CLUB MANAGERS ASSOCIATION OF AMERICA

CAN CAPEX PROTOCOLS DISTORT DUES PRICING?

July, 2015
By Peter Nanula

Avoiding the Cycle of Capital Dues

Here's a question that general managers and board members at private clubs nationwide should ask themselves in earnest: How many businesses ignore market pricing in setting the price for their own product?

Some clubs today do exactly that, and the root of the problem can be found in the way clubs routinely handle capital expenditures, or CapEx. While this connection might seem illogical on its face, here's how the puzzle pieces fit together.

Ideally, businesses budget a percentage of gross revenues every month, and divert those funds into a separate bank account earmarked for capital expenditures. This is how businesses maintain the integrity, charm and value of their properties over time.

If you belong to a private club today or serve on its board you may be shaking your head right now—because this is not necessarily the way clubs fund CapEx.

Many clubs do, in fact, develop a long-range plan for capital projects, usually five to seven years out — or they develop a depreciation schedule

that uses income from operations to pay for improvements or future projects. Data from Club Benchmarking indicate that 63 percent of clubs maintain a Capital Improvement Reserve Fund. However, I investigated this figure with Club Benchmarking and we discovered that of those clubs with a Capital Improvement Reserve Fund, 25 percent have no money in said account! It's hard to attribute actual CapEx planning to clubs that have reserve funds but don't fund them.

Clearly there are many, many clubs out there that neither maintain reserve accounts, nor fund them. For these clubs, the CapEx scenario is quite different: board members may identify the need to fund a new clubhouse roof, for example. They meet, and the board may decide to assess the members—all at once or over time—to cover this theoretically one-time expense.

These episodic assessments are called different things: "capital dues" is a popular euphemism, as are others such as "clubhouse dues" or "operating assessments." Whatever the term used, if deployed incorrectly, the capital dues process can mask a club's inability to properly fund CapEx reserve accounts from existing revenue streams, year in and year out.

Many private clubs in America have long used episodic assessments. But make no mistake: It's far more common today because another longstanding CapEx funding method—borrowing—is a less likely option. Since the recession of 2008, local banks and specialty golf lenders have essentially vacated the golf space.

Capital dues for a new roof may add only $50-$100 to a member's monthly dues bill. But these hikes tend to stay in place, permanently, as new CapEx projects are identified each year. Here I cite evidence/data we at Concert Golf Partners have gathered directly from clubs (where we've assumed ownership) and anecdotally from our many discussions with private clubs mulling conversion to non-equity status.

According to Club Benchmarking data: "Two-thirds of clubs have some sort of recurring capital dues. The more 'high end' the club (as evidenced by a higher initiation fee), the lower the proportion that have recurring capital dues — 50 percent of clubs with greater than a $50K initiation fee have recurring capital dues."

If infrastructure isn't methodically updated through proper CapEx planning, roofs and furnaces and pools and HVAC systems inevitably fall into disrepair—meaning these recurring, more or less permanent capital dues grow in size. Before you know it, members wake up and the club they

joined for $800 in monthly dues is now costing them $1,200 a month. Similarly, the board wonders why its annual member attrition rate has gone up — the typical response to any dues increase. Again, according Cronin, “There is no question that when dues are increased, members leave. This is especially true at less expensive clubs. The effect is less prominent at more expensive clubs.”

Clubs should consider a 3-5 percent profit margin on their gross revenues to fund a rolling capital reserve. It can be accomplished within the existing service levels. If running the club at that level seems daunting, then your club isn’t being operated efficiently enough.

PART TWO – CAN CAPEX PROTOCOLS DISTORT DUES PRICING?

A Dangerous Effect on Pricing

In every metropolitan area, there are top tier clubs that compete with each other for the wealthiest members, a mid-level tier that competes for the next rung of members and a bottom-level tier.

Among that percentage of clubs operating without a proper CapEx reserve, a dangerous myopia can take hold at the board level. In short, the board at a mid-level club tends to forget that its original dues level was $800 a month — because an aggregation of capital dues, over time, has bumped that dues level to $1,200, which is what the top-tier clubs in town are charging. Soon the board of this $800/month club, based on this higher aggregate dues figure, begins to view itself as a $1,200/month club, competing with other $1,200/month clubs for members.

But it’s not real: The level of service and amenities at the $800/month club has not changed. A new roof and functioning AC are not service enhancements; they don’t add to the member experience. So the price has risen to $1,200/month but the club experience — the value for money — remains $800/month.

How does this impact the ability of the overpriced, mid-tier club to compete for members? For clubs in this fix, it’s like a Marriott trying to compete with a Four Seasons.

To stay with the hotel analogy for a moment, our firm operates a club on Amelia Island that sits beside a Ritz-Carlton hotel. Our colleagues on the hotel side are keenly aware (as we are) of exactly whom they're competing against at $420 a night. They understand (as we understand) that a hotel cannot charge $490 a night for a $420 room simply because it hasn't funded its CapEx properly. If it does, the result is an untenable level of vacancy.

Over the last five to six years, private golf and country clubs have fallen into this "out of market" cycle, en masse. There are other ways that clubs fall into this trap. Since the recession, many clubs delayed capital projects and only spent on those maintenance projects that were broken — the lack of new members (and initiation fees), plus falling member retention, all contributed to this "catch-up phase" of renovations. But the big culprit is poor CapEx planning. Once out of market, clubs resort to a step we all recognize for its ubiquity in the market: discounting like mad to maintain consumer interest. And we all know where that leads — to more member attrition and a complete loss of price/value credibility in the market.
A club board can also misjudge the effect of capital dues and continual assessments on the existing membership base. While the top 20 percent of any membership (in terms of wealth) may not care about another $200-$400 a month, the bottom 20 percent is another story. These members can become as disillusioned by the dues increase as they are by the unpredictability of this expense from year to year. All too often, these capital dues result in some members saying, "You know, we don't even use the club that much…"

You can see how poor CapEx planning may have contributed to the attrition that has afflicted so many private clubs the last 5-6 years. When enough customers opt out (or move to the neighboring club where pricing is more in line with the value offered), the critical mass of dues-paying members is lost — endangering far more than your CapEx. In good economic times, many clubs can fudge this process through assessments and not suffer the consequences. In less stable economic times (the likes of which we've endured since 2008), it can mean a death spiral.

This 20 percent rule is also instructive at the macro level. In good times or bad, the top 20 percent of private clubs in America will survive no matter how they handle CapEx. The remaining 80 percent are walking a much finer line. They must develop (or bring in) the discipline to run a three to five percent profit margin devoted to CapEx. For these clubs, which represent the majority of clubs, this discipline is not discretionary—it's often the difference between success and failure.

Peter J. Nanula is chairman of Concert Golf Partners, an owner, operator and all-cash buyer of private golf and country clubs. Concert Golf specializes in recapitalizing member-owned clubs carrying too much debt, converting them to non-equity status, and maintaining the clubs as fully private. Nanula is the former CEO of Arnold Palmer Golf Management.