

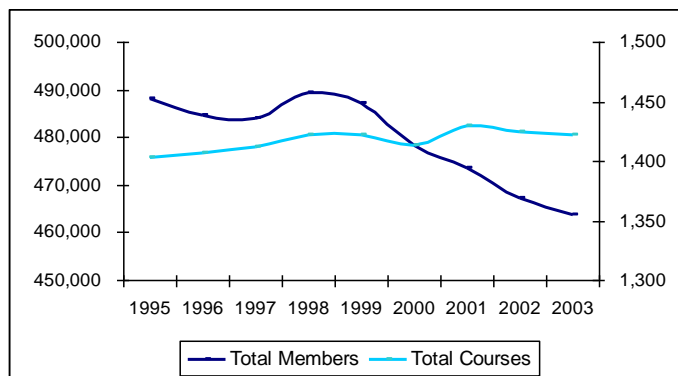
The Residential Led Supply Risk

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In these inaugural editions of BOTC we have provided a solid introduction to the participation numbers evident in this country. Knowledge of these going forward will be assumed in most things we write. (It is actually our desire to have these numbers widely known and accepted so we'd appreciate you also spreading the word.)

Anyway, the relevance of this to this topic is on the supply side, with the question for today's class being "if demand is reasonably flat, then why are so many new courses being built?"

The stats show that since the year 2000 24 new courses have opened, a 2% increase over total supply. (We have excluded the 400 clubs with sand greens from our supply base as they aren't competing with the new supply.) We are aware of a further 48 new courses proposed between April 2004 and early 2009, a 4.1% increase over the current supply base. As detailed in our supply register of May 2004 (yep, on the website), 38% of these are proposed for Victoria, 34% for NSW, with Queensland accounting for 19%.



The graph above reflects numbers sourced from the AGU and we have used them to illustrate our point about the supply/demand relationship. (A note on the numbers - when talking about supply we mean actual courses, not golf clubs so we removed social clubs from the equation, same goes for social member numbers. As these are AGU numbers we have also not included unaffiliated courses – both old and new and approx 15% of supply.) What we hope you can see is that the supply growth over the past eight years hasn't been offset by any increases in demand and have pulled from the existing flat demand pool, further diluting the pool and making it harder for everyone.

We asked the question as to why new courses keep coming. Here's the answer. Further analysis of these proposed new courses shows that 70% have some form of residential reliance/orientation. That is golf is the secondary amenity to the primary residential product. Compare this number to the ten-year period 1987 to 1997 which saw only 20% of new courses having a permanent residential component and you can see just how the golf club of the future will look.

Ok, so golf is secondary, but can the current golf market dynamics possibly play a role and perhaps cause development to be reconsidered? In the big picture probably not as the dollars are in houses, however, not understanding the market size/depth could see golf costing considerably more than planned. In the earlier part of the 1990's, plenty of average golf oriented real estate was developed. The impact to the developer was minimal however as the golf was only ever average (lower maintenance costs) and therefore the market size didn't really matter.

In the 21st century, more attention is being given to the golf operations and their likely success (read as not losing money!) as a stand-alone operation. What is now being developed is really good (more dollars) real estate matched with really good golf that has a much higher expense base. The playing market therefore plays a bigger role as really good golf can only be sustained if the market is sufficiently sized.

A smaller market means potential long-term involvement in the golf asset from the developer, and probable funding of golf operational short falls as a club size that is self-sustaining is never reached. (We are assuming a club-based course here, not 100% pay for play.) The outcome sees the developer stuck with an asset that requires continued investment. Stop this investment and the golf quality declines, and this leads to declining real estate value, the reason they are there in the first place. Both sides of the fence must mirror one another.

Take the example of a course opened in the late 1990's in NSW, a golf course ranked just in the Digest Top 100, surrounded by residential which has encountered some trading problems. The developer no longer wishes to keep funding the golf losses. It is a non-equity club, so a long-term hold was inevitable for the developer anyway, but the current members, having been offered equity to take the developer out, don't want it. They just want to play golf with no added responsibility. The non-golfer residents on the other hand also expect their "backyard" to be maintained to the level they have become accustomed to, protecting their investment, putting the developer in a huge bind for the reasons outlined above.

The lesson – Even if you are pursuing a residential led strategy pick your market wisely, paying attention to the existing supply and demand relationship. The right exit strategy is critical and it must reflect what the market will allow. (We are aware of some developments that might be making or have already made this mistake.)

The hope for existing golf clubs – If new residential developments are being considered then maybe you'll be asked to move your club, bringing members with you, with one course replacing another, not adding new supply pressure in already pressurised market.