Crooked Creek golf development: A case in commercial bank lending

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ABSTRACT

This case provides a platform to involve students in the process of analyzing a commercial loan request. Jacob and Nate MacVey own a construction company called Mac Brothers Construction. They have also been avid golfers since they were young. They have decided to build a golf course on a portion of their family farm and requested financing from our bank. Through a series of questions, the students analyze the lending request. Topics covered are the strengths and weaknesses of the request, potential economic factors, and additional information needed. The students are also required to complete proforma financial statements using the information given. This case is suitable for a class in banking, corporate finance, or possibly investments. It can be explained in one class period and discussed in the next.

Keywords: Commercial lending, financial statement analysis

INTRODUCTION

Jacob and Nate MacVey are brothers who co-own a construction company called Mac Brothers Construction. They are both in their 40's and the business has been very successful. They build higher quality homes in the $200,000 to $400,000 price range in and around the Vinemount, Texas (fictional town) area. They have also both been avid golfers since they were young.

Henry MacVey is the father of Jacob and Nate. Henry owns a 565 acre farm about 2 miles from Vinemount city limits. He once ran a large cattle operation, but has since cut back as his children have grown and started their own business. Henry taught his sons to play golf, and is a very good player himself.

The family has decided to begin a new business which they believe will take advantage of their talents and interests. They would like to develop a large portion of the family farm into a golf course and residential community called Crooked Creek (named after a small branch which runs through the property). They have worked with a well-known golf course architect to design the course and lot layout. The course, club house, and pool will use about 160 acres of property. After all the necessary roads and easements, there will be 172 home lots ranging from 1 to 3 acres.

Their plan is to develop the golf course and club house as soon as possible. As it is being completed, they will also begin construction on the roads and other infrastructure (lights, water lines, sewer, etc.) and develop the lots in five phases. Phase 1 will include 31 lots, Phase 2 will include 43, Phase 3 will include 34 and many of the larger lots, Phase 4 will include 40, and Phase 5 will include the final 24. Their goal is to sell 75% of a phase before developing the next phase and opening it for lot sales.

While home owners will not be required to use Mac Brothers to build their homes, they anticipate they will build a large number. They currently have 7 "crews" so they can build 7 homes at any given time. It usually takes them about 4 to 5 months to complete a home. Homes will range from $200,000 to $400,000, and Mac Brothers usually earns a profit of around 15% to 20% of the building costs after all expenses.

Golf course construction is estimated at $1.8 million. Henry has $400,000 in retirement savings which he can use for the project, and Jacob and Nate can also contribute about $200,000 each. They are requesting the other $1 million as a loan from your bank. They will also contribute $100,000 in cash into the business to provide working capital once the course is operating.

They estimate it will cost $20,000 per lot to make each completely ready for the builder. This figure includes road construction, all utilities, grading, street lights, etc. Lots will sell for an average of $40,000.

Crooked Creek Golf Links is a separate business from Mac Brothers. It is a limited liability company owned by Henry, Jacob, and Nate. Mac Brothers is also an LLC, and is owned by Jacob and Nate only. None of the borrowers are current bank customers, but they are well known and well respected in the community.

PROJECTIONS

All the McVeys are members of a local country club, and many of their friends are either members or regularly play. Their new course will be a public course (meaning anyone can play) but will also offer memberships. They will set greens fees at $35, and annual memberships (which allow for unlimited play) will be $1500. Their projections for rounds of golf "sold" and annual memberships are below:

	12/31/2016	12/31/2017	12/31/2018	12/31/2019
rounds	0	7,300	8,300	9,300
memberships		25	50	100

Their estimated operating expenses are below:

	12/31/2016	12/31/2017	12/31/2018	12/31/2019
Salaries	0	150,000	180,000	200,000
Maintenance	0	15,000	20,000	25,000
Advertising	0	12,000	12,000	12,000
utilities	0	3,500	3,500	3,500
Depreciation	0	14,000	14,000	14,000
Insurance	0	10,000	10,000	10,000

For the balance sheet, the only assets are cash and the developed land. The only liability is the loan, and the beginning equity is the amount of the family investment ($800,000 now and another $100,000 in January of 2017).

THE REQUESTS

The family has been talking with your bank concerning funding. They have basically made two loan requests: one for Crooked Creek Golf Links, and one for Mac Brothers.

Crooked Creek

They want to begin building the golf course as soon as possible, and can actually start moving dirt in the next few weeks. They also want to begin the infrastructure for phase 1 at the same time. They believe they can complete the necessary improvements and sell all the lots within the next year. In fact, they have 10 buyers on a waiting list. The golf course will take the full year to build and will be open for golf in January of 2017.

For the projections, calculate the total revenue and cost of improvements for Phase 1. The $20,000 cost per lot includes all expenses except interest.

The family has come to the bank to request a loan commitment for $3.4 million for the rest of the infrastructure cost.

Mac Brothers

They plan to build and sell 12 houses in phase 1 next year (2016). The average price of a home will be $250,000. The materials and other expenses will be the same percent of sales as in

2015 (total cost of all building expenses around $167,500 per house). Therefore, seven houses times $167,500 per house = $1,172,500, which is their line of credit request.

None of the borrowers are current bank customers, but they are well known and well respected in the community.

ASSIGNMENT

Construct balance sheets and income statements for 2013 to 2015 and for 2016 projections for both companies. Use raw numbers, common size, and year over year growth.
Construct cash flow statements for 2014, 2015, and 2016 projections for both companies.
Include comments concerning the trends/comparisons for the financial statements.
Construct Excel sheets that you believe are necessary for the loan.

Questions to Discuss

1. What additional information do you need from the McVeys or from other sources in making the loan decision?
2. What are the strengths and weaknesses of this credit request?
3. What economic factors may impact the viability of the project?
4. What are the main concerns (if any) that you would have as their lender at this point?
5. Based on the analysis, should your bank grant the commitment? If so, what would be the amount and how would it be structured? Justify your position.

Mac Brothers

Income Statement

Period Ending	12/31/2013	12/31/2014	12/31/2015
Sales	1,344,000	1,492,300	1,778,740
Materials	395,000	500,000	645,000
Gross Profit	949,000	992,300	1,133,740
Operating Expenses			
Salaries	698,500	720,000	875,000
Officer Salaries	150,000	165,000	175,000
Advertising	3,000	3,000	3,000
Utilities	3,940	4,000	4,200
Depreciation	12,000	13,562	14,523
Insurance	27,000	28,000	32,000
Miscellaneous	8,000	10,000	10,000
Total Operating Expenses	902,440	943,562	1,113,723
Operating Income (EBIT)	46,560	48,738	20,017
Interest Expense	24,754	31,971	18,875
Interest Income	2,410	3,140	1,850
Income Before Tax	24,216	19,907	2,992
Income Tax			
Net Income	24,216	19,907	2,992

Mac Brothers

Balance Sheet

Period Ending	12/31/2013	12/31/2014	12/31/2015
Current Assets			
Cash and Equivalents	25,000	24,962	17,821
Short Term Savings	95,000	114,000	100,000
Net Receivables	16,520	18,634	19,452
Inventory	612,480	740,850	542,000
Other Current Assets	5,684	6,254	7,126
Total Current Assets	754,684	904,700	686,399
Gross Fixed Assets	119,560	126,840	145,600
Less: Depreciation	36,450	50,012	64,535
Net Fixed Assets	83,110	76,828	81,065
Total Assets	837,794	981,528	767,464
Current Liabilities			
Accounts Payable	56,785	58,963	61,520
Line of Credit	412,562	532,850	314,580
Income tax payable	0	0	0
Other Current Liabilities	5,624	6,985	5,642
Total Current Liabilities	474,971	598,798	381,742
Bank Loan	0	0	0
Total Liabilities	474,971	598,798	381,742
Capital Stock	100,000	100,000	100,000
Retained Earnings	262,823	282,730	285,722
Total Stockholder Equity	362,823	382,730	385,722
Total Liabilities and Stockholders Equity	837,794	981,528	767,464