator. The town is creating a partnership of sorts, however the management company is generally more concerned with its base fee and less by the incentive component, therefore in some cases, profitability can be sacrificed. And, town resources, oversight, budgeting and planning is still required by the town, yet this work is being done in conjunction with a professional third party.

Lastly, the town could enter into a third party lease. This is much like other commercial lease agreements; the contract outlines the expectations of the parties involved, namely the lease term, periodic payments, maintenance standards, and the recovery or payment of certain expenses. This option provides the least amount of control, but the most security and least amount of oversight. This option also limits the upside potential of the cash flow, but buffers against downward trends. While incentives are often included in percentage rents, expense savings are typically not considered. The town would benefit from professional management; the facility would operate as a stand-alone entity and be subject to less political pressures and decision-making.

This particular town had been leasing the property; the rent being paid was around $400,000 a year on just under $2 million in total sales. As a percentage of revenue, the rent amounted to about 20%, which was appropriate at the time. The market for rentals has declined over the years, the same way golf values have. The same golf company that has been paying $400,000 in rent was hired by another town to "manage" their course. With similar revenue, here the town is only making about $100,000 a year after all expenses are paid, including the $130,000 management fee. When the town is paying the bills, the company has less incentive to trim costs; they tend to be less bottom-line conscious. However, when forced to, they can operate quite efficiently, and still make money after paying the town $400,000 a year in rent.

Rents for golf courses are similar to other types of commercial real estate; they often rent as a percentage of revenue like restaurant, banquet halls, grocery stores and certain retailers. With flat to declining revenue, yet rising expenses, percentage rents have come down over the years. The outlook for golf is uncertain and for that reason operators are more conservative when making future projections. Rents also vary based on the source of income, as some departments are more profitable than others. Golf and cart fees are the most profitable, while food, beverage and pro shop revenues are the least profitable, since they carry high costs of goods.

In 2003 the town of Abington, Mass., put out an RFP to lease the Strawberry Hills GC, and three local golf companies responded. The bids were all very close, ranging from $115,000 to $125,000 a year with escalations. Gross revenue was being projected at between $571,000 and $600,000 and the average rent equated to 20% of sales at that time. Since then a new lease was signed in April 2009 for this same course; a five-year deal was negotiated at $36,000 in year 1, and $43,200 for years 2-5 based on projected gross sales of only $325,000. The new percentage rent is 12.8%. There have been no changes to the property or inventory of competitors, the only change was the economic impact the market has had on golf, and what operators can expect to pay in rent. Examples like this help show the change in market conditions. Even with the decline in rental rates, we feel a municipality can achieve more security and better results by leasing versus working with a management company, as long as the right operator is selected.

That's where we can help. Having worked in the golf industry for 25 years we have consulted on almost 2,000 assignments over the years, in 23 states.

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