For private equity clubs: choices, choices

BY PETER J. NANULA AND VAN A. TENGBERG

Membership in a private equity club has historically been considered to be one of the hallmarks of success. The most prestigious golf clubs in America were generally private equity clubs. It was believed that there were significant benefits to belonging to a private equity club, including the ability to influence management decisions through the exercise of voting power, exclusivity of membership and perceived social status. Of course, there were trade-offs as well, including the ability of the club to assess its members each year for capital improvements, members (who often had no experience) becoming involved in club management and the necessity to have sufficient funds each year (through dues, etc.) to balance the budget. In some cases, it worked well. In other cases, it was a recipe for disaster.

COMMENTARY

During the time period between 1990 and 2000, a new form of private club emerged and became popular: the private non-equity club. These clubs were generally owned by a large golf company, a wealthy entrepreneur or a developer. Private non-equity clubs ostensibly offered many of the benefits of a private equity club, including a membership cap, careful screening of prospective applicants and all, or substantially all, of the services offered in a private equity club. However, these new private non-equity clubs also eliminated some of the perceived negative problems associated with private equity clubs, including members becoming involved in management, elimination of assessments for capital improvements and a degree of certainty regarding dues.

Moreover, in many cases, these types of clubs offered a fully or partially refundable membership deposit, which meant the member could receive back all or a portion of his or her membership deposit in the future. The perceived benefits of these private non-equity clubs were many, especially if the club was owned by a benevolent owner willing to spend any sum of money regardless of the impact to the bottom line. As a result, the popularity of private non-equity clubs rose significantly during this time period.

Scroll forward a few years and the golf industry found itself in the middle of an economic recession. This, coupled with an overall decline in the demand for golf, resulted in a perfect storm. With few exceptions, private clubs (both equity and non-equity) experienced an increase in resigned members, a decrease in demand for memberships, an increase in the waiting time on the seller's resignation list, an increase in monthly dues, a decrease in the fee/deposit for memberships and a long list of deferred capital improvements and repairs.

In many instances, private equity clubs continued to raise dues to unprecedented — and in many cases — above-market levels. Unfortunately, when many found themselves in the position when they could no longer raise dues, they took on debt and pledged the clubs' assets and properties to finance deficits. During this time period, private non-equity clubs struggled financially as well, and many found themselves in positions where they could no longer honor their commitments to refund the membership deposits to resigning members. Private equity and non-equity clubs faced foreclosure proceedings and some filed bankruptcy. Members were left in a quandary. What was once one of the hallmarks of success (membership in a private club — equity or non-equity) had become a financial burden from which there was no escape.

What was once one of the hallmarks of success (membership in a private club — equity or non-equity) had become a financial burden from which there was no escape.

Private clubs and their members began to question the future. The private equity club model is clearly the right one for many prestigious, historic clubs with long waiting lists of prospective members, large capital reserves, strong management, a rich history and geographic barriers to entry.

The question then becomes: What about the thousands of other private equity clubs in America? Does it make sense for them to fight to preserve their tax-exempt statuses and remain as private equity clubs? Some have concluded yes and have continued on their current paths or have retained professional management to take over operations. Others have concluded it is no longer worth trying to preserve their tax-exempt statuses and have sold the club assets and properties to separate owners in exchange for debt-free capital structures and committed capital projects. They've converted to non-equity private clubs. Some of the pros and cons of this decision are outlined in the chart on this page.

Private Club Financials

	Private Equity Club	Private Non-Equity Club
Debt	Usually no. However, some private equity clubs have resorted to debt financing to sustain operations.	Usually no. As part of the conversion, the owner-operator may pay off all debt.
Assessments	Yes	No
Capital Improvements	Funded by assessments and transfer fees	Funded by owner-operator as part of the conversion, and ongoing
Private	Yes	Yes
Dues	Must be at a level to allow the club to at least break even in operations	Market-rate dues
Membership Fee Refunds	Yes. Members are generally entitled to a designated percentage of the resale price of the membership, less a transfer fee. The resale price may be more or less than the membership fee originally paid.	No. Private non-equity clubs generally offer only non-refundable memberships, and restructure or eliminate prior refund obligations.
Governance	Member-managed	Managed by owner-operator. Member advisory board provides guidance.

The decision to convert from a private equity club to a private non-equity club is one that requires the careful weighing of all of the facts and circumstances. Just as no two clubs are alike, each club must decide what is best for its members and take the steps necessary to ensure its long-term viability and success. ●

Peter J. Nanula is chairman of Concert Golf Partners. Van A. Tengberg is a partner with Foley & Lardner LLP