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The Challenges Facing Distressed Golf Courses

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Operating a successful golf course is a challenge even in a favorable market, and the market right now is far from favorable for this industry. Whether the problem lies in marketing golf to a younger generation, a surplus of courses, or the increasing expense of keeping courses watered and maintained, golf course values face significant downward pressures. When combined with regular debt service or an unexpected expense or lawsuit, a Chapter 11 bankruptcy case may be seen by a golf course owner as necessary to obtain breathing room to attempt to restructure the business, or market and sell it.

There are typically two distinct players in business Chapter 11 bankruptcy cases, the company and its lender. In a golf course bankruptcy case, nearby homeowners, which may be represented by a homeowner's association (HOA), also may be involved. Additionally, local government entities such as water districts or county zoning boards may play a role.

The goal of any business bankruptcy case is to develop a plan of reorganization by which a company can pay off its debts to its creditors. In many businesses, the primary creditor will be a lender secured by the golf course property itself. Given the downward pressures affecting the industry, it may be that the impetus to commence the bankruptcy case came from the lender's unhappiness with the course's profits or potential for profit. All business debtors face pressure to reduce expenses and revisit their business plan, but golf course debtors may face that pressure more than most, given the recognized pressures facing the industry.

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As a golf course debtor formulates its plan of reorganization, it will be natural for the company to investigate whether the property can be redeveloped as something other than a golf course. Residential property, in many areas, is more valuable than a golf course. In most cases, however, such redevelopment will be prevented by zoning restrictions, or possibly covenants running with the land that require the property to be used as a golf course (such as in a residential development built around a golf course). Covenants on adjacent residential properties may provide a steady income stream to a course owner, but may simultaneously require the owner to maintain and operate the course.

Golf course owners may have the option, outside of bankruptcy, to attempt to alter or amend these restrictions that, in the owner's mind, suppresses the ''full value'' of the land. Once a bankruptcy case is commenced, golf course debtors may attempt, pursuant to Section 365 of the Bankruptcy Code, to reject an underlying covenant as an executory contract and thus excuse the debtor's further performance under it. While covenants running with the land do not bear the hallmarks of a typical executory contract (the definition of which reaches far back into the historical record, but is summarized most commonly as a contract in which both parties have continuing obligations to each other), it is not uncommon for parties to assert that they can be rejected anyway. Some courts have held that some rights which run with the land can be rejected, specifically, rights of first refusal. While no bankruptcy court has extended this exception to apply to other rights that run with the land, such as the obligation to operate a parcel of property as a golf course, the temptation to argue that a court do so will be strong for any golf course debtor who could make more money selling the property for a different use.

For these reasons, a golf course bankruptcy poses unique challenges to a lender. In filing a motion for relief from the automatic stay to foreclose upon the debtor's property, the lender may have difficulty in asserting that the lender is not adequately protected solely because the property is declining in value, or that the property does not generate enough regular income. A debtor might counter those assertions by stating that it intends to redevelop the property, or that it at least needs time to evaluate whether it can do so. At the very least, a debtor likely will convince a bankruptcy court to

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continue a hearing on a lender's motion for relief from stay, if it is filed early in the case. Nevertheless, such a motion is a powerful tool for a lender to keep a debtor on course to sell or redevelop the property.

Likewise, golf course bankruptcies pose unique challenges to any adjacent homeowners or HOA. Any residential community built around a golf course will have covenants obligating the golf course owner to maintain its property as a golf course, may give homeowners an easement to use the course, and may even have covenants running with the residential properties that require homeowners to pay the golf course for this privilege. To the extent a golf course debtor seeks to escape any of these obligations, homeowners will find themselves in direct conflict with the debtor. The homeowners may become the most significant creditor group in the case. Homeowners can voice their concerns in court either through a committee of creditors, if one is formed, through an HOA, or even individually, and it is unlikely that bankruptcy courts will be dismissive of their concerns. Homeowners may determine that negotiating with the debtor, filing a motion to appoint a trustee or dismiss the bankruptcy case, or even filing their own plan of reorganization, may be an appropriate course of action as circumstances dictate.

For the local regulatory entity or municipality interested in the golf course, bankruptcy creates no obstacles to enforcement of their regulatory power. The automatic stay does not apply to government units to enforce their police and regulatory power. Thus, zoning laws will remain in effect and may be enforced against the debtor. Fines might be imposed for violation of nuisance laws, such as when a golf course debtor fails to maintain the course or remove weeds. While these governmental units are not likely to take an active role in a case, they may assert claims or even join in pleadings designed to obtain relief consistent with their interests, and as such may become useful allies to other parties.

The golf course debtor, thus, could potentially face an unhappy lender, HOA, and regulatory agency all at the same time. If the debtor does not possess the needed expertise, its first priority should be to file an application to retain a competent golf course management company. In that application, the debtor can set out the issues facing the course and begin to outline possible exit strategies. To the extent the company desires to sell the property, the debtor should consider filing an application to retain a broker to market and sell the course. Both of those applications, filed early in the case, will demonstrate to the court that the debtor is taking the appropriate steps to reorganize. If the company is not interested in a sale, the company should still consider filing an application to retain a valuation expert to appraise the property and inform the company about possible redevelopment options. These applications may even be helpful in placating an unhappy lender or HOA. At the very least, they provide the company with a ready argument against any motion against it, that is based on the premise that the debtor is not capable of reorganizing effectively.

Simultaneously with these applications, the debtor must look, with a clear eye, at the potential to redevelop some portion of the golf course. If the only barrier to redevelopment is a zoning change, the debtor may want to begin pursuing that early in the case. To the extent a covenant impacts redevelopment of the course, the Debtor should consult with counsel and weigh the merits of pressing the argument that the bankruptcy court may reject those covenants as executory contracts. And simultaneously with this, of course, the debtor should be speaking with the HOA and its lender to attempt to work out a deal.

Golf course bankruptcies call for a negotiated resolution to these issues. Early in the case, any group which asks the court to rule in its favor is likely to have its hearing continued for several months, no matter how strong its arguments. This applies to a debtor seeking a court ruling that it can reject a covenant as an executory contract, to a lender filing a motion for relief from the automatic stay, and to a homeowner group seeking to either dismiss the case, appoint a trustee, or terminate the debtor's exclusive right to propose a plan of reorganization. Competent legal advice, combined with a clear understanding of the various moving parts, has the potential to turn a case with significant barriers to success into one with a significant payout to creditors, and opportunity for a debtor to reorganize and potentially redevelop its property.

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