Capital Funding: Inertia is the Enemy

While private clubs rank second only to the power industry in capital intensity, many remain bogged down in resisting the need to invest in the service and amenity offerings that are needed to remain fresh and relevant.

By Ray Cronin, Club Benchmarking Founder & Chief Innovator

"**In this world**, nothing is certain except death and taxes." That well-known phrase originated in the 18th century, but it's still quite fitting for members, volunteer leaders and management of private clubs with one significant addition…nothing is certain except death, taxes and the need to continuously invest in the club's facilities to meet the future.

The theme of this issue, "Futurecasting Facilities," is a timely concept that provides ample fuel for boardroom conversations, as a growing number of clubs recognize the importance of remaining fresh and relevant in the face of societal changes. The fact is that clubs can and do get stuck, bogged down by inertia and avoidance. Club Benchmarking refers to these as "red-bucket clubs," characterized by outdated and dilapidated facilities.

Clubs that are stuck share a common resistance to investing in the latest service and amenity offerings such as upscale casual dining, resort-style pools, fitness and wellness, golf learning centers or pickleball. Contributing factors include operational versus strategic governance, and members thinking like customers rather than stewards and owners who are willing to invest in the club's future. Unless that mindset is reversed, such clubs will ultimately fail.

As seen in Figure 1, 74% of the assets on the average club's balance sheet are invested in facilities in the form of property, plant & equipment (PP&E).

Figure 1: Percent of the Assets on the Average Club's Balance Sheet

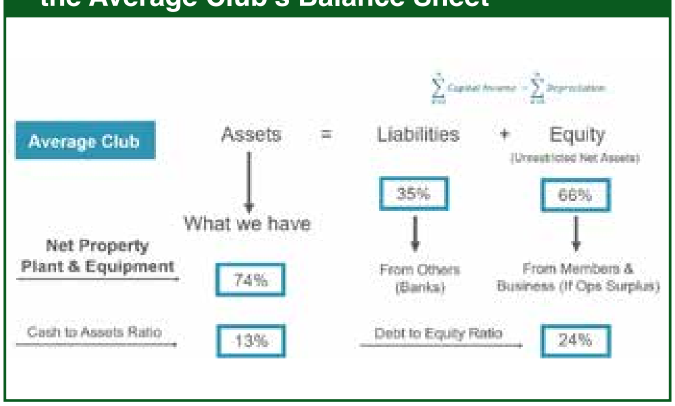


Figure 2: Analysis of the Capital Intensity of Various Industries

Capital Intensity	Sector	Ratio
High	Power	293%
High	Private Clubs	283%
High	Oil and Gas	108%
High	Metal Manufacturing	85%
Low	Healthcare	57%
Low	Capital Goods	45%
Low	Fast Moving Consumer Goods	44%
Low	Information Technology	38%
Low	Auto	35%
Low	Consumer Durables	26%
	Average	101%

Figure 2 presents an analysis of the capital intensity of various industries. The private club industry is second only to the most capital-intensive industry on the industrial spectrum, generating and distributing electricity. In both the private club and the electrical power industry, roughly $3 of capital investment are required for each dollar of revenue generated.

Private clubs are clearly capital-intensive, and the financial repercussion of inertia and avoidance is a constantly increasing amount of deferred capital investment. Deferring obligatory investment, meaning repair and replacement of existing assets, manifests in the previously mentioned dilapidated assets. Clubs with significant deferred obligatory investment look old, smell old and are old. Deferring aspirational capital investment in new services and amenities demanded by incoming generations of members manifests as a lack of competitive relevance in the market. A key sign of lack of relevance is flat or declining initiation fees over time.

Every club can stop the downward spiral if action is taken before the deferred investment has grown to an insurmountable sum. The key is futurecasting —developing an informed vision for your club's future that is supported by a comprehensive capital plan.

PULSE SURVEY INSIGHTS

Which Outside Source(s) Have You Used to Obtain Loans for Capital Projects?

Source: McMahon Group Facilities Pulse Survey, 2024

Percentages reflect "check all that apply" responses from total number of survey respondents.

Comprehensive Capital Planning

It is not difficult to develop a comprehensive capital plan, but doing it correctly requires the facilitation and involvement of an objective, experienced partner. There are four key concepts at the root of an effective, comprehensive capital plan:

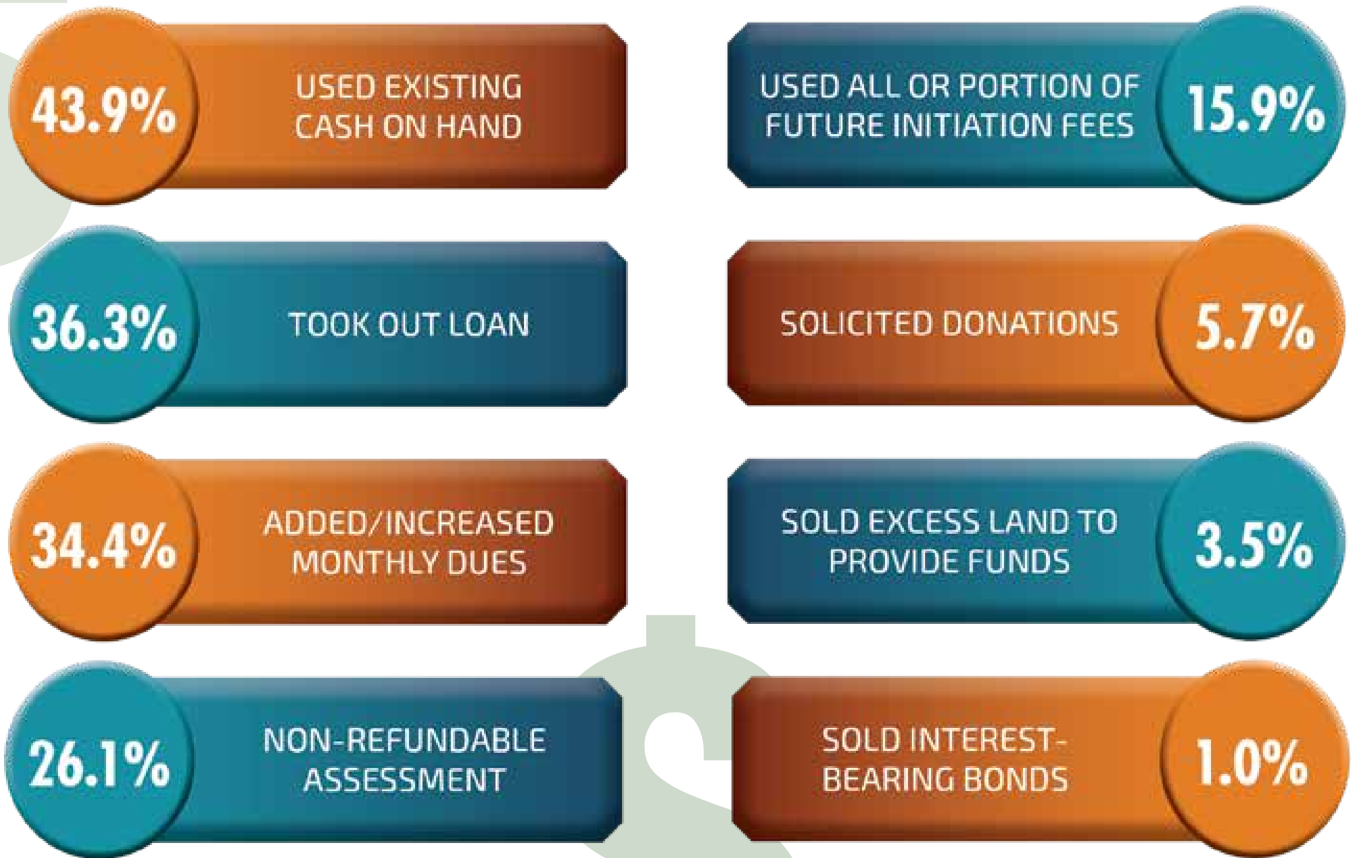
- **Asset Evaluation**: An accurate and up-to-date asset inventory, useful life and replacement cost database (historically referred to as a reserve study). This database quantifies the cost to replace all assets currently owned by the club and the date at which each asset is expected to be replaced (aka the end of the asset's useful life based on an assessment by an objective, knowledgeable professional firm). Clubs that attempt to "DIY" this complex and labor-intensive step on the advice of members who "know better" usually fail to do the asset assessment correctly.
- **Futurecasting**: A futurecast is a crisp, detailed statement of exactly how the club will look and the services and amenities the club will offer at a specific date in the future. It is the club's vision. This effort will help to clarify the aspirational capital investment required to meet that vision.
- **Membership Projections**: A detailed, category-by-category membership model covering annual intake and attrition, alongside the cost of belonging and entrance-fee projections. Detail in this regard is critical.
- **Enduring Commitment to the Plan**: The capital-planning process across the industry has historically been episodic when it should be perpetual and systematic. Every club must have at least a 10 year view that ties to the futurecast of facilities and services and amenities. The primary purpose is to have a precise model of the projected gap between forecasted capital needs and resources, meaning the sources available to fund investment. The key is to ensure that the gap between needs and resources is always closed looking forward over 10 years. That financial modeling, coupled with the futurecast vision of facilities and services, will generate momentum and protect the club against these common pitfalls:
  - The club becoming complacent or "stuck."
  - Buildup of deferred maintenance.
  - Lack of funds to service debt while simultaneously re-investing properly in both obligatory and aspirational capital.
  - Reactive, project-based debt. If the vision is clear, a club can begin aggregating capital proactively to meet those future needs.
  - Reactive capital assessments that are indicative of reactive versus proactive capital planning. While an assessment may be necessary in the case of overcoming significant deferred maintenance, recurring capital dues assure each member is covering their fair share of obligatory capital.

> *"Clubs with significant deferred obligatory investment look old, smell old and are old. Deferring aspirational capital investment in new services and amenities demanded by incoming generations of members manifests as a lack of competitive relevance in the market. A key sign of lack of relevance is flat or declining initiation fees over time."*

One doesn't have to look very far to find examples of procrastination or inertia in a disparate group of people engaged in joint endeavors. Consider issues such as road and bridge maintenance, social security funding, or paying down national debt. In the club industry, maintaining club facilities and investing in the future vision are equally germane examples. Establishing the proper amount of recurring capital dues to ensure

PULSE SURVEY INSIGHTS

Which of the Following Methods Have You Used to Fund Major Capital Projects?



Source: McMahon Group Facilities Pulse Survey, 2024

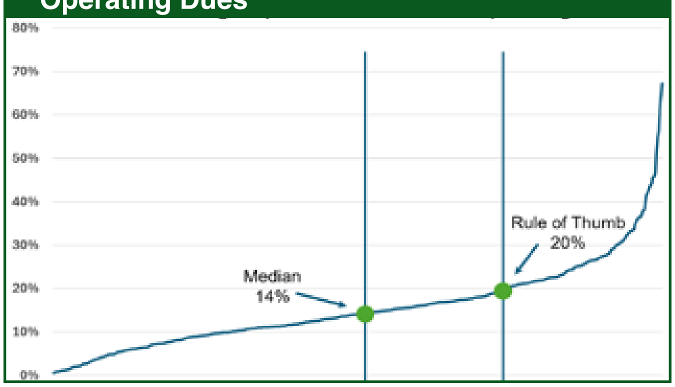
Percentages reflect "check all that apply" responses from total number of survey respondents.

funding for that vision is a remedy for procrastination and a central feature of systematic, proactive capital planning.

Analysis of data from 1,000+ clubs in the Club Benchmarking database shows that 25% have recurring capital dues at a threshold equal to or greater than 20% of operating dues. Those clubs have the capital necessary to invest in their vision consistently without reactive debt and possibly "zombie debt" (debt that outlives the assets it was used to purchase).

"We have not encountered clubs that failed because they were too expensive—but we do know of clubs that failed because they capitulated to overwhelming deferred investment and a lack of resources needed to deliver a compelling and relevant member experience."

Chart 1: Recurring Capital Dues as a % of Operating Dues



A rule of thumb based on Club Benchmarking research and experience with applying its COMPASS capital-planning platform in more than 200 clubs indicates that recurring capital dues should equate to approximately 20% of a club's operating dues (see chart 1, left). That level will allow funding to be available to do exactly what is portrayed throughout this issue of *Club Trends*—continuously invest in the future to remain relevant and to keep members satisfied and engaged.

We have not encountered clubs that failed because they were too expensive—but we do know of clubs that failed because they capitulated to overwhelming deferred investment and a lack of resources needed to deliver a compelling and relevant member experience. ■