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The Private Club Minefield by Scott Kauffman

Cash-strapped member-owned clubs are selling, but deals are taking time because of their complexity.

Golf courses have always been some of real estate's most complex transactions. Few other assets have as many moving parts, including course operations, real estate development, restaurants, hospitality and lodging. And private clubs are even more complex.

Yet, some of the most sought-after acquisitions in the U.S. are the 2,500 member-owned private clubs, many of which are struggling with dangerous levels of debt and stagnant membership growth.

The most active buyers in recent years, including ClubCorp, Concert Golf Partners, McConnell Golf and Escalante Golf, have been successful in repositioning dozens of undercapitalized private clubs.

Jim Hinckley, CEO of Century Golf Partners, said most of the long-term leases or purchases his Dallas-based firm are pursuing have the same recurring themes: high debt and initiation-deposit repayment obligations.

"I think when the members realize the club's in trouble because they may have spent too much money on capex or they borrowed too much, you'll usually see a new board come in and say, 'We need to change direction or do something different' " Hinckley said. "That's where we've been successful, working with them to come up with a solution that works for them"

Dennis Hillier, an attorney who specializes in private clubs, said it is imperative to cover the following due diligence steps: study member plan documents and associated member deposit refund policy; obtain current title policy; and secure environmental inspection.

If there is one omnipresent legal obstacle, he said, it is ascertaining the nature of the private club's pool of member-initiation deposits. As any buyer will note, it is paramount to study the existing member plan documents and determine if there is a refundable member-deposit program and whether there is potential liability.

"If there is, you want to, in most cases, extinguish that liability and move to a nonrefundable program rather than a refundable program" Hillier said. "If you are nonrefundable and sell a membership, it's a debit-to-cash and credit-to-initiation-fee income, which is taxable, but you don't have a liability on your books. If it's a refundable program, the entry is a debit-to-cash and credit-to-membership-deposit liability, which is a liability on your balance sheet, and buyers will pay you less for a club if there is a refundable deposit"

Hillier said a successful approach used by many buyers to navigate this member minefield, especially if it's a struggling asset, is to work with the owner either to foreclose on the property to clear up the title and "extinguish membership liability" or to have the club go through bankruptcy to "extinguish the member debt"

"You want to clean this thing up so you can put in a new membership plan with a new set of membership plan documents" Hillier said. "That's what creates value if you want to sell it [one day] or if you're developing it down the road"

For Concert Golf Partners Chairman Peter Nanula, whose private equity group has picked up a dozen member-owned clubs in recent years, refund liability is a big issue.

"That's why we and others typically don't buy membership agreements or refund obligations" he said. "Sometimes they're tiny, and it's OK. But when it's meaningful, it can be daunting, and we'll try to structure around that somehow. We have solved those membership-refund balances at many of our current clubs by either restructuring the program or assuming the liability outright"

Nanula tries to broker a win-win deal that delivers a debt-free club to the members and promises significant capital improvements — all in exchange for a willingness to change the way the refunds work.

“They’re always in favor of that” Nanula said. “We talk to so many members who say, ‘Yeah, I spent $50,000 years ago, and I never expected any money back. But I’ve got this document that says I would get all of my money back’

“I just think a lot of these board members, they’re not lawyers and they get really scared that they’re in charge of a $6 million asset. The last thing [they] want to do is get in any hot water for a breach of fiduciary duty.”

—Peter Nanula, Chairman, Concert Golf Partners

“So they’re struggling with the way they’re doing it, because they’re admitting new members in at $20,000 and paying out old members at $50,000. Well, of course, they’re going bankrupt”

He said it is often more important to members to have a club that is debt-free, well-run and being improved than to hold onto the promise of a refund.

“So, if you want to restructure the program in such a way that you can afford to pay out some reasonable refunds over time, and give people some certainty that they will actually get something back someday, that sounds terrific” he said.

Nanula also finds it difficult to earn the trust of board members and make them comfortable discussing exploratory options, because many of them are worried about breaching their fiduciary duty.

“They’re uncomfortable talking about it and just generally fearful” Nanula said. “It’s leading into an area that this club has never considered for 90 years.

“I just think a lot of these board members, they’re not lawyers and they get really scared that they’re in charge of a $6 million asset. Usually it’s a professional who likes to go play golf. He’s a 2 handicap and … volunteering two hours every month to go to a meeting. The last thing [they] want to do is get in any hot water for a breach of fiduciary duty”

Golf broker Jeffrey Woolson of CBRE Golf & Resort Properties said it’s equally important to understand the bylaws of the club and the financial ramifications of a sale as it relates to the club’s corporate structure.

For instance, what does it take to approve a sale or qualify as member consensus. Is it 55 percent or 70 percent of the vote?

Also, because many clubs are set up as corporations, Woolson said it's important to be aware of taxation and other ramifications.

"You have to have the bylaws in order" said Woolson, who is currently going through this process with the proposed sale of Las Vegas Country Club. "If the members are going to walk away with anything from the sale, you have to keep that in mind. Also, what if there's a liquor license. Is it transferrable going from a non-profit club to a for-profit? So, you need to fully understand these financial and taxation issues too"