The Framework for a Strategic Response to the Coronavirus Crisis

Guiding private clubs through the short-term and long-term financial impact of the COVID-19 crisis

March 31, 2020

by Raymond P. Cronin
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Dear Fellow Club Industry Leader:

This letter serves as an introduction to a white paper I have been working on since March 19th. More than 100 hours of research, analysis and writing have gone into its creation. Reflecting on both my tenure as a club board member during the 2007-2008 meltdown and my experience working closely with more than 500 clubs over the last 10 years, I am producing this white paper in the hope of making a positive contribution to our industry's response to recent events.

My estimate, based on intense analysis of our database over the last decade, is that approximately half of the private clubs in North America reacted inappropriately to the last recession. The decisions made during and after that crisis led to the state of the industry entering this one. Our view is that on March 1, 2020, 25% of clubs in North America were in severe financial distress and shrinking, 50% were somewhere between going sideways and growing marginally and 25% were doing fabulously well and growing purposefully.

Since the lockdown began around March 16th, I have received many calls from club leaders and I sense the stress (panic may not be too strong) rippling through boardrooms across the industry.

While we recognize the economic impact of the virus is ***an issue*** for clubs, we don't believe it is, or should be, ***the issue***. The lockdown's impact will mainly cause marginal, short-term, stress on the club's operating finances. The analysis laid out in this white paper indicates that most clubs will be able to absorb the financial impact. The long-term impact, just as it was in the last recession, will be affected much more profoundly by decisions made in boardrooms during and after the event itself. Hopefully, this paper will help clubs focus on making thoughtful, strategic, informed decisions.

The underlying theme of the whitepaper is this… please don't make decisions that have long-term, strategic effects based on short-term information and while under stress. We advise clubs to resist the urge to hack away at 2020 operating and capital plans while the lockdown is underway. We counsel patience to allow the short-term effects of the crisis to play out so that clarity exists before forging decisions that will change the long-term trajectory of your club.

If you believe we can be of help as you navigate this crisis, please feel free to reach out at any time. We are here to help you make the best decisions possible, with the best data available.

With Deep Respect,

Ray Cronin
Founder and Chief Innovation Officer

Executive Summary

The club industry was impacted following the 2007-2008 financial meltdown and the ensuing recession. Club Benchmarking has studied changes in members' equity (net worth) of 600 clubs since 2006, just prior to the last recession. Since 2006, 50% of clubs have experienced a decline in their inflation-adjusted net worth. Also, since 2006, only 35% of clubs have seen net worth increase at the rate necessary to meet future capital needs. The unsatisfactory trend of net worth across the club industry since 2006 results from more than just the impact of the last recession. Club Benchmarking analysis of the annual financial and operational results from nearly 1,000 clubs across North America supports a premise that the shrinking equity has less to do with economic and demographic trends than it has to do with the decisions made in club boardrooms.

This white paper presents and examines factors that cause changes in net worth over time. Those factors, which have only recently been unearthed through Club Benchmarking research, form best financial practices for clubs. The purpose of this white paper is to present a case that leads management teams, boards and finance committees across the industry to understand and embrace the annunciated best practices as they make decisions to address the impact of the coronavirus crisis.

Applying lessons learned during and after the last recession, this white paper lays out a framework for a strategic, rather than tactical, response to the issues resulting from the virus. It is proposed clubs address the situation in three distinct time periods: Through the end of April, May – June and July through the end of 2020 and beyond.

Through the April time period, it is recommended clubs only make targeted, tactical decisions, such as how to compensate the staff, until there is complete clarity as to the effect of the virus on the economy. In the May – June timeframe, this paper suggests clubs should use membership recruitment and attrition data to assess the expected longer-term impact. Finally, in the second half of 2020, a framework of financial best practices should be employed by every club.

The thesis of the white paper, supported by a significant volume of data, is that the virus is ***an issue*** clubs must face, but not ***the issue***. The decisions made as a result of the virus will have a more profound impact on clubs than the shutdown does. The framework presented herein will help the leadership of clubs in North America make decisions that improve their club's prospects, rather than damaging those prospects. The paper posits that half of the industry made poor decisions during and after the last recession. Those decisions are the root of the declining net worth of half the industry.

The framework in this paper provides a roadmap to make the best decisions possible as the industry emerges from the financial situation resulting from the virus. The roadmap is a detailed presentation of financial best practices linked to forging sustainable financial growth. The best practices addressed include; precise evaluation of membership trends against competitive clubs and the industry at large, understanding the importance of measuring and driving growth of net worth over time, embracing the capital ledger as the club's financial driver, embracing the operating ledger as the vehicle for delivering services and amenities, understanding the characteristics and importance of a forward-looking capital plan and understanding and embracing the fact that clubs compete on value, not price. The identified best practices serve clubs well in both up and down markets, but they are absolutely essential in times of stress.

Our World Has Changed

Life as we knew it has suddenly changed and economic and social activity in North America has been forced into hibernation for at least the next 30 to 60 days. The shutdown that began in mid-March has been extended to the end of April and it is possible that it will drag on into the middle of May.

While we could never have imagined such an abrupt change, we have been expecting economic winds to shift for some time. Based on historical patterns, the economy was obviously closer to the next recession than it was removed from the meltdown in 2007 and 2008. With that in mind, our counsel to clubs over the last three years has been to prioritize strengthening the balance sheet. During that timeframe, we have helped many clubs precisely understand their financial model which led them to focus on shoring up their balance sheets. As a result, those clubs are entering the current downturn in a stronger position.

It is not too late to measure and, if necessary, improve the health of your club's balance sheet. Understanding and embracing the sustainable financial model of clubs becomes more important than ever during this crisis. Far too many clubs (at least half the industry) made poor decisions during and after the previous economic meltdown, due in large part to a lack of data and lack of understanding of the financial model of clubs. This white paper is a clarion call to the industry to ensure we don't repeat those mistakes this time around.

The Financial Model

The concepts behind sustainable financial results are the same during economic downturns as they are during boom times. CB's data clearly indicates that upon entering the virus crisis clubs in the industry fell into one of three buckets financially; 25% of the industry is in severe financial distress, 50% are somewhere between going sideways and experiencing marginal growth and 25% are doing fabulously well and growing purposefully. The main issue in the club industry has been a lack of widespread understanding regarding the sustainable financial model. It is our belief the lack of knowledge regarding the financial model has led to poor decisions in the boardroom – especially during and after the 2007-2008 economic meltdown. We also believe those misplaced decisions have impacted clubs more negatively than the changing and evolving demographic shifts which are also clearly affecting clubs. In the end, decisions made in the boardroom impact a club's destiny as much, or more, than market forces. It is thus imperative that we begin by reviewing the financial model as the basis for sound decision-making during this crisis.

The key concepts behind long-term, sustainable financial success are as follows:

- The club's operating ledger is not the financial driver. It isn't meant to be and never will be and here's why: In the private club industry, 90 percent of clubs set the operating ledger to break-even excluding depreciation. Break-even is not a financial outcome. The operating ledger is the vehicle for delivering services and amenities to the members. The money flowing through the operating ledger is consumed every year by members enjoying the club. Again, it does not produce a financial outcome. Over time, cutting expenses on the operating ledger will not produce a financial outcome. While cutting expenses will lessen the operating dues a member pays, it will also negatively impact the member experience.

- The club's financial driver is the capital ledger as manifested by capital Income and capital Investment. Clubs that entered the current crisis with a strong balance sheet have a strong balance sheet because they have generated adequate capital income over time. Period. Full Stop. They are also the clubs that apply the operating ledger as it should be: To deliver a compelling member experience, period.

- Net Worth Over Time (NWOT) is the key performance indicator (KPI) that depicts how a club has fared long term. Ultimately, it reflects the intersection of a club's financial outcome and its culture. We have been monitoring NWOT from 2006-2019 for 600 clubs and we are about to add data from another 1,500. We intentionally chose 2006 as the starting point because we wanted to capture the impact of the last recession. The data is clear… decisions clubs made during and after the 2007-2008 downturn have impacted their net worth growth (or decline) in the years since. NWOT data also segments the industry into three buckets; net worth shrinking (50% of clubs), net worth stagnated (15% of clubs) or net worth growing at an adequate rate (35% of clubs).

- As GMs, CFOs, Controllers, Finance Committees and Boards grapple with their decisions in the months to come, the impact on net worth over time should be a central focus. Proper decisions will grow net worth looking forward, while poor decisions will cause it to decline.

The current health of your club's balance sheet describes your position right now, but the rest of the story has yet to be written and what you do next matters greatly. Shutdowns and resulting loss of non-dues revenue will cause marginal, short-term stress on the club's operating ledger, but poor decisions will cause significant, long-term stress on the balance sheet which is exactly what happened in 2007-2008. Don't let history repeat itself.

A Proposed Framework for Navigating the Crisis

Time can either be our enemy or our friend as we navigate the coming months. Obviously, we know very little now, we will know more as time passes. A recent review (on March 27th) of seven economists and bank GDP forecasts says it all: Projections across the banks vary wildly for Q2 and Q3 GDP, but projections for the ultimate GDP for 2020 are all fairly close with results ranging from flat year over year to a decline of one or two percent. The point is, nobody really knows what will happen between now and June, but the likely outcome in the longer term is that we will recover from the virus crisis when the virus is under control, which is more likely than not to be around the middle of the year.

In the end, we can't truly understand the impact of the virus until more time passes. As such, our strong recommendation to clubs is this: Do not panic in the short term and view the rest of 2020 in time periods:

Phase 1: Mid-March to April 30
Phase 2: May 1 to June 30
Phase 3: July 1 to December 31

Phase 1: Mid-March Through the End of April (6 Weeks)

The Main Issues

- How long is the club shut down or severely restricted in operations?
- Do we pay the staff or not during the shut-down?
- What is the financial impact?

The issues arising in this time period are mostly operational and the financial impact is on the operating ledger. We strongly advise clubs to limit their decisions to the financial impact on operations. Do not make decisions that have long-term impact during this time frame. For instance, don't cut the initiation fee now in anticipation of a lack of demand to join clubs after the crisis abates.

For the most part, F&B operations (A La Carte and Banquet) will be shut down by edict for between three and six weeks during this first time period, depending on the virus situation in each state or city. We believe most clubs will also significantly restrict various other operations (fitness, group exercise, etc.). Golf course maintenance will likely continue in a normal manner and yachting and marina operations at yacht clubs may also continue. Other areas likely slowed or shut down include the pro shop, fitness/wellness and racquets. For reference, Charts 1 and 2 show the labor by department at the average club with and without golf.

Chart 1 – Labor by Department – Average Club Without Golf

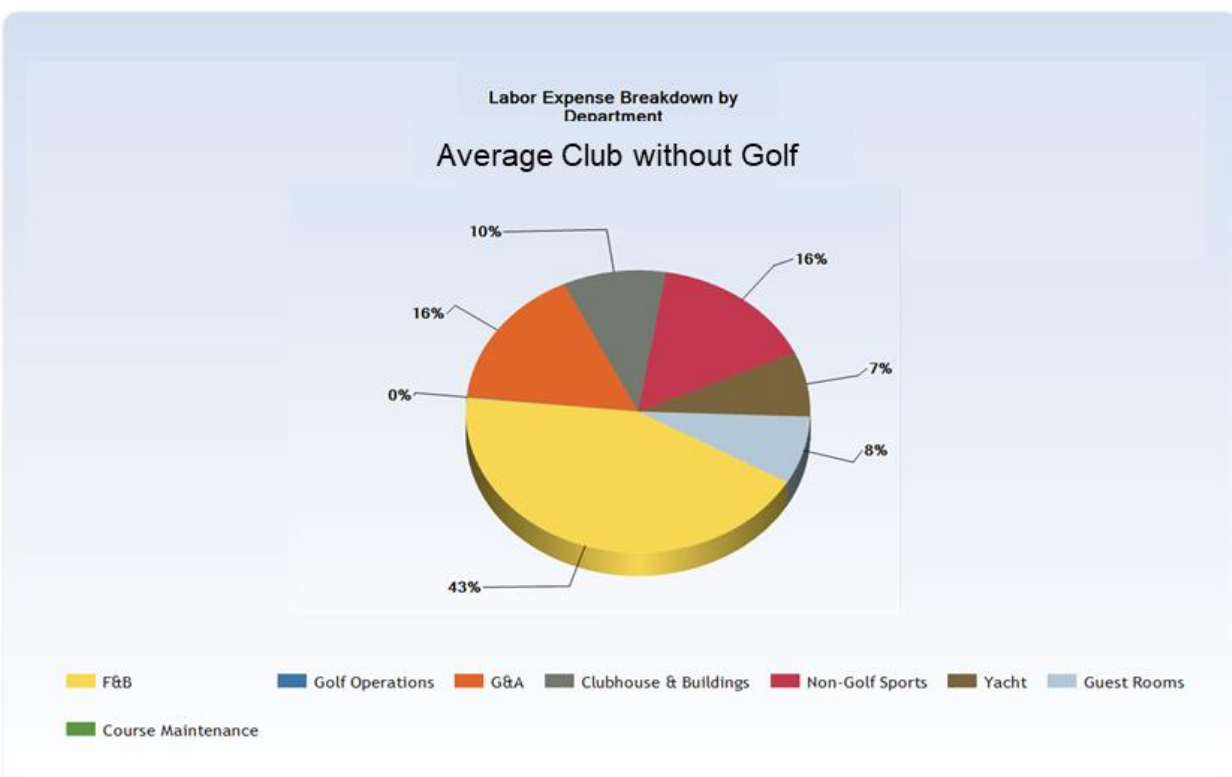
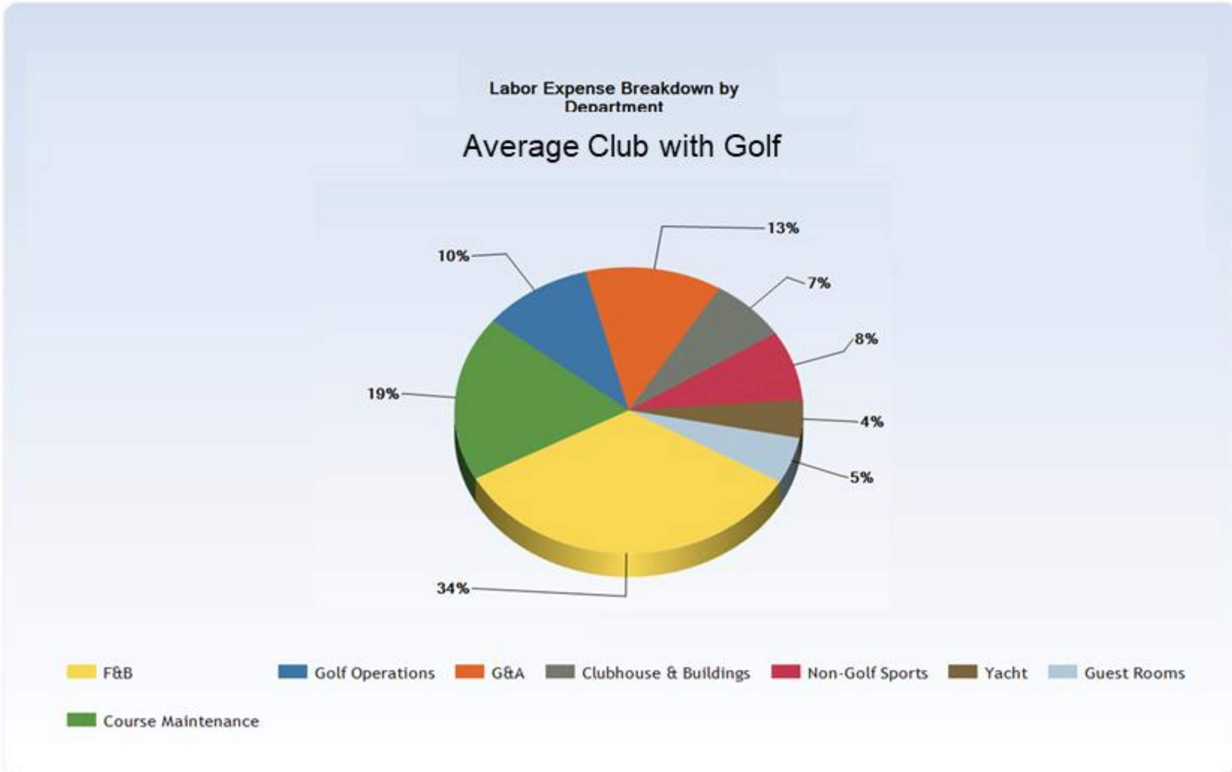


Chart 2 – Labor by Department – Average Club With Golf



One of the most pressing questions during this timeframe is – Should the club pay affected staff or have affected staff turn to unemployment for relief?

Our current view based on surveys we are watching is that clubs will fall into one of three categories: About 1/3 of clubs will pay the staff during the entire shutdown, 1/3 will opt to pay the staff for a defined period of 2-6 weeks and 1/3 will not pay the staff during the shutdown. Ultimately, we believe clubs with the strongest balance sheets will opt to pay the staff for as long as possible. Clubs with average balance sheets will pay the staff for a defined period of between 2 and 6 weeks and clubs with weak balance sheets will ask the staff to access unemployment. There is also consideration as to whether the club's pay or the supplemented unemployment benefit serves the staff better. As of this writing, furloughed staff may receive $600 per week above their otherwise calculated unemployment benefit based on prior earnings.

Table 1 is presented as a framework for estimating the financial impact of the shutdown on the club at the median (both with and without golf). At those median clubs, the hit to the operating results for a one-month shutdown, assuming that business lost is lost forever (worst case) will be approximately $140,000 for the club with golf and $90,000 for the club without golf (clubs can prorate the $140,000 and $90,000 based on their own club's revenue versus the median club's revenue. For example, a club with twice the revenue of the median would see a $280,000 or $180,000 impact respectively). Essentially, clubs have three choices as to how to absorb the impact:

1. **Pay the staff and absorb the deficit.** This choice translates to funding the deficit using capital income. Capital income at the median club is close to $1.1 million, so the $140,000 operating deficit would leave that club $1 million in capital for the year, which we consider a marginal impact.

2. **Pay the staff and fund the deficit.** Ask the members to fund the deficit. That cost would be about $300 per member at the median club with golf and $150 per member in a club without golf.

3. **Don't pay the hourly staff.** As can be seen in Table 1, the estimated deficit is very close to the hourly labor for one month in clubs both with and without golf. Of course, there are other issues if the staff is temporarily "let go." Will they return? Will they feel the club treated them fairly? What will it cost to replace lost employees and repair morale? Will the club be able to ramp up operations as quickly as if the staff were retained?

Given that clubs are essentially communities with staff at the core, it is logical to lean towards paying the staff. Our recommended course of action is to pay the staff and absorb the impact if possible.

Table 1 – Estimate of Financial Impact of Shutdown on Median Club With and Without Golf

	Estimated Foregone Contribution for One Month		
	Clubs with Golf	Clubs without Golf	
F&B - A La Carte	$60,000	$49,000	6.5% of annual revenue x 55% Gross Profit + Estimated Service Charge
F&B – Banquet	$37,000	$28,000	6.5% of annual revenue x 70% Gross Profit + Estimated Service Charge + Estimated Fees
Greens Fees Guests	$10,650	NA	Estimated 5% of annual revenue at 100% contribution
Greens Fees - Outings	$3,200	NA	Estimated 4% of annual revenue at 100% contribution
Pro Shop	$5,000	NA	Estimated 5% of annual revenue at 25% contribution
Carts	$11,500	NA	
Fitness Fees and Group Exercise	$6,640	$9,945	Estimated at 8.5% of annual revenue at 100% contribution
All Other	$5,000	$5,000	Conservative estimate
Total	$138,990	$91,945	
Hourly Staff Expense	$126,000	$82,000	Estimated at 5% of total annual hourly payroll including Payroll Taxes and Benefits
Operating Revenue	$7,700,000	$5,100,000	
Don't Pay Hourly Staff	Lost Contribution nearly matches reduced Labor	Lost Contribution nearly matches reduced Labor	
Do Pay Hourly Staff	Impact is $140,000	Impact is $90,000	$140,000 can be siphoned from Capital Income or Assessed to Members
Full Member Equivalents	468	640	
Impact Per Full Member Equivalent	$297	$144	Impact per Full Member Equivalent
As % of Annual Full Dues	3.6%	4.6%	

The main assumptions driving Table 1 are as follows:

Number one is that the lost business is lost forever. Some clubs have had cancellations of outside tournaments that are likely to rebook later in the year. The other assumption is that March and April are not "high-season" months (of course this is not true in Florida and Arizona). This table is a blended estimate for all regions and assumes a shutdown duration of one month. The key takeaway here is that the financial impact of a one-month shutdown is marginal, so don't overreact. For perspective, the impact is likely to equate to between 3.5% and 4.55% of the club's annual dues revenue. If the shutdown extends to six-weeks, the impact will equate to between 5.5% and 7% of dues revenue and an eight-week shutdown will be between 7% and 9% of annual dues revenue. Such impact is marginal, so please do not overreact. It is important to note that the impact will vary based on a club's operating model. Clubs with "leveraged" operating models (meaning the club is more reliant on non-dues revenue than dues revenue) will see the effect magnified. Table 2 summarizes the effect based on the operating model.

Table 2 – The Effect of Shutdown Based on a Club's Operating Model

	Leveraged Operating Model		**Average Operating Model**		**Dues Centric Operating Model**	
	With Golf	Without Golf	With Golf	Without Golf	With Golf	Without Golf
Dues to Operating Revenue Ratio	< 45%	< 40%	45% to 55%	40% to 50%	> 55%	> 50%
Effect of Shutdown	Effect will be greater as these clubs rely on non-dues revenue to subsidize dues. Non-Dues revenue is lost during shutdown.		Effect at the estimated $140,000 for clubs with golf and $90,000 for clubs without golf.		Effect will be less as less revenue emanates from non-dues and dues revenue will still flow during shutdown.	
Balance Sheet Strength	Clubs tend to have weaker balance sheets.		Clubs tend to have average balance sheets.		Clubs tend to have the strongest balance sheets.	
Ability to Absorb Impact of One Month Shutdown	May be difficult		Should be able to absorb impact – make the choice to absorb it		Should easily absorb impact	
Performance Since 2007/2008 Meltdown	• These clubs reacted to 2007/2008 meltdown by focusing on cutting costs, keeping dues low (thus the leveraged model), and decreasing or eliminating initiation fee. They tend to have a weak member experience. • NWOT typically decreasing since the last recession and significant deferred capital asset maintenance.		• These clubs tend to be able to meet repair and replacement capital needs. Some are also able to grow the asset base (adding new services and amenities). They have an acceptable member experience. • NWOT typically flat (0% growth) to 3.5% annual growth rate since 2006.		• These clubs tend to have invested consistently over time. Compelling member experience. Well-maintained asset base and have also been expanding services and amenities. • NWOT typically increasing at an annual rate of over 5% since 2006. Generating adequate capital to grow.	
Percent of Industry	**25%**		**50%**		**25%**	

Turning Crisis into Opportunity

At Club Benchmarking, we have this crazy obsession with studying data to provide context. For too long, the club industry operated without accurate data and without context, flying blind when it came to decision making. Good decisions demand consideration of context. Crises tend to invoke panic and panic can lead to poor decisions, as happened in 2007-2008 in the club industry. As the industry grapples with the coronavirus crisis, our goal is to provide context based on fact.

Obviously, a club's ability to handle the impact of the shutdown will be directly related to the financial strength of the club as it entered the crisis. When making decisions concerning the shutdown, consider the decisions that put your club wherever it was at the start. As the saying goes, the definition of insanity is doing the same thing over and over and expecting different results. If you embrace data and fact-based insight, you have an opportunity now to change the future for your club. If you make "knee-jerk" decisions without context and fact, the future will not be bright.

The inability of a club to absorb the impact reflects a weak balance sheet, which is ultimately a result of members inadequately funding the club over time and a reflection of a club culture in which members think like customers and not the owners that they are. Though the situation in which we all find ourselves is difficult, we believe an opportunity exists for clubs to become stronger and ultimately alter the course of their futures for the better. Ask yourself the following questions as food for thought:

- Can we use data and fact-based insight to change the future of our club by making better decisions during this crisis?

- Can we begin acting as a community of owners who are ready and willing to properly fund the club over time?

- Is there a better way to start than by asking members to rally around and contribute the money necessary to help the staff during the crisis?

In a community where members feel like owners, it certainly doesn't make sense to offer a "dues holiday" while the club is shut down. Operating dues cover nearly 80% of the club's fixed operating expenses. Dues revenue is more important than ever during the shutdown and a dues holiday will unnecessarily exacerbate the financial impact. Clearly, members must band together, with the board leading the way, committed to paying dues for the sake of their club. Put another way, when you leave your home in the middle of winter, you don't turn off the furnace.

There may be certain scenarios where giving members a break from dues or fees does make sense. One example would be relaxing the F&B minimum while the clubhouse is closed. The median club receives about $25,000 per year in unspent F&B minimum, so relaxing that during the shutdown will have minimal impact and it makes sense. Similarly, some city/athletic or country clubs have base dues that cover the clubhouse and F&B privileges with an additional dues charge for athletics. Those clubs may forego the athletics dues during an operational shutdown while all members continue to pay the base dues. We recognize each club will use common sense in navigating their own decisions.

Our recommendations regarding decisions being made during the first phase (Mid-March – April 30) are:

- Stay focused on the short-term impact on operational finances. Please do not start hacking away at the overall 2020 operating and capital budgets. Keep the decisions focused on the short-term shutdown until we have more information.

- Considering the strength of your club entering the shutdown and the historical drivers of that strength or weakness is critical context for all decisions moving forward. If your club is strong, don't depart from what has made it strong (an owner mentality willing to contribute what is necessary to properly fund the club). If your club is weak, try to change what is likely a historical hesitance to ask members to contribute the money necessary to properly fund the club.

- Wait until the end of April, or if the news is better sooner, to have the proper information to make long-term decisions.

Phase 2: Between May 1, 2020 and June 30, 2020 (8 weeks)

The key issues in this timeframe can be characterized as monitoring membership changes closely to determine if the effects of the virus are short-term or longer-term. This timeframe is one of strategic analysis centered on the strength of your club's membership engine.

- Has the lockdown ended?
- Is the club operational?
- What is our member intake and attrition?
- What is happening in the stock market?

By the end of April, a more accurate picture will emerge as to how long the acute virus situation existed or will exist. China was essentially in lockdown by the end of January. The city of Wuhan, the epicenter of the virus, was locked down and isolated on January 23. After a seven-week shutdown, China went back to relatively normal operations on March 19 and 20. Wuhan is on track to open back up on April 8 and the province of Hubei (Wuhan is the capital of Hubei province) reopened on March 25. The city of Wuhan will have had an 11-week shutdown, and the province (Hubei) a nine-week shutdown. It is possible that we will see a similar situation in North America. Hard hit areas like New York City and Seattle may see longer lockdowns than the states, cities or provinces that have seen fewer cases.

In North America, cities and states went into lockdown somewhere between March 17 and 23. A seven-week timeline from March 17 takes us to May 5. Eleven weeks from March 17 takes us to May 19. President Trump recently declared that the current emergency state requiring social distancing will remain in place until April 30. Using the data that exists currently and looking forward from this point in time, two scenarios seem likely to exist in the May 1 to June 30 window.

Scenario #1: Heading Back to Normal – Things are returning to normal. The lockdown has ended, the virus is abating, things are returning to normal (maybe a new normal) and it seems the crisis has passed. The stock market has somewhat recovered, and the Dow is in the 24,000+ range.

Scenario #2: Not Heading Back to Normal – Things are not returning to normal. There is an expectation the virus will be in circulation for a longer time. People may be going back to work but there is still a risk of transmission and a lengthy period of societal vigilance. The economy is still suffering, and the stock market reflects that trouble with the Dow in the 21,000 range or lower.

Clearly, Scenario #2 will result in a membership malaise in the club industry. Scenario #1 will likely still produce some marginal impact on membership attraction and attrition.

We suggest the data clubs must closely monitor in this timeframe will be the same in both scenarios. The data central to essential context for decision-making in the May-June timeframe is accurate measurement of members entering, members exiting and number of people on the Wait List and/or Sell List. We must track the trends of those metrics in relation to the same timeframe in the previous few years. The April – June timeframe throughout much of the industry is when prospective members are usually looking to join clubs for the season.

Table 3 indicates that membership counts (full member equivalent is calculated by dividing total operating dues revenue by the amount a full member pays in operating dues annually) in the two basic market segments, Clubs with and without Golf, have been consistent for the last three years. Data from our Strategic Monthly Dashboard as of January 31, 2020 indicated 25% of clubs had a wait list and 25% also had a sell list (in certain clubs with refundable equity a wait list and a sell list can exist simultaneously).

Table 3 – Member Count Over Time for Clubs With and Without Golf

	Clubs with Golf		Clubs without Golf	
	Total Member Count - Median	Full Member Equivalents - Median	Total Member Count - Median	Full Member Equivalents - Median
End 2019	646	468	885	656
End 2018	641	457	862	673
End 2017	633	443	862	675

Since 2010, our ongoing annual analysis of financial and operational data from approximately 1,000 clubs across North America indicates that in terms of the ability to attract and retain members, clubs again fall into one of three buckets (a theme is emerging):

1: Strong Membership Engine - Clubs that are full and have a wait list. This bucket includes 20% to 25% of the market.

2: Moderate Membership Engine - Clubs that are not full but have enough members to fund operations and capital at a level that is mostly adequate. This bucket includes 50% of the market and is filled with a combination of clubs that are near capacity and clubs that are much less full but still have an acceptable number of members.

3: Weak Membership Engine - Clubs that do not have enough members to adequately fund operations or capital. These clubs have very low initiation fees and very high membership churn. As we will see, the two are related. This group represents 25% to 30% of the market. These clubs will most acutely experience both the short-term and the long-term impact from the virus crisis. Members in these clubs tend to think like customers instead of owners.

Charts 3 and 4 show the distribution of the initiation fee at clubs with and without golf, respectively. We have also overlaid data which characterizes the strength of the membership engine, the emphasis on the member experience and the strength of the balance sheet.

Chart 3 – Initiation Fee, Clubs with Golf vs. Membership Engine, Experience and Balance Sheet

Full Member Equivalents	393	462	527	509
F&B Subsidy	-117,000	-233,000	-425,000	-670,000
Non-Golf Sports Expense	148,000	404,000	580,000	820,000
Member's Equity	3.7 Million	8.2 Million	13.5 Million	23.8 Million
Net to Gross PP&E	41%	47%	50%	50%

Chart 4 – Initiation Fee, Clubs without Golf vs. Membership Engine, Experience and Balance Sheet

Full Member Equivalents	678	551	637	722
F&B Subsidy	-37,000	-77,000	-96,000	-581,000
Non-Golf Sports Expense	92,000	104,200	354,000	668,000
Member's Equity	3.3 Million	3.2 Million	8.7 Million	14.7 Million
Net to Gross PP&E	44%	44%	51%	56%

Charts 3 and 4 contain a significant amount of data. Rather than going through each metric and KPI one-by-one, a summary of the resulting insight is presented:

- The initiation fee is the market's objective assessment of the strength of a given club's membership engine and membership experience.
- Clubs with higher initiation fees have more members and a more compelling member experience as evidenced by the F&B subsidy (F&B is, and always will be, an amenity and not a profit center) and by the amount of money allocated to services and amenities other than golf.
- Clubs with lower initiation fees have substantially fewer members, lower initiation fees, are more golf centric and aim to treat F&B as a profit center. Not surprisingly, that results in a lackluster member experience that has narrower appeal (mostly to golfers) which is the cause of lower member counts and lower initiation fees.
- Clubs with strong membership engines enjoy stronger balance sheets as evidenced by the significantly increasing membership equity (aka Net Worth) as the initiation fee increases. Those clubs also enjoy more updated and fresher assets (because they have more capital) as evidenced by the Net to Gross PP&E ratio (defined and reviewed in Section 3).
- Clubs with weak membership engines suffer weaker balance sheets as evidenced by the significantly lower membership equity (aka Net Worth). These clubs also offer less updated and more depleted assets (they have less capital) as evidenced by the Net to Gross PP&E ratio.

While focused on the initiation fee, the insight in Charts 5 and 6 is presented for further reference. Membership churn is a strategic issue in every club. Charts 4 and 5 show a clear relationship between churn and the initiation fee. As previously discussed, the initiation fee is the market's objective measure of a given club's member experience. A higher initiation fee is evidence of a compelling member experience. A pedestrian or lackluster member experience will be evidenced by low or no initiation fee. Clubs with a compelling member experience have higher initiation fees and less churn. Clubs with a lackluster member experience have lower initiation fees and higher churn.

Charts 5 and 6 also provide evidence that simply cutting initiation fees will not solve problems resulting from deficiencies in the member experience. In fact, it is our view that cutting or eliminating the initiation fee will foster acceleration of a downward spiral by encouraging people to join the club with little skin in the game. Those are the same members who are more prone to think like customers than owners and who are price, not value shoppers.

Chart 5 – Membership Churn vs. Initiation Fee – Clubs with Golf

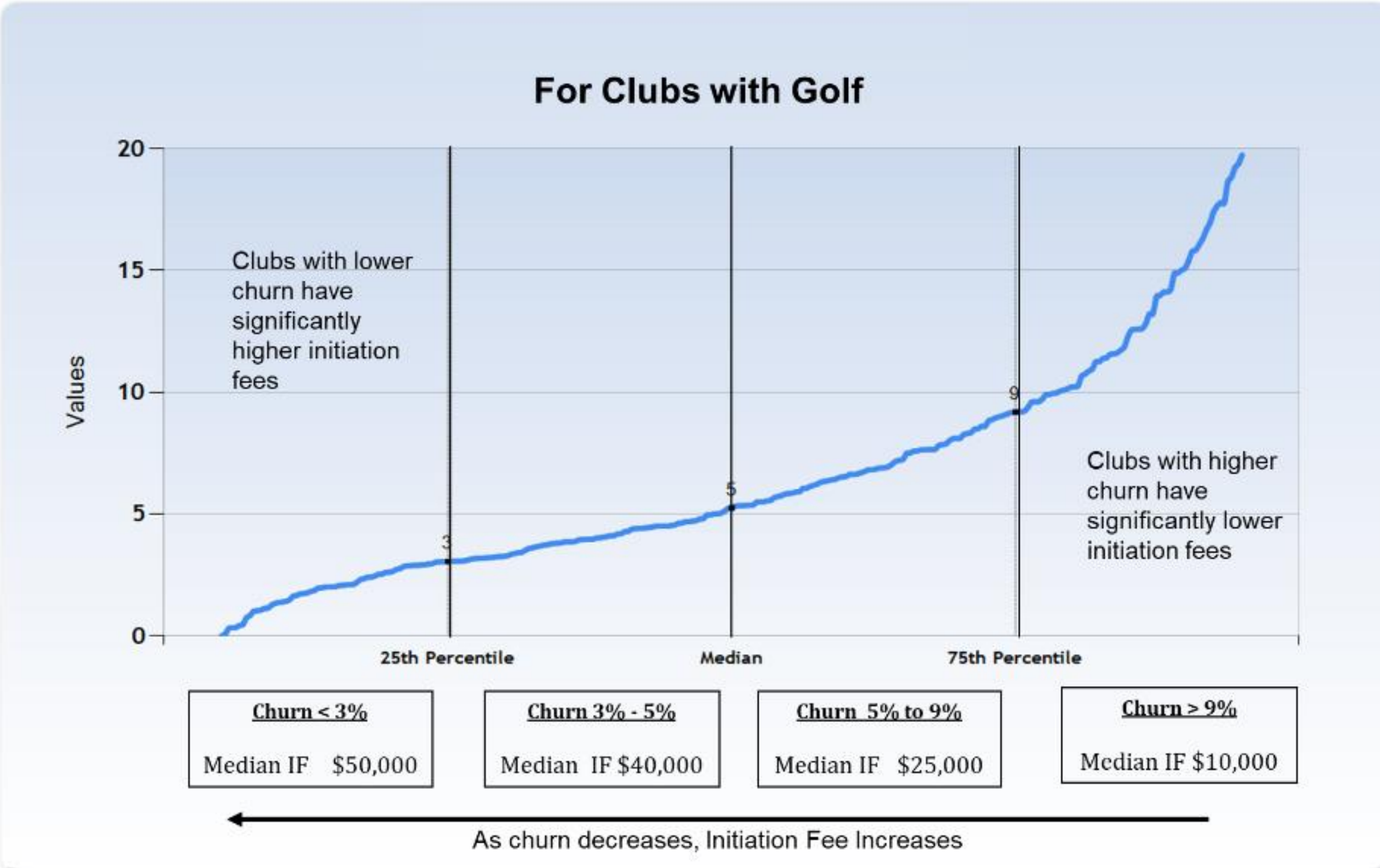
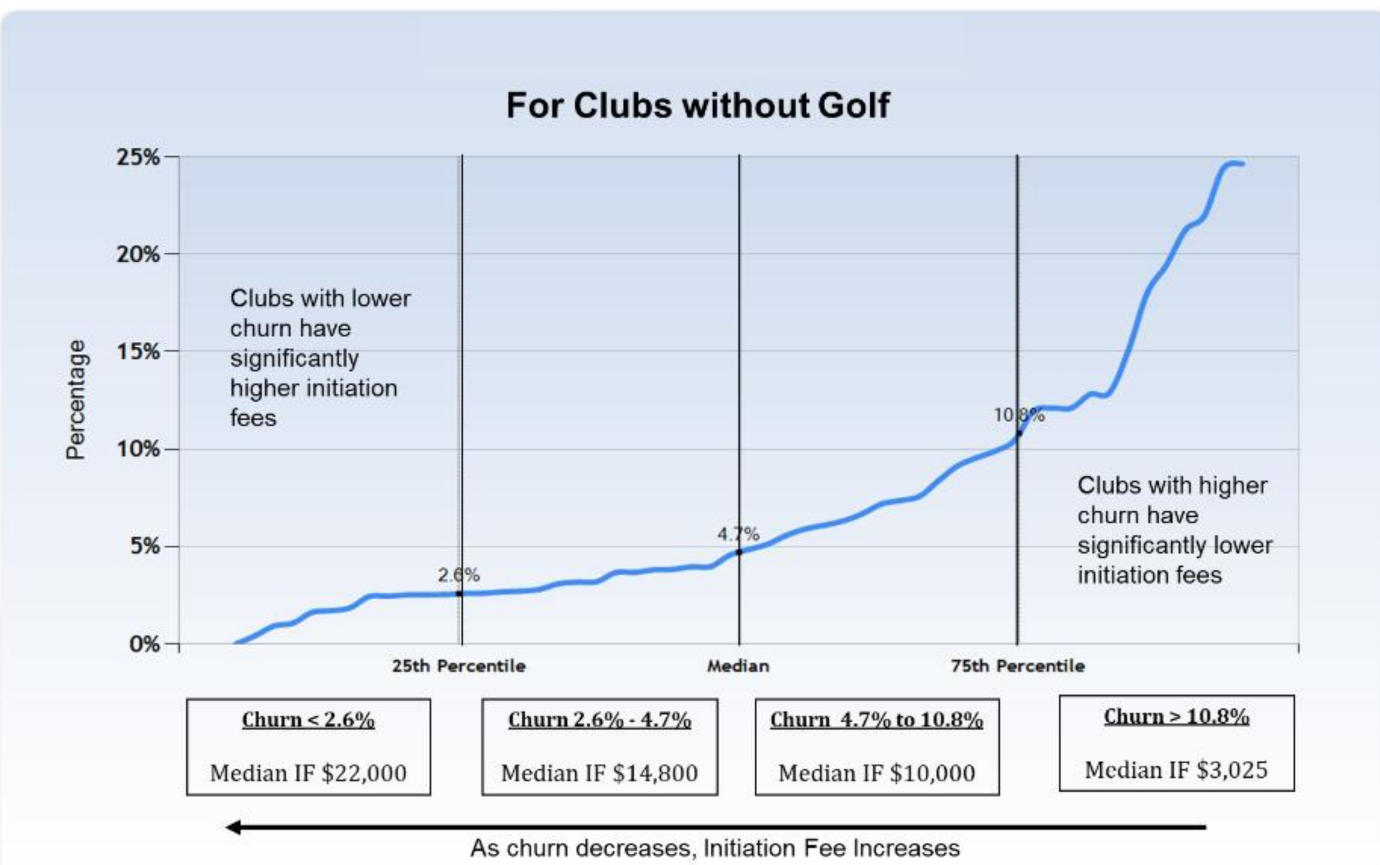


Chart 6 – Membership Churn vs. Initiation Fee – Clubs without Golf



Once the economy gets past the shutdown, this insight must be considered as clubs make decisions related to member intake and attrition. To our knowledge, the membership churn and initiation fee insight just presented did not exist during or after the 2007-2008 meltdown – but it does now.

It is imperative clubs make decisions within the context of the strength of their membership engine. Each club must recognize that the strength or weakness of their membership engine in the present moment is the outcome of decisions made since the last recession. Since the last recession we have seen clubs change the strength of their membership engine. Certain clubs that came out of the last recession with a moderate strength engine have entered this crisis with strong engines. Some clubs that had strong engines coming out of the last recession have sunk into moderate or weak engines. Those shifts are directly related to decisions that were made in the boardroom over the last decade. Decisions made in reaction to this crisis during the coming months <u>will</u> have a more lasting impact on your club's future than the crisis itself.

This white paper is an attempt to provide insight and data that gives pause before clubs simply start hacking away at operating, capital budgets or initiation fees as a result of the coronavirus crisis. We suspect clubs with weak membership engines are likely the clubs that will knee-jerk into cost cutting mode. Such action will only hasten their inevitable demise.

In the May – June timeframe, as the economy is hopefully ramping up, we should also have more clarity as to the market environment clubs are facing. Two scenarios were previously presented – Scenario #1 is a scenario in which the market environment is likely marginally weaker than it was entering the virus crisis and Scenario #2 would pose a market environment that would be much weaker. As previously noted, we recommend clubs wait until there is data-driven clarity as to which Scenario exists before reacting with long-term decisions. Suggested action – chart the strength of your club's membership engine entering this crisis. Does your club have a strong, moderate or weak membership engine?

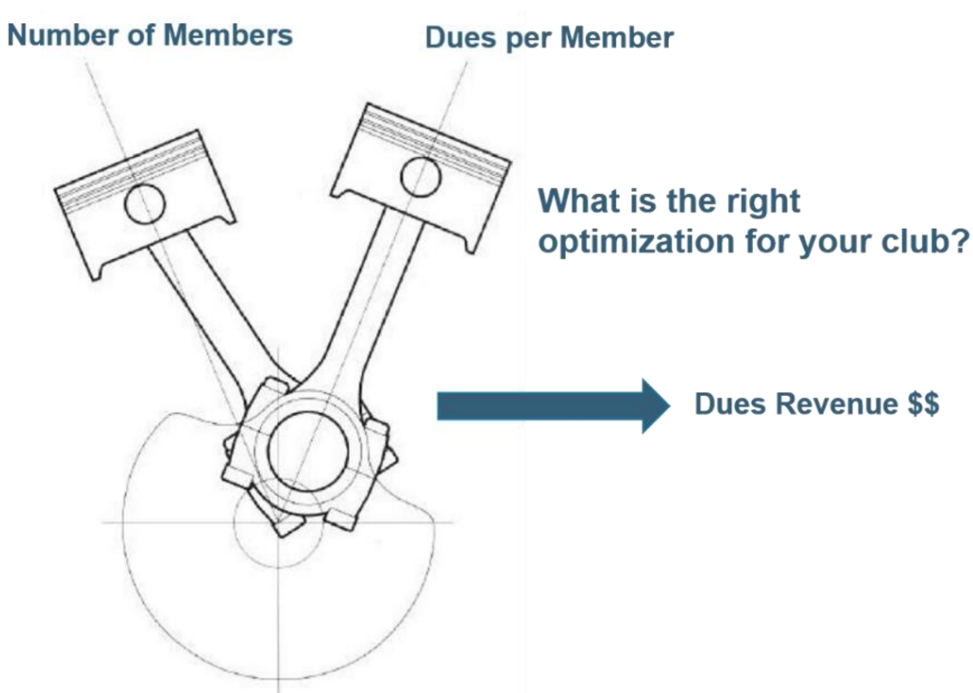


Table 4 – A Framework for Considering Decisions Based on Scenarios in May - June

Issue	**Scenario #1** Heading Back to Normal	**Scenario #2** Not Heading Back to Normal
Operating Budget	• Moderate and Strong Engines should absorb the impact of the shutdown with cash or by dipping into capital income. • Weak Engines should enlist outside help and use the crisis to pull the members together to contribute the money to absorb the impact. These clubs SHOULD NOT start cutting the budget on an already weak member experience. These clubs have an experience problem, not a cost problem.	• Assess severity of situation and don't panic. Don't cut budgets in a knee-jerk manner. • Measure any member count decline accurately. • Two generic approaches – make up for lost members by surgically trimming budget or ask members to cover the gap. • On the margin, for all clubs, the bias should lean towards maintaining the member experience. • Very Weak Engine clubs may consider management company, sale or another strategic alternative.
Capital Budget	• Strong Engine and Moderate Engine should make every effort to invest as planned. If that is difficult combine delays of tactical investment with members contributing so that strategic projects move forward. • Weak Engines must realize the weakness Is a result of underinvestment. These clubs must strategically consider their future. Investments must be made outside golf in golf centric clubs.	• The bias should be towards carrying on with Long-Term strategic investments that were already underway (clubhouse renovations, etc.). Don't overreact, there will be a normal future at some point. • Tactical capital investments can likely be delayed.
Dues & Fees	• Do not reduce dues or fees. That is panic.	• Do not reduce dues or fees. That is panic.
Initiation Fee	• Cutting the initiation fee doesn't work. • Strong and Moderate clubs that were considering an increase in 2020 should carry on.	• Cutting the initiation fee doesn't work. • Strong and Moderate clubs that were considering an increase will likely revisit and may consider pushing increase out in time.
Comments	• All clubs should embrace Strategic Governance and stay focused on the future and the continuous improvement of their member experience. • All clubs should avoid falling into Operational Governance as a result of the crisis. • Best Practices haven't changed as a result of the crisis. Understanding them and embracing them have become more important.	• Without question the operating budget will become a focus. Try not to get dragged into Operational Governance for the entire year. Make the operational decisions and move back to Strategic Governance and considering the future in this "new environment." • Best Practices haven't changed. Understanding and embracing them have become more important.

As previously mentioned, in 2018 in anticipation of an inevitable market turn, Club Benchmarking invested in the development of a free industry service. The Strategic Monthly Dashboard (SMD), enables clubs to measure monthly membership trends against defined, local peer groups, their region and the industry at large. As of mid-March, nearly two hundred clubs are participating across North America and the crisis at hand has resulted in more clubs committing to participate. The data provided by participating in the Strategic Monthly Dashboard is critical for the industry as we move forward after the shutdown. Participation requires less than 20 minutes a month and enables better decisions as a result of understanding competitive and market trends. The lack of market data during the 2007-2008 meltdown led too many clubs to poor decisions regarding initiation fees and dues. Without such data, how would a specific club know whether a decline they are seeing in membership is a result of the market or a reflection of something specific to their club?

In addition to membership trends, the Strategic Monthly Dashboard allows clubs to benchmark their cost of belonging (including initiation fee) and high-level financial metrics such as dues revenue, non-dues revenue, capital income, capital investment and debt. Each of those metrics will show the first signs of the impact of the virus on the industry. Participation will yield each club near real-time data to track how their club is faring in relation to other clubs. To participate, visit www.clubbenchmarking.com/monthly.

Phase 3: Between July 1 and December 31 (6 months)

The key issues in this timeframe can be characterized as strategic and long-term. Hopefully, the crisis has motivated clubs to embrace best financial practices, to scrutinize their member experience and to shore up the balance sheet for the future. Both the normal operating future and during future challenges which will inevitably arise.

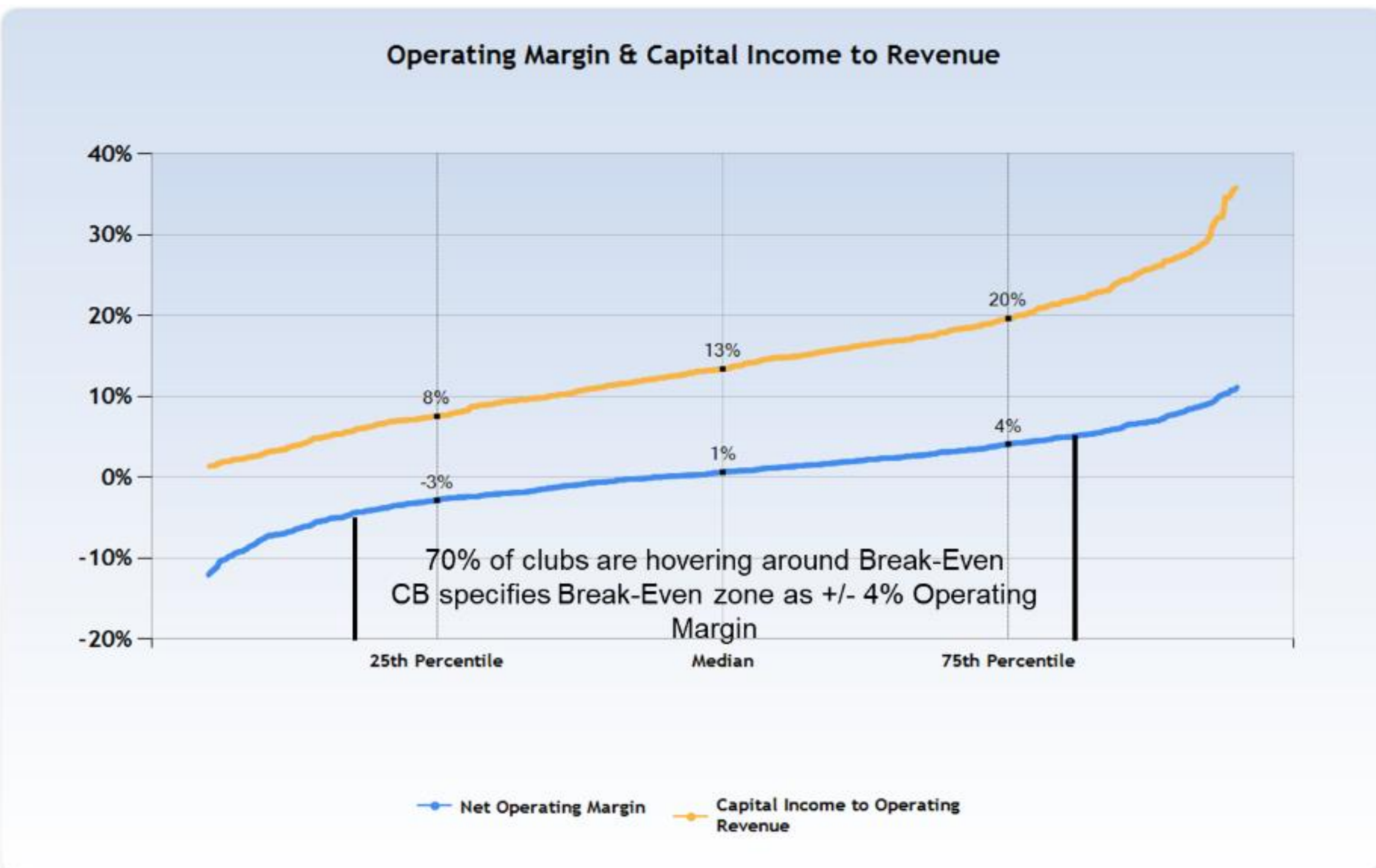
- Do we have a compelling member experience driving a strong membership engine?
- Do we understand and embrace financial best practices?
- Are we increasing Net Worth Over Time and aggregating the capital necessary to meet the future?
- Have we embraced data-driven leadership or are we still steered by the loudest voice in the room?
- Do we have a membership culture of owners or customers?

Warren Buffet said, “It is only when the tide goes out that you learn who has been swimming naked.” At Club Benchmarking we employ a variation on that observation… over time the market will always expose a weak business or financial model. As things begin to return to normal in the coming months, we should realize the crisis provided an opportunity to see our own club’s business and financial model under stress conditions. The previous economic meltdown showed us “who was swimming naked” in the club industry and it fueled more than a decade of data-gathering and analysis undertaken by Club Benchmarking to prevent history from repeating itself. Better data leads to better decisions. That data has allowed Club Benchmarking to unearth a fact-based view of best practices.

Use the crisis as an opportunity to change the future – simple as that. When we reach the second half of 2020, every club should be asking; “How do we make our club stronger?” This section of the white paper provides the roadmap for employing the best financial practices in the management and governance of every club. It is the following best practices that made the clubs with the strong membership engines strong. It is ignorance of (most common), or an unwillingness to embrace best practices (less common but it happens) that made the clubs with the weak membership engines weak. Every club can benefit from studying and embracing the following best practices. Emerging from a crisis seems like a perfect time to do so. The best practices are a failsafe roadmap for clubs with strong membership engines to remain strong and for clubs with weak or moderate membership engines to improve their future. The best practices that should be reaffirmed and embraced as we emerge from this crisis are:

1. Recognize the operating ledger as the vehicle for delivering services and amenities to members. It reflects the member experience. Financially, it is consumed every year by members enjoying the club. It is not the financial driver.
2. The financial driver is the capital ledger. Capital Income is the source of money a club uses to drive itself forward financially.
3. Every club, like every business and family, must increase NWOT. NWOT grows as a result of adequate capital income and decreases as a result of inadequate capital income.
4. The key to sustainable financial success is a comprehensive, forward-looking capital plan.
5. Clubs compete on value, not on price. In 2020 and beyond, clubs must offer a compelling member experience if they are to succeed. On the margin, clubs must lean toward funding the member experience and lean away from a focus on cutting expenses.

Chart 7 – The Financial Impact of Operating Margin and Capital Income



The Operating Ledger

Chart 7 presents the most important bit of insight Club Benchmarking research has uncovered to date. Ninety percent of clubs set the operating ledger to break-even, excluding depreciation (which is considered a capital expense). Chart 7 shows the results for 2019 for more than 500 clubs (2019 year-end data gathering is still underway).

Key Takeaways from Chart 7:

1. The blue line presents actual operating results (excluding depreciation) affirming clubs set the operating ledger to break-even. Seventy percent of clubs are hovering around break-even (+/- 4% of the operating revenue). Break-even is not a financial outcome.
2. While the operating ledger is not a financial driver, it is the vehicle for delivering services and amenities to the membership. The money flowing through the operating ledger is essentially consumed year-in and year-out by members enjoying the club. Just as it should be.
3. In terms of capital income (the gold line) the median club had capital income equivalent to 13% of its operating revenue – significantly overshadowing the operating result. It is capital income that provides the money for a club to drive itself forward financially.
4. We advise clubs to view the operating ledger as the member experience, not a financial driver. We advise clubs concerned about finance to focus on the capital ledger.
5. Clubs with weak membership engines typically focus on the operating ledger as the financial driver. These clubs lean towards expense management and cost reduction thinking the club will have more money, but it won't. Such efforts will certainly lessen dues, but the member experience will also be negatively impacted, and the operating ledger will still only produce a break-even outcome. Such misplaced focus is most often the result of misunderstanding the financial model of clubs (although we have run into board members who simply disregard that data and insight).

The Capital Ledger

Club Benchmarking defines Net Available Capital as the KPI gauging how much capital a club has for one, or all three of these things: capital investment, debt repayment or increasing cash reserves. Thus, the term, Net Available Capital. The calculation for Net Available Capital is:

Net Available Capital = Total Capital Income + Operating Result (interest is tallied as operating expense) – All Lease Payments

Every club's primary financial goal must be to continuously generate the available capital to meet future capital investment needs (both obligatory and aspirational), debt repayment obligations and to increase reserves to an acceptable level. Clearly, there is a pecking order in the allocation of Net AC – debt repayment comes first, capital investment second and increasing reserves third. The data indicates 70% of all clubs are not generating the capital necessary to meet those future needs without either assessing the members or deferring capital maintenance. We are using data to lead the industry away from assessments (the reason why is a topic for another day) or from deferring capital maintenance, both of which we contend are poor practices.

The primary reason the industry has done a poor job of generating adequate capital is that clubs lack a comprehensive, forward-looking capital plan. Taking it a step further, the main reason for the lack of that plan is the result of boards and finance committees spending too much time scrutinizing the operating ledger as a result of misunderstanding the financial model presented in this white paper. We estimate that less than 5% of all clubs have a comprehensive, forward-looking capital plan.

As a means of standardizing Net Available Capital (Net AC) across all clubs, Club Benchmarking uses the Net AC to Operating Revenue Ratio. Net AC is an absolute measure – smaller clubs with smaller footprints do not need to generate the same magnitude of Net AC as larger clubs with larger footprints. The Net AC to Operating Revenue Ratio normalizes all clubs. Chart 8 presents the Net AC Ratio for all clubs. The recommended ratio is at least 18%.

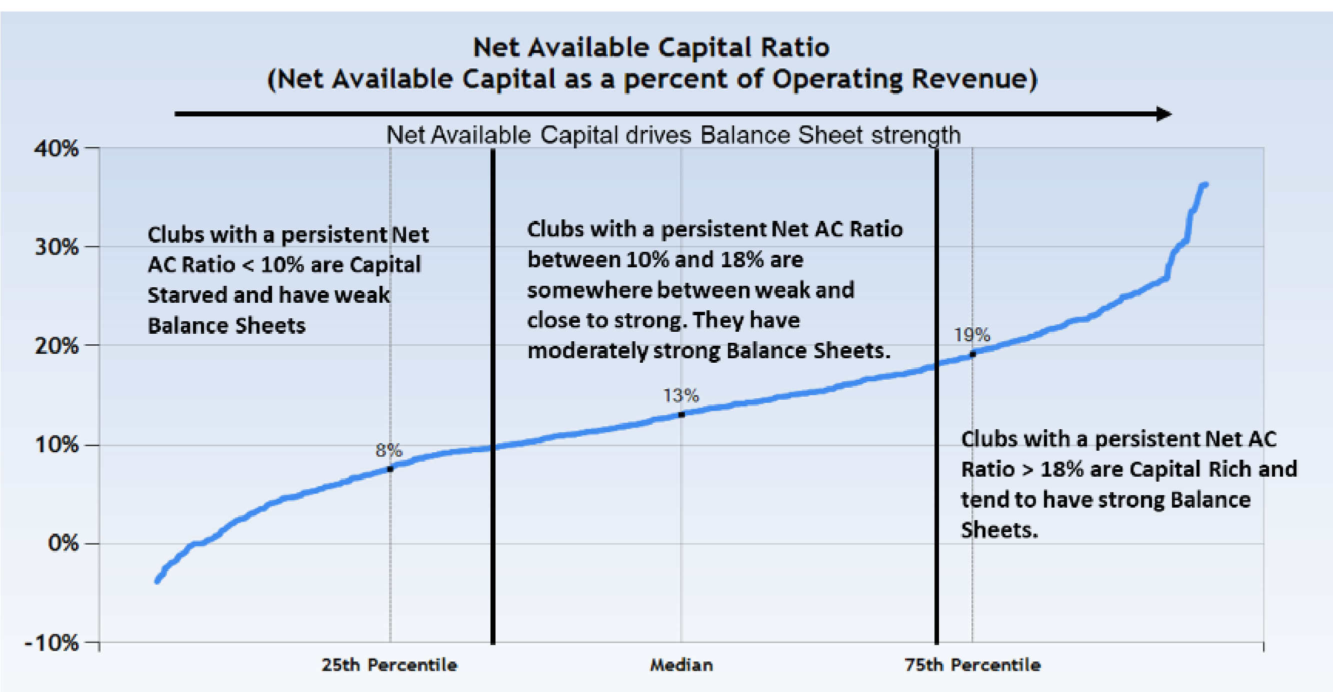
The secret to sustainable financial success is consistently, year-in and year-out, generating the necessary Net AC. The wonderful thing about the club industry is each club controls its own destiny in terms of Net AC. Independent of competition, independent of the market. The generation of Net AC is tied only to:

1. Understanding and embracing the concepts presented in this white paper.
2. Developing the forward-looking capital plan necessary to deliver a compelling member experience. (See Club Business Magazine - Spring 2019)
3. Club leadership, very likely in concert with outside objective experts, communicating the plan to convince the broader club membership (the owners) to fund the plan.

A plea to clubs with weak or moderate balance sheets entering this crisis – use this experience as an opportunity to change your future. While creating your forward-looking capital plan may be difficult (given the magnitude of deferred maintenance), clubs have done it. Members in clubs with weak balance sheets have simply not contributed the capital that was necessary over time. Changing that is as simple as implementing the three steps above.

To the clubs that entered the crisis with a strong balance sheet – keep doing what you have been doing but also make sure you implement the three steps above. Don't leave the future to chance.

Chart 8 – The Net Available Capital to Operating Revenue Ratio



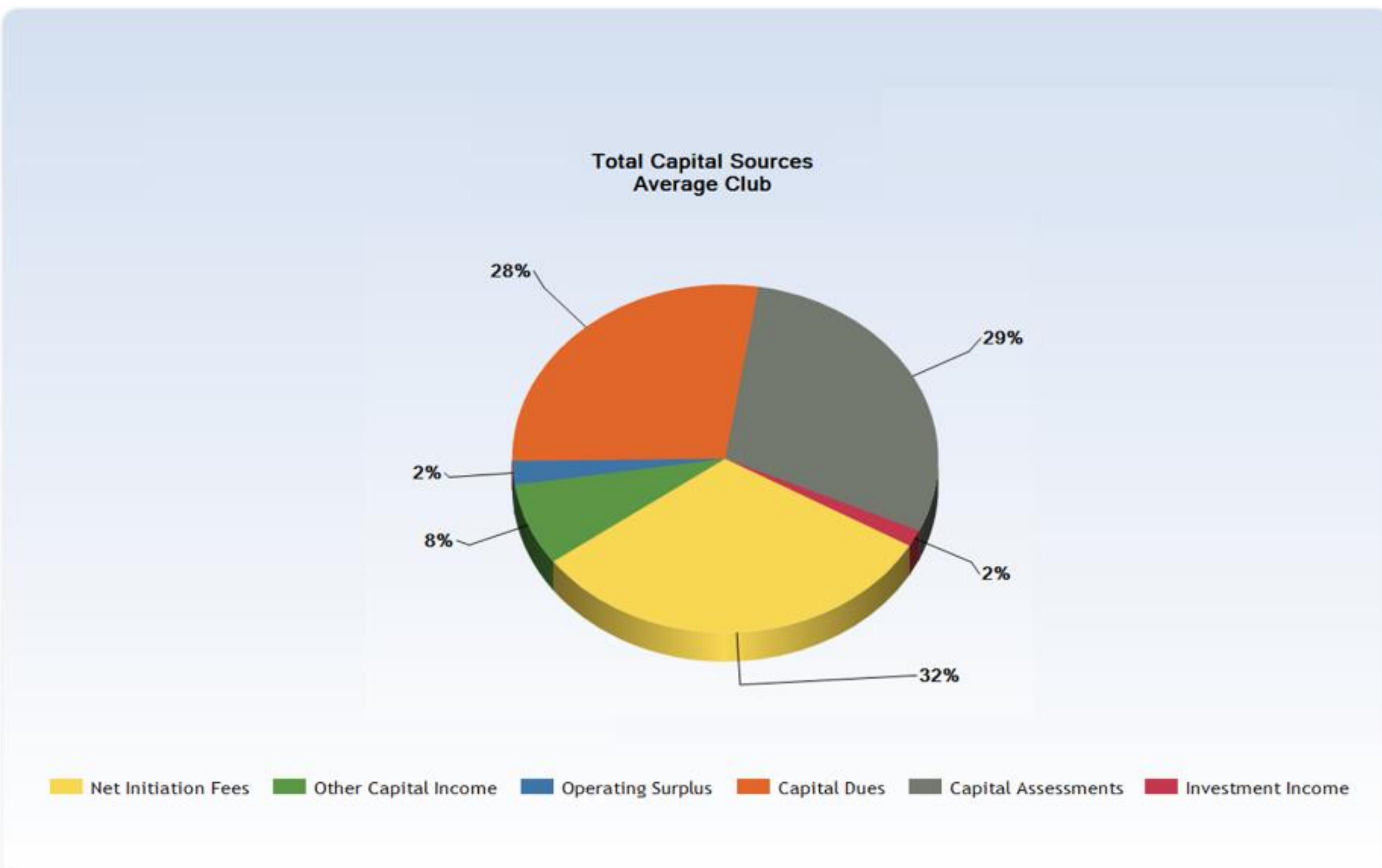
Key Takeaway from Chart 8:

1. Net Available Capital is the engine that drives sustainable financial results (not the operating ledger). Clubs with strong balance sheets and strong membership engines have continuously generated the capital necessary to consistently and adequately invest in evolving the member experience over time. Clubs with weak balance sheets and weak membership engines have a historical pattern of inadequate and/or inconsistent generation of the capital necessary to invest in the member experience over time.

One last note on Net Available Capital. Based on experience, there are folks on boards and finance committees who have a strong (but misplaced and not data-driven) view of the operating ledger as a force driving capital. Chart 9 is presented in the hope of tempering that view because it will lead clubs astray. Chart 9 shows the sources of money forming Net Available Capital. As can be seen, the average contribution to Net Available Capital resulting from operating margin across the industry is a paltry 2%.

To be sure, there are a handful (approximately 10%) of clubs where the operating margin contributes a substantial portion to available capital. But that contribution is really a "head-fake." Effectively, those clubs are allocating a portion of the dues a member pays to the operating surplus which is destined for capital. Those clubs have capital dues, without the name. Membership dues intentionally segregated from operations and delivery of the member experience, by definition, is money for capital.

Chart 9 – The Net Available Capital to Operating Revenue Ratio



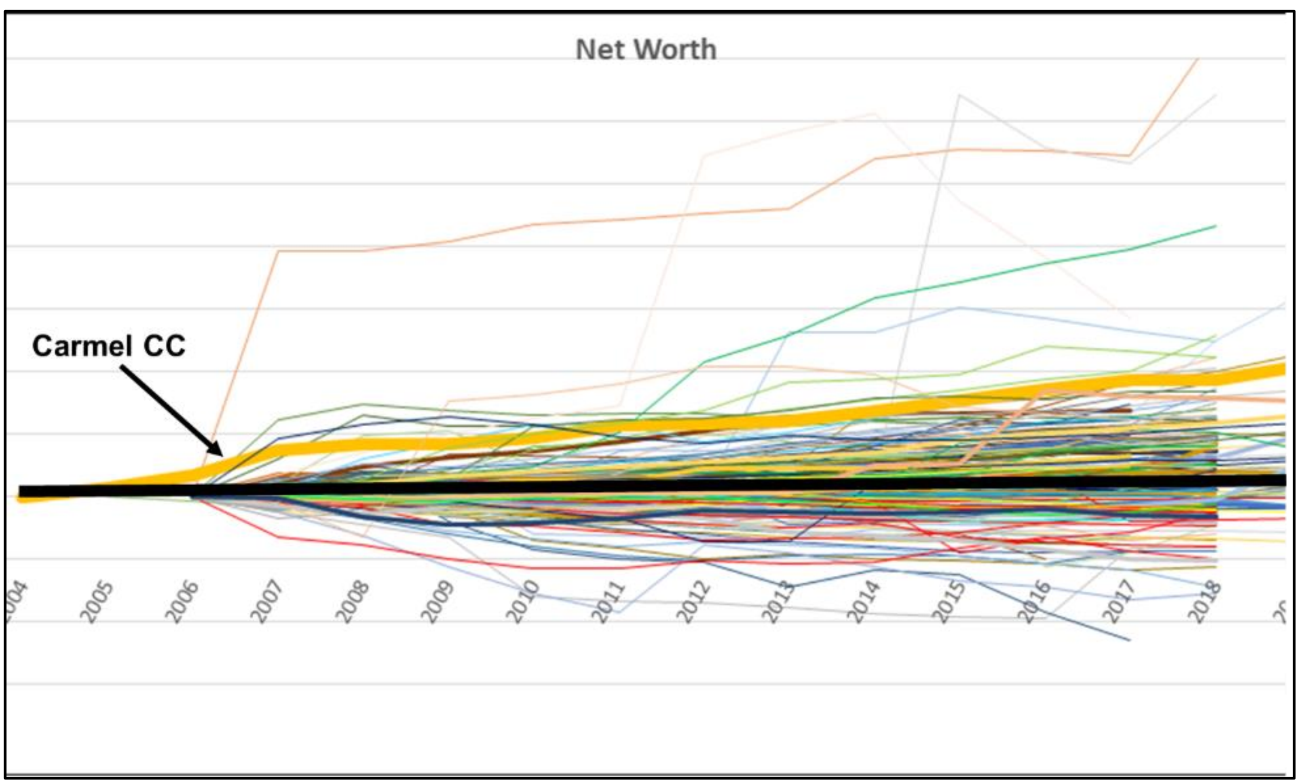
Net Worth Over Time

In 2016, Club Benchmarking research uncovered a critical concept and associated KPI for the industry by recognizing the importance of measuring Net Worth Over Time. Net Worth (aka Member's Equity or Owner's Equity) is the most strategic KPI on a club's balance sheet (as it is on the balance sheet of every business). It is the definitive measure of how well a club has performed generating capital over time. As a side note, we employ the term Net Worth since every club member, regardless of financial acumen, can relate to the concept that Net Worth must increase as a result of handling their personal finances.

Given that 90% of clubs set the operating ledger to break-even, excluding depreciation, clubs can only increase their Net Worth when Net Available Capital is greater than the depreciation expense. Thus, over time, in the years that Net Available Capital is greater than the depreciation expense Net Worth increases. To be completely accurate, there is a detail regarding lease payments, which is changing due to accounting regulations, but that is outside the scope of this white paper. Alternatively, Net Worth decreases in the years that Net Available Capital is less than the depreciation expense.

Chart 10 presents the year-by-year changes in Net Worth for 600 clubs since 2006 (2006 was chosen as the base year to capture the effect of the last recession). The data shows 30% of clubs have lower Net Worth in absolute dollars in 2019 than in 2006. If one assumes Net Worth must increase at least at the rate of inflation, 50% of clubs are worth less in real dollars in 2019 than in 2006. Half of the clubs in the industry have literally shrunk since the last recession.

Chart 10 – Net Worth Over Time – 600 Clubs



In Chart 10, each club's Net Worth is indexed to provide a normalized benchmark. The clubs below the heavy line are shrinking in absolute value. Club Benchmarking analysis indicates Net Worth must grow at a minimum CAGR of 3.5% to assure a club is able to meet future repair and replacement capital needs. Only 35% of clubs are currently meeting that threshold.

Our investigation into Net Worth Over Time began in 2016 with a hypothesis and analysis of three clubs: one club investing consistently in the member experience (Carmel CC in Charlotte, NC), one marginally investing with an average experience and one restricting capital investment and cutting operating costs (and thus the member experience). Our hypothesis was that the club investing in and delivering a compelling member experience would have a relatively high growth of Net Worth, the club with the average experience would have flat Net Worth and the one restricting investment and cutting costs to the detriment of the member experience would have declining Net Worth. When the Net Worth Over Time for those three clubs was gathered, the hypothesis was confirmed as anticipated. It was an important breakthrough.

Since that initial effort in 2016, we have gathered Net Worth Over Time data from 600 additional clubs and we have visited, experienced and advised hundreds of those clubs. The pattern continues to hold rock solid. Clubs with lackluster member experiences (and relatively low initiation fees) show NWOT flat or shrinking, clubs with compelling member experiences (and relatively high initiation fees) show upper quartile growth in NWOT. Ultimately, NWOT measures a club's market relevance or lack thereof. As in any business, Equity (Net Worth) represents the strength of the business. Strong businesses are growing equity, weak businesses are shrinking equity. Consider the fact that over the same time period 2006 – 2019, Amazon's equity grew at a CAGR of 47% and Macy's shrunk at a CAGR of -6%. One company is relevant in today's world, one company is not.

Carmel's Net Worth Over Time is a Best-In-Industry benchmark. Carmel's NWOT has grown consistently year after year and at an upper quartile CAGR of 6.6% since 2006. Carmel offers members an amazing experience and they enjoy a full membership roster and waiting list. The club is highly relevant for young families and is a hive of member activity. Their increasing NWOT reflects the ongoing ability to invest in and deliver a compelling and relevant member experience. The market's objective measure of the club's relevance, the initiation fee, has increased from $40,000 in 2006 to $85,000 today.

Table 5 – Industry Net Worth Growth and Impact of the Virus

Quartile	CAGR Breakpoint (Since 2006)	Comments	Situation and Effect of Virus Crisis
Lower Quartile	-1% and Less	These clubs are consuming themselves. Assets are worn, depleted and unappealing to prospective members. These clubs are shrinking, not growing and are in a serious situation with a lackluster member experience and low or no initiation fees. They also tend to be the clubs focused on cutting costs and governed with a short-term, operational perspective that is the root cause of their problem. The perspective must change, the clubs must plan forward and convince their members to contribute capital and to invest in the member experience.	A market pullback in members joining clubs or an increase in members leaving clubs (as was seen during and after the last recession) as a result of the virus crisis will hurt these clubs the most. If the crisis ends up in Scenario #2, a number of these clubs may either close or have to seek strategic alternatives like management company or sale. The clubs in this group can change their prospects, but time is of the essence. Net Worth must begin growing immediately. These clubs need a plan.
25th Percentile to Median	-1% to 2.2%	These clubs are also having difficulty. Any club with Net Worth growing less than the rate of inflation (2% CAGR since 2006), is consuming itself. The extent of the problem is greater with lower rates of growth. These clubs also must plan forward and convince members to contribute the capital necessary to drive the member experience forward.	These clubs are not necessarily in a crisis and they will mostly weather the storm. However, time is working against them until they begin to grow Net Worth at a rate of 3.5% or higher. When the crisis abates – in the July to December timeframe - they must begin planning forward immediately.
Median to 75th Percentile	2.2% to 4.9%	This group is generally able to keep up with repair and replacement capital needs but less able to invest in expanding the asset base with new services and amenities. These clubs are on the cusp of being capital rich and can fairly easily develop a forward-looking plan to become capital rich.	Clubs in this group with a CAGR over 3.5% are relatively healthy. The clubs under 3.5% are not likely generating adequate capital to meet obligatory capital needs. All clubs must develop a forward-looking capital plan.
Upper Quartile	5% and Greater	These clubs are capital rich. They are generating the capital necessary to repair and replace existing assets and to invest to add to or expand the asset base. These clubs are the industry leaders and are investing in new services and amenities (fitness, wellness, spa and salon, resort style pools, casual dining, etc.) and setting the pace for the industry.	These clubs will weather the crisis well. They are also most likely the clubs that will cover staff payroll for the longest period because they have balance sheet strength that allows them to do so. They still need a forward-looking capital plan to continue building on their strength.

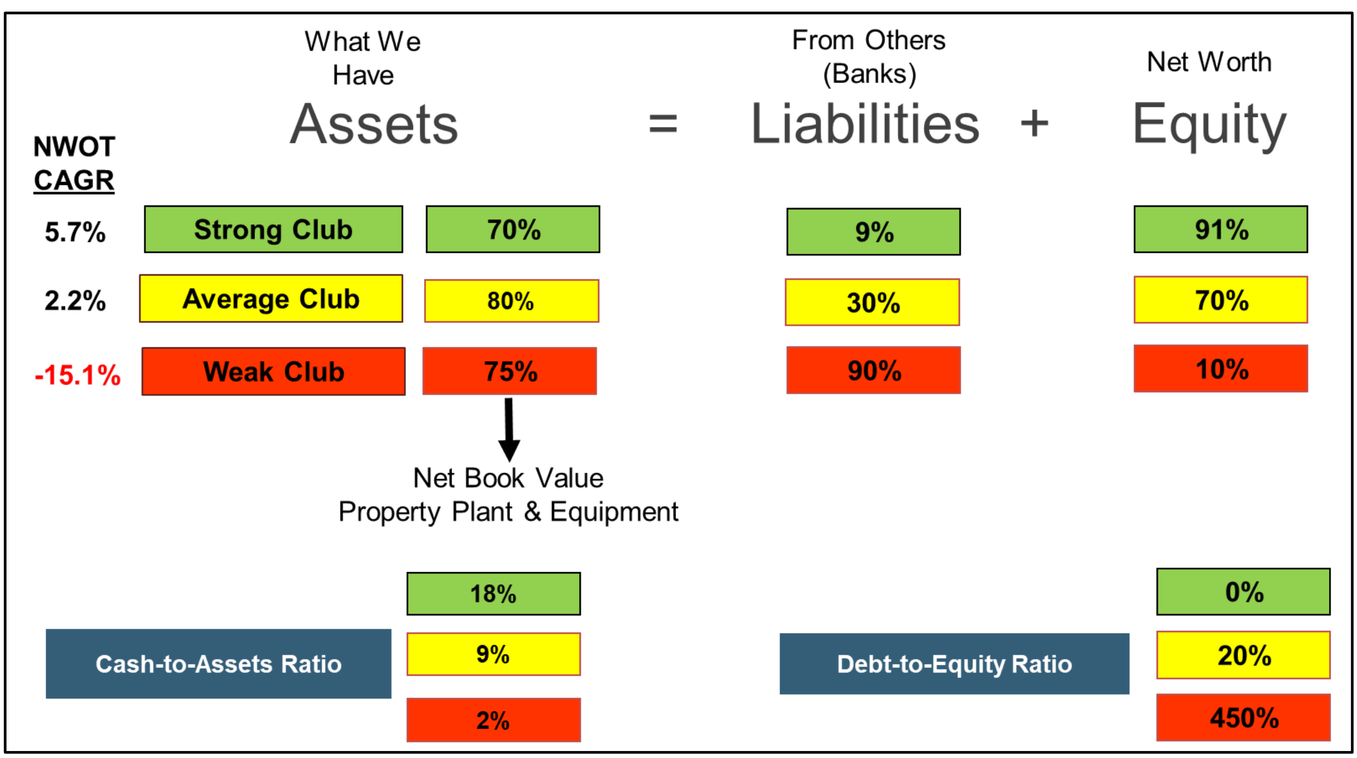
Table 5 presents analysis of the four quartiles of Net Worth Over Time growth. The table is self-explanatory. The key point is that every club must have a comprehensive, precise, forward-looking capital plan that is naturally supplemented by a strategic plan. Again, CB estimates less than 5% of clubs have such a forward-looking capital plan.

The Forward-Looking Capital Plan

While most member-owned clubs are organized as tax exempt under section 501c7 of the internal revenue code (in the USA), that does not mean they don't earn money. It simply means earnings must go back into supporting the club, not into the members' pockets. Over time, as with any business, clubs must generate the cash to reinvest. The cash generation engine, as we have learned, is the capital ledger. While significant money runs through the operating ledger, data has been presented here that shows the money flowing through the operating ledger is consumed delivering the member experience.

Net Worth (Equity) serves as the anchor of every balance sheet. Figure 1 presents the balance sheet of three clubs – the average club, a club with an extremely strong balance sheet and a club with an extremely weak balance sheet. The Net Worth Over Time CAGR since 2006 is also presented for each of the three clubs. Conducting the research reflected in this section of the white paper was an experience akin to solving a puzzle. With the hindsight of 10 years of intense study of club finances, it is now clear that real understanding didn't occur until the meaning of a club's balance sheet came into focus. The story of the balance sheet was the critical piece of the puzzle snapping into place that unveiled the picture of a club's financial sustainability over time. That picture of financial sustainability changed Club Benchmarking's business and how we seek to help clubs. As the picture became clear, so too did the importance of a forward-looking capital plan.

Figure 1 – The Balance Sheets of a Strong, Average and Weak Club



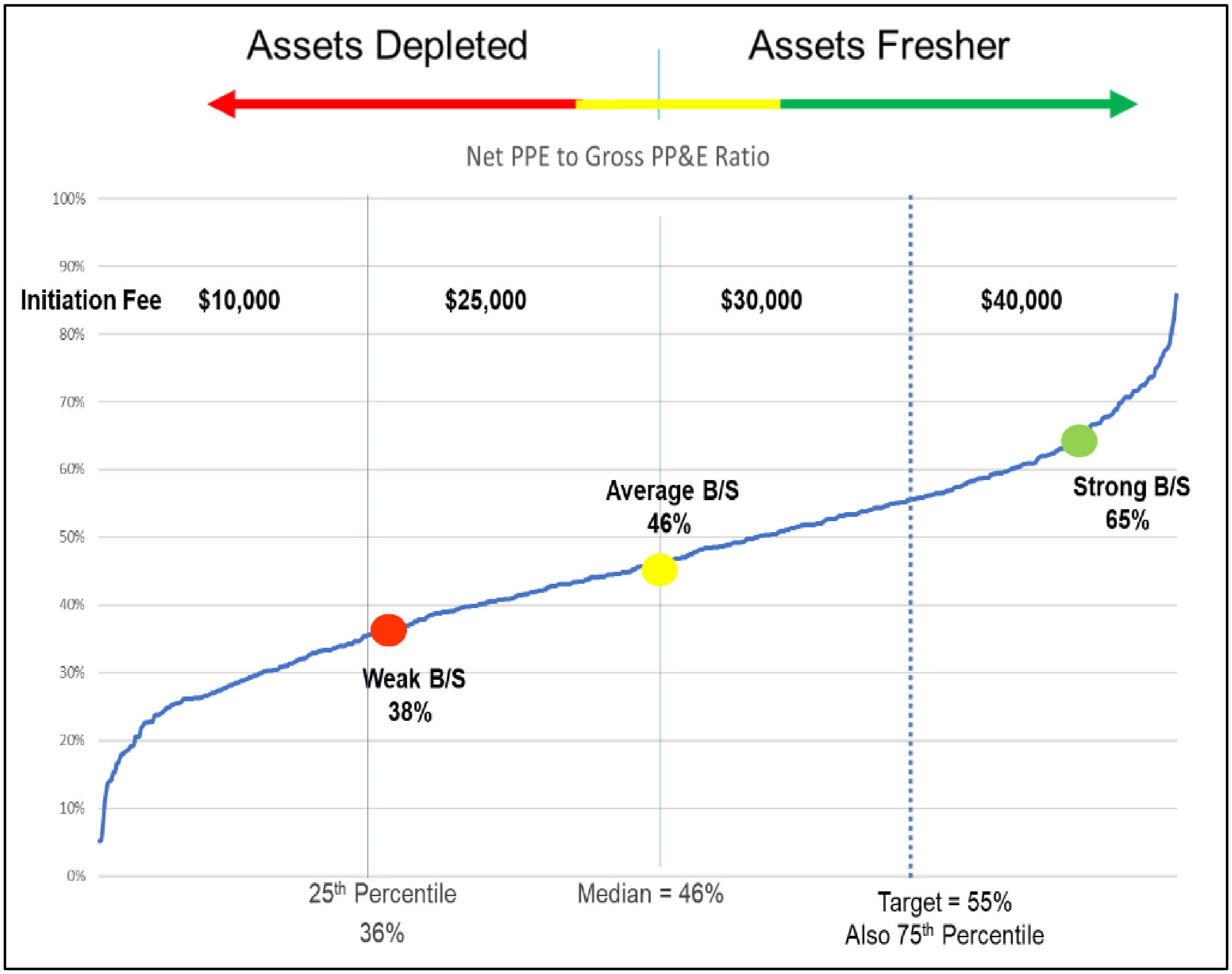
All three balance sheets in Figure 1 have one thing in common: Nearly 80% of the assets are the net book value of property, plant and equipment (PP&E). Following on, at the average club, 70% of the funding of those assets flowed from Member Equity. In the end, member equity is actually the tally of all the capital income over time, less all the depreciation over time – and that ends up as the net book value of PP&E. It makes perfect sense.

Given 80% of the average club's assets are PP&E, it obviously follows that clubs must focus on PP&E from a financial standpoint. Following the clues, the next balance sheet puzzle piece that clicked was the discovery of the Net to Gross PP&E ratio – which is a critical KPI for every club. Figure 2 presents the concept of the Net to Gross PP&E ratio. The ratio is simple to calculate and is a very accurate measure of the extent of depreciation of a club's PP&E.

Figure 2 – The Net to Gross PP&E Ratio Concept

Chart 11 presents the distribution of the Net to Gross PP&E Ratio at more than 600 clubs. The median is 46% which means the median club has an asset base a little more than halfway through its depreciated life. As can be seen, there is a significant variation across the industry (the 25th percentile is 36% and the 75th is 55%). It is also important to note, as shown in Chart 11, the initiation fee climbs consistently in concert with fresher assets as indicated by the increasing Net to Gross PP&E ratio.

Chart 11 – The Net to Gross PP&E Ratio Concept



Again, applying the puzzle analogy, key pieces fall into place with the insight flowing from Chart 11. First, 80% of a club's assets are PP&E. Second, Net Worth growth is a result of capital income overcoming depreciation expense. Third, the industry has significantly wide variation as to the extent of asset depreciation. The concepts that follow from there are critical:

1. Clubs with acceptable increasing Net Worth have enough capital income to account for depreciation and can thus adequately repair and replace assets and keep them, fresh, up to date and relevant. Those clubs have relatively high Net to Gross PP&E ratios and assets that are appealing to prospective members as indicated by the relatively high initiation fee.

2. Clubs with decreasing or unacceptable Net Worth growth do not have adequate capital income to account for depreciation and can't properly repair and replace their assets. Their assets look older, are older and are not fresh and up to date. Their older assets don't show well for prospective members. Clubs with ratios under 40% face two problems. The first is that they have a hidden liability in terms of the amount of deferred maintenance, and the second is that the depleted assets lack appeal to prospective members which as can be seen, negatively impacts the initiation fee. Problematically, the clubs that need capital the most are those with the lowest initiation fees.
3. Given 80% of a club's financial assets are PP&E, clubs must assure they have a plan to keep their assets in adequate shape (no different than the homes of the club members). A primary duty of an organization's fiduciaries is to protect, preserve and grow the assets of the organization. In clubs with low Net to Gross Ratios, how well are the boards meeting their fiduciary obligations? Half of all clubs are realizing a shrinking asset base in inflation adjusted value (most without even realizing that fact).
4. CB contends (passionately, but empathetically and respectfully) that shrinking or inadequate Net Worth growth causing a less than ideally maintained asset base, is a result of clubs overly focused on the operating ledger in search of financial outcomes. But, as we learned, that is a misplaced effort.
5. All of the data, all of the analysis and all of the logic presented thus far in this white paper leads to a critical conclusion that is widely misunderstood in boardrooms across the industry: From a financial perspective, clubs with weak balance sheets don't have an operating problem, they have a capital problem.
6. The final piece of the puzzle is something that must be embraced. Clubs must properly plan to meet their future capital needs, rather than being mainly focused on last month's operating ledger actual-versus-budget results. Thus, the need for a comprehensive, accurate, forward-looking capital plan. That plan is central to protecting, preserving and growing the club's assets.

Reviewing the balance sheets presented in Figure 1, alongside the Net to Gross PP&E ratios presented in Chart 11, a pattern emerges in terms of the story behind a club's balance sheet. Clubs with weak balance sheets have relied more on debt than on members contributing equity. These clubs have historically shied away from asking members to contribute capital. That is evidenced by declining or inadequate growth of Net Worth. Frankly, these clubs find it easier to go to a bank to ask for capital than to ask their member/owners. The inadequate contribution of capital over time manifests in two ways. First, the debt to equity ratio is higher than the average club and second, the asset base is more depreciated as indicated by the lower Net to Gross PP&E ratio.

Clubs with strong balance sheets have historically compelled their members to contribute the necessary capital. In the case of the club with the strong balance sheet, the members have been funding depreciation through recurring capital dues since the mid-1950s. Since that time, with obligatory capital being funded by recurring capital dues, the club was able to use initiation fee income to make aspirational investments in resort style pools, indoor tennis, large and beautiful fitness and wellness operations including spa and salon services – all keeping the club relevant and appealing to younger, less golf-centric families. As can be seen, this club has no debt and a relatively fresh asset base as evidenced by their strong Net to Gross PP&E ratio.

Figure 3 shows the two types of capital investment clubs must continuously plan to make. Clubs with upper quartile growth of Net Worth – successful, relevant clubs – have made the necessary investments, prior to, through and after the 2007-2008 recession. They meet their obligatory, repair and replacement capital needs while also having enough capital to add to and expand the asset base by investing heavily in aspirational projects as well. Since that last recession, the clubs leading the industry have invested heavily in fitness and wellness, spa and salon services, an array of nice, casual dining options, resort style pools with outside dining options, firepits and brick oven pizzerias, and other socially centric amenities to create a vibrant, social scene.

Clubs with weak balance sheets haven't had the capital to even meet obligatory capital needs, thus causing lower net to gross PP&E ratios. Clubs with average balance sheets can generally meet obligatory needs and possibly some aspirational needs but still need more capital to boldly drive the club forward.

Figure 3 – Two Types of Capital

The Types of Capital

Obligatory

- Repair and Replacement of existing assets
- Depreciation = past cost – "matching depreciation" is not enough
  - Assets cost more to replace than when originally acquired
  - Fully depreciated assets in use that will need to be replaced
- Past and Existing Members are Obligated – not future Members
- **The Source of Obligatory Capital → Recurring Capital Dues**

Aspirational

- Expand existing Assets (Clubhouse expansion)
- Add new Assets (entire new Clubhouse, adding a pool or fitness when none existed)
- Adding new Amenities – Croquet, Pickle Ball
- Current and Future Members are on the hook. Future members more so
- Aspirational Capital should have a Return on Investment – Capital Income is the Return
- **The Source of Aspirational Capital → Initiation Fee Income and Debt**

Club Benchmarking recommends a minimum growth in Net Worth of 3.5% per year **to meet Obligatory Capital Needs**

The Capital Income for Aspirational Capital will grow Net Worth on top of the 3.5%

A forward-looking, capital plan is a proactive plan that ensures a club will be able to meet future capital needs (without deferring maintenance or reactive assessments). While every club should have such a plan, Club Benchmarking believes no more than 5% do. The plans we have seen universally fall short in terms of precision, comprehensiveness (a tally and assessment of every asset based on a professional capital reserve study), objectivity and a thorough, bottoms-up projection of membership assumptions.

Applying diligence, best practices and objectivity to the completion of a forward-looking capital plan will drive the following outcomes:

- The knowledge the club has a plan today, that assures the needs of tomorrow can be met.
- Every member will contribute equally their share of the money to meet future obligatory needs as they consume the assets that will ultimately need to be replaced. A side note, too many clubs use debt to meet obligatory needs which is a worst practice as the debt will be repaid through capital contributions from future members rather than from capital contributions from the members who consumed the assets that will be replaced.
- Knowing the plan will drive adequate growth of Net Worth and thus strengthen the balance sheet in terms of asset investment and the reserves necessary to meet future challenges.
- The knowledge that the forward-looking capital plan is the vehicle for assuring that the members as stewards and owners are meeting their fiduciary obligation to the club by assuring the capital necessary to protect, preserve and grow the assets in place.

In summary, the key to sustainable financial success is a comprehensive, accurate, forward-looking capital plan. Every club that creates one will be assured of meeting the future with a strong balance sheet supported by members who think like owners and who are committed to proactively contributing the necessary capital to meet the future.

Clubs Compete on Value, Not Price

The data and insight presented in this white paper clearly support the conclusion clubs must invest in offering a compelling and relevant member experience to attract and retain the optimal number of members to fund that experience.

The last recession provided a learning opportunity indicating clubs must think more strategically when making decisions in the second half of 2020 than they did in 2009 and 2010. Charts 12 and 13 should make a few critical points abundantly clear:

1. Clubs with lower dues and initiation fees have fewer members, not more. Cutting the initiation fee will not solve an inadequate member experience problem at the root of member attraction and retention problems. The lack of members is a value problem, not a price problem. Cutting the initiation fee will increase member churn as a result of attracting people who think more like customers than owners, while also decreasing the amount of capital available. Clubs facing member experience problems need more capital, not less. Don’t cut price – increase the value by offering a more compelling experience.
2. The clubs with the most members are the clubs with the highest initiation fees and the highest dues. They are also the clubs with the most compelling member experience. Clubs compete based on the member experience they offer, not the price they charge for it.
3. As we have learned, the operating ledger is the vehicle for delivering the member experience. As such, on the margin clubs should aim to invest more in the member experience, not less. Cutting operating expenses leads to a diminished member experience. Chart 13 shows that clubs with the lowest expenses have the fewest members and the lowest initiation fees, while clubs with the highest expenses have more members and higher initiation fees.

Chart 12 – Initiation Fee versus Member Counts and Member Dues

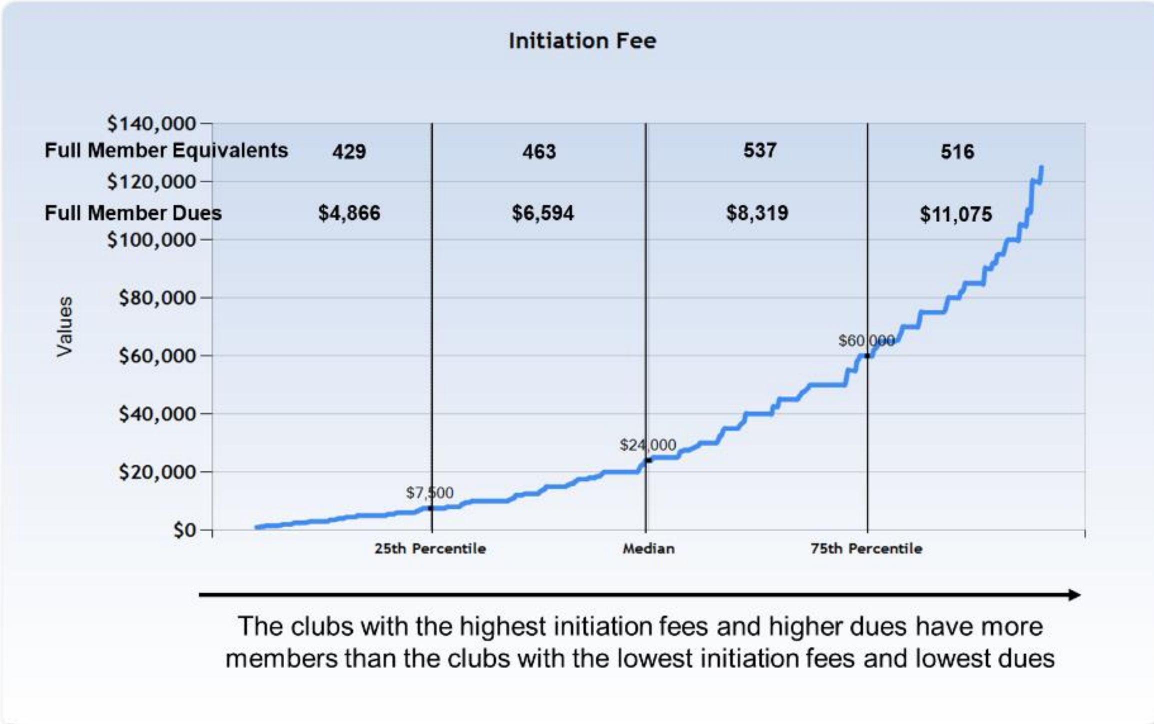


Chart 13 – Operating Expenses versus Member Counts, Dues and Initiation Fee

In the second half of 2020, as the club industry navigates toward the future, we are likely to face a market environment for club membership that is either marginally less friendly or much harsher than the market existing at the beginning of 2020. As mentioned earlier in the white paper, it is our view the resulting market environment will be a result of where the stock market sits. The Dow at less than 21,000 will likely produce a harsh environment, while a stock market rebound into the mid 20,000s or above will likely produce an only marginally less friendly environment. In either case, clubs should begin to think strategically about how to navigate a weakening market.

Clubs that entered the crisis strong are likely to remain strong (as long as they don't panic and start slashing). Clubs that entered the crisis weak must confront their member experience, weak balance sheet and lack of capital head on by focusing on driving investment in their member experience forward. If they don't, over time, they will continue to see declining or stalled Net Worth due to inadequate capital income. The longer that situation persists, the less likely those clubs will survive over time.

All clubs can embrace the same concepts: Plan the future, fund the plan and drive the member experience to be relevant for society in 2020. Don't get stuck focusing on operating expenses and operating budgets to the detriment of thinking strategically about the future. The real crisis of the virus will occur if it causes club boards to get trapped in operational governance (managing costs, worrying about efficiency) rather than strategic governance (planning, and funding, the consistent evolution of the member experience).

Conclusions and Recommendations

A framework has been presented to help clubs navigate the impact of COVID-19. The framework is based on data and fact-based insight resulting from analysis of the finances and practices of hundreds and hundreds of clubs since 2010 and from the experience of having advised more than 500 of those clubs.

The framework encompasses the following advice:

1. Consider three timeframes for decisions: through the end of April (the main period of the lockdown), May–June (gauge impact on member attrition and recruitment) and July through the end of the year (drive long-term, strategic outcome for the future by embracing best practices).
2. Through the end of April and into the middle of May, the lockdown will impact the operating results of clubs. The financial impact of a 30- to 60-day lockdown will be marginal and can be absorbed by most clubs. Avoid making decisions that cause long-term and strategic consequences during the lockdown crisis, i.e. don't hack away at the 2020 operating and capital budgets.
3. In the May–June time period, gauge the impact of member attrition and attention as the means of gauging the long-term impact of the crisis. Accurately track member intake and attrition in relation to the last few years and in relation to your market, region and the industry. Participate in CB's Strategic Monthly Dashboard to assess membership trends in the market.
4. Before making long-term, strategic decisions make sure your club has objectively assessed its membership engine and balance sheet as manifested by member counts, the initiation fee, Net Worth Compounded Annual Growth Rate (since 2006), the balance sheet benchmark and the Net to Gross PP&E ratio. CB offers a free service to benchmark your Net Worth and Balance Sheet. Don't make critical decisions without context. The crisis hasn't caused the problems clubs face. After the last recession at least half the industry made poor decisions as evidenced by the decline of Net Worth since.
5. As the second half of the year unfolds, commit to embracing best financial practices and to use data to diagnose and solve real problems (membership experience and capital). Don't look to simple answers like cutting price. Focus on your club's value proposition and aim to assure your

club offers a compelling member experience. The virus is **an issue**, it is not **the issue**. View the operating ledger as the vehicle for delivering the member experience and the capital ledger as the vehicle for driving the club forward financially.

6. Create the forward-looking capital plan that is at the root of sustainable financial success. That plan, coupled with a clear vision for the future member experience, will define the future. That is the way to avoid letting the crisis that we are experiencing define the future.