Private Clubs Quarterly

Capital Planning and Financing Considerations

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A private club exists to provide an experience to its members. The perceived value of that experience can depend heavily on a club's capital assets. Although some departments will rely on other revenue producers, such as tangible goods sold in the pro shop, clubs are primarily in the dues-collecting business and the dues are earned by providing access to the club's physical facilities. As a result, clubs must continuously plan for capital improvements and enhancements to provide value to members and protect the dues revenue stream.

A capital budget, including analysis of the related financing options, is necessary to fulfill these requirements. A capital budget requires different inputs and analysis than the standard operating budget. The capital budget must span at least three to five years at minimum, rather than just one operating cycle. Some clubs may even choose to perform a capital reserve study to help guide the process. Monitoring the capital budget on an ongoing basis is essential and should be given the same attention as the operating budget.

An important factor to keep in mind during this process is the impact that the pandemic has had on the club industry. Many private clubs experienced significant membership growth during the pandemic, which comes with an increase in operating revenues as well as initiation fees and capital revenues. Additionally, many clubs greatly benefited from various government programs such as the Employee Retention Credit. A natural reaction was for Boards to designate this influx of cash for much needed capital projects. At the same time, we encourage clubs to maintain a reasonable level of pragmatism as growth and cash flows may not continue increasing at this rate.

Planning and Determining Priorities

The capital planning process ideally begins with a capital reserve study evaluating remaining useful life and replacement costs of the assets, as well as an internal survey to determine what would provide the greatest value to the membership. The studies must also address any legal issues (such as ADA rules), zoning issues (such as property lines and easements) and safety requirements for both employees and members. Clearly identifying the capital needs and wants, ranking the projects and developing a timeline of crucial deadlines will provide clarity and consistency when evaluating the financing options. This can be accomplished by sorting projects into three buckets:

1. First priority – Critical projects needed in order for the club's facilities to continue functioning properly; will result in a significant loss of business without action (code violations, safety issues leading to accidents, unusable amenities)

2. Second priority – Projects that will become a critical issue causing a loss in business if not addressed as soon as possible (aging sprinkler system, outdated technology)

3. Third priority – Projects to enhance the member experience (adding new amenities, adapting to trends and members' lifestyles)

The next hurdle will be getting members on board and excited about upcoming projects, which is proving challenging recently as the club industry is also dealing with a changing of the guard, so to speak – millennials are making up a much larger portion of the club's target audience, which was previously dominated by baby boomers. Many baby boomers are retiring and beginning to consider moving to other states, playing less golf, traveling more and possibly cutting back on expenses. An older member may be planning to leave the club before or shortly after a capital project is completed, making them unwilling to pay large assessments or see their capital dues increase to fund new projects. However, it is key to help long-term members understand that new projects must be completed to allow future generations to experience the club at its best, just as they did upon joining.

There are many factors that interfere with gaining the support of members. For example, Board turnover during the project can cause changes in priorities and friction if there is not a clear plan with buy-in from all generations/groups represented at the club. Additionally, it is not uncommon for a Board member or the Board as a whole to have a pet project that they want to undertake during their term. However, these projects may not be in alignment with the overall vision of the club. Active listening, thoughtfully communicating the value of the project to the membership and encouraging members to stay invested in the overall vision of the club will help with navigating these situations.

Financing Options: Pros and Cons

Once the club has defined the scope of the project during planning, it is time to evaluate financing options. The pros and cons to each method of financing will vary from club to club, as each club is its own unique community. Additionally, the club will likely need to use a combination of different financing options with the breakout depending on the club's specific needs and membership characteristics.

Bank Funding: Bank borrowing is perhaps the most common method of funding capital projects and is generally combined with the other options discussed below. Often bank financing will create additional complications for the club, such as more compliance and reporting requirements. Negotiating the most favorable loan terms can involve a lot of back-and-forth between the club and the bank, which can be very time consuming. A very long payment term can also create a disconnect with the members — for example, new members may come into the club and have to pay down debt incurred on a project that is no longer adding value to the membership. Although bank borrowing is not always the most appealing financing option since it must be repaid with interest, it can be used to cover shortfalls from the other more desirable funding options. It may also be more readily available to the club than other financing options.

Capital Assessments: Capital assessments are a financing option available to many clubs, but they can be a very controversial issue and the response will vary greatly depending on the culture of the membership and sensitivity to new assessments. Would the assessment cause sticker shock and upset folks? Or, if welcomed, what is the breaking point? As mentioned above, capital assessments may be the most likely option to cause members to feel that they are funding a project from which they will not receive any benefit. If the assessment is not in line with expectations and the members' financial tolerance, it could damage the club by pushing members away. However, on the plus side, capital assessments can create a feeling of ownership similar to investing in a business venture and giving members a desire to continue investing into the overall experience. Additionally, unlike debt, the club does not have to be concerned with repaying principal and interest.

Member Bonds: Member bonds, often considered "friendly debt," are also an option for financing capital projects. They are considered friendly because there is generally more flexibility, lower interest rates and fewer compliance requirements than standard bank debt. Similar to capital assessments, the member bonds help members feel a sense of pride and more invested in maintaining their club. Before issuing any member bonds, however, be sure to check with any current lenders as member bonds may be considered subordinate to your mortgage or other bank debt. Member bonds may also trigger the often-overlooked tax reporting requirements to report the interest paid to the member which can catch the member by surprise. There may also be a large administrative burden placed on the accounting team for maintaining the records and payment schedules, especially when there is a large quantity of individual bonds.

Reserves/Initiation Fees: Many clubs already have reserves of initiation fees and other savings set aside and designated for capital purchases. Using reserves to fund capital projects is desirable since there are no repayments to be concerned about and members are already expecting to pay an initiation fee upon joining so it is unlikely to cause controversy. Using initiation fees to fund the project may also help to give the impression that current/active members are the ones funding the projects that they will be using. One downside of using these reserves is that the funds will no longer be available in case of an emergency, so the club will want to develop a plan for how the reserves will be replenished. Additionally, by placing a Board designation on funds, clubs should be sure to track the income and expenditures to make sure the funds are being properly used and authorized for the designated purpose.

Angel Funds: Commonly referred to as "angel funds," donations and pledges from members can be very helpful. It is a source of financing that does not have to be repaid, is not charged interest and is unlikely to cause controversy since the angel funds are voluntary. These donor-restricted funds will need to be tracked to ensure they are being used properly, but otherwise come with minimal compliance requirements. On the other hand, members can be very specific regarding the use of the angel funds which can influence the club to take on a project or task that is not truly in line with its long-term plan. For example, a member may be willing to contribute half of the cost of new artwork, but artwork may not be a priority for the club.

Final Thoughts

Clubs are in the dues-collecting business and, as a result, the physical assets are the primary revenue producers. These capital projects are done to increase the club's value in the eyes of members and potential members which ultimately leads to longevity and financial stability for the club. Having a strong vision in place, with clear priorities, a realistic financing plan and cohesion among the members, will allow the club to meet this goal.

Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private clubs. Please reach out to the partner in charge of your account or any of the authors in our Private Clubs team below:

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