How Do You Pay For An Irrigation System Renovation?

BY **MICHAEL G. MEACHER**

RENOVATING YOUR IRRIGATION SYSTEM IS ONE OF THE MOST EXPENSIVE PROJECTS YOUR CLUB IS LIKELY TO UNDERTAKE.

As your existing system ages, maintenance expenses increase and greens suffer, club members or owners are compelled to explore the options of renovating their irrigation system.

Studies by our banks show that capital availability is the number one issue that delays irrigation system renovation. Many board members and club owners tell us they did not fully understand all the options available to supply the cash for their project. As a result, financial decision makers at clubs across the country have asked for a review of the options available to golf courses to pay for a golf irrigation system renovation.

At most golf courses, four options are available to pay for your irrigation system. Each has benefits, but each option also raises some additional questions. The options are: 1) pay cash 2) assess the members 3) borrow at a local bank with a mortgage backed financing or 4) utilize a manufacturer-supplied program of specialty financing.

Cash: Saving enough cash to pay for an irrigation system is an elusive goal for most clubs. Many membership clubs are not-for-profit corporations, which makes it additionally difficult to reserve enough capital for an irrigation system and not create a tax liability. Both daily fee and membership courses typically have more capital improvement projects on their planning schedules than they have available capital. Even if a club has enough money set aside to pay for an irrigation renovation, the golf course should ask, "Is this the best use of the club's capital?"

Certainly for daily fee course owners, there's an opportunity cost of capital. If you have plans to expand your facility or to buy another golf course, you will have calculated what your potential return on that investment should be. If this ROI is greater than the interest expense of financing your irrigation system renovation, you should finance. An irrigation system has a long-term useful life and a shorter, but still significant-term, technical life. With depreciating assets, it is usually more fiscally prudent to pay for the asset as you use the asset rather than as a cash purchase. The exception would be if a club has more cash than projects to spend it on.

Assess the members: A private club has the option of assessing members to pay for an irrigation renovation. The willingness to do this depends on many factors such as the cost of the memberships, age of the members, recent assessment history at the club and the size of the proposed assessment as it relates to the member-perceived 'equity' in their club membership.

As an example, a club with high membership cost, stable and full membership, a waiting list, high monthly dues and no recent assessment history might be a reasonable club for assessment.

In contrast, a club with little or no cost to join, open membership positions, low monthly dues and a recent assessment history would represent a less likely choice. If members perceive the assessment cost to be a significant portion of, or exceeding their 'equity' in the club, an assessment may not be effective and may drive members away. At clubs where the average age of members is high, there's often a resistance to assessment. These members typically would like to pay for the irrigation system renovation with dues increase over time. If the older members continue their membership for only a portion of the term of the dues increase, they perceive they have paid for only the portion of the renovation they have utilized. The succeeding members pay the balance.

Borrow from the local bank: Most clubs will have one or more members who are affiliated with a local bank. The advantages of local bank financing are convenience and lower borrowing rates if the club pledges the real estate as collateral. The rate differential narrows when additional costs in mortgage- backed borrowing such as MAI appraisals and Phase One Environmental Impact studies are considered. If the Phase One study finds deficiencies, the club can be compelled to spend significant money in bioremediation. This is a Pandora's Box that most clubs wish they had never opened. In reality, a club should ask, "If we have to pledge the real estate to do this deal, will the members or owners agree?"

The bylaws at most clubs prohibit pledging the club's primary asset without a high concurrence of the membership. Many times, the value of the land is eight or ten times the planned amount for the irrigation renovation. Does it make sense to encumber the real estate for 10 or 20 percent of its value? Typically this is not desirable since it restricts access to the remaining equity in the property without either paying higher interest rates for a second mortgage or fees to refinance the first.

Mortgage-backed financing should probably not be the first avenue to consider as a means to pay for an irrigation system unless the cash flow and credit history are weak. Collateral lenders are less concerned about cash flow and credit history.

Most local banks will not have any experience in providing financing for a golf course irrigation system. They may not understand that 50-60 percent of the total costs of the project are soft costs, are buried in the ground and are not cost-effectively recoverable.

They may not understand the need for progress payments or how to evaluate the credit worthiness of not-for-profit businesses. On a major project like golf course irrigation financing, lender experience with this type of specialty financing is important.

Local banks usually prefer to provide variable-rate financing structured as a line of credit. The risks of this type of financing are rate risk and the annually renewable structure of a line of credit.

Does the club really want to bet that interest rates are going to remain flat or go lower than current levels during the term of the borrowing? Can the club afford to risk that this loan could be called during the annual renewal period? Such a call can be executed because of bank changes like consolidation, not just negative changes in club credit. Most member-owned clubs should not be in the interest rate risk business nor should they have short-term renewable debt at the discretion of the lender.

Another consideration for borrowing from the local bank is that a club uses a significant portion of their local credit capacity with this financing. If the club needs to secure immediate capital for emergency needs, and they are already extended at the local bank, serious cash flow problems can arise.

The final consideration for borrowing from the local bank is the concept of concentration of credit risk. This is the 'all your eggs in one basket' problem. As an example, if the club has some savings accounts at a bank and that bank provides a loan used for irrigation system financing, the bank will consider its risk reduced by the amount of deposits and savings the club has placed with the bank.

Further, that bank may have language in the loan documents referencing 'rights of offset.' This could allow the bank to seize, or at least tie up, other club assets if a dispute or default were to occur on the borrowing. Banks seldom advertise their rights to seize other assets, and clubs should be aware of their risks under these types of contracts.

Manufacturer-supplied programs of specialty financing: Recently, the two major irrigation manufacturers have begun providing financial solutions for their customers. They have realized what the golf car manufacturers have understood for years: with installed projects that range from $100,000 to $3 million, the golf courses must be provided with viable financial alternatives to paying cash, assessing members or mortgaging their property.

The ideal manufacturer-irrigation-financing program provides fixed-rate, fixed-term, uncollateralized borrowing for all the hard and soft costs of the renovation project. If a club is to qualify for such ideal financing, the club should have strong cash flow and credit history since irrigation projects have high soft costs. The best programs have flexible terms with payments that are customized to the cash flow of the club.

Manufacturer-supplied programs can also provide progress payments to vendors as products and services are provided. These manufacturer programs match clubs with lenders who have financed hundreds of irrigation projects around the country and who understand the requirements of such specialty financing.

As your club begins to consider upgrading your irrigation system, make sure you review all these financial options. If you understand the benefits and risks of each of these major choices you can make a faster and more informed decision. Your club should weigh these options and make your financial decisions in the beginning stages of planning an irrigation renovation. **BR**

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