Reduce Club Debt and Increase Membership Value With a Refundable Initiation Fee Program

By Fonda Hereford & Drew Feldman

Many prospective private club members have expressed concern about the refundability of initiation fees, especially in the event of a relocation. As a result, many clubs have added, or are considering adding, a refundability feature to their fee structure.

Some of these programs can be complicated and clumsy. Most create debt for the club and require resigning members to wait for their refund, sometimes for years. In addition to the financial liability these refunds represent, club leaders may also find they hinder the recruitment of new members.

A new product, Initiation Fee insurance, may solve these difficulties for clubs that choose to offer a refundability feature. Available through Owners & Members National Insurance Services, LLC, and the Chubb Group of Insurance Companies, Initiation Fee insurance allows clubs to obligate a specific refund for a specific period of time without funding it themselves. The following article describes some of the problems typically encountered with refundable initiation fees and how this new insurance coverage works.

Methods of Refunding Initiation Fees

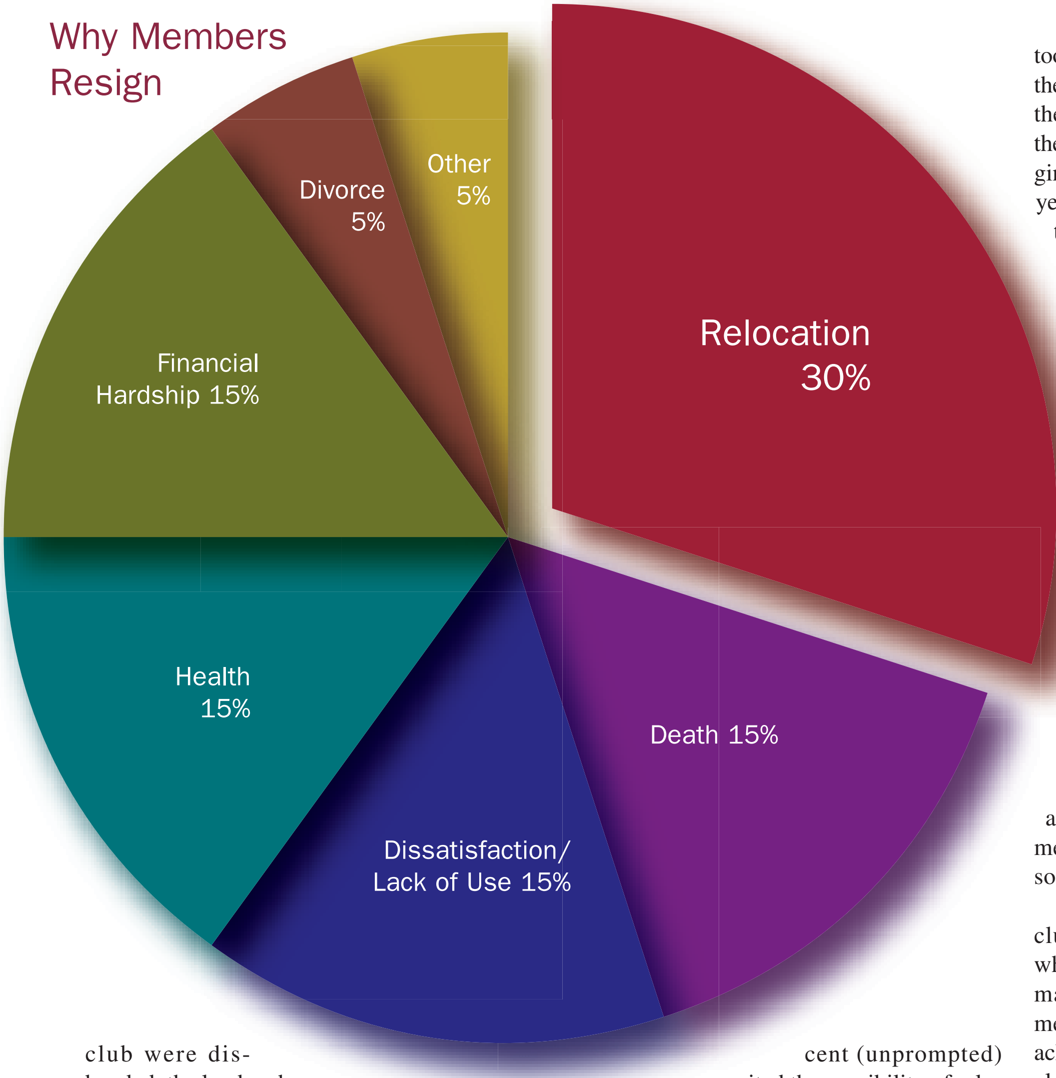
There are a variety of refund formulas available—from initiation fee deposit programs to membership deposit programs, bonds and certificates, equity ownership interests, and many hybrids of these, all of which create debt for the club. In order to refund an initiation fee, a club must first make the promise of a refund and then treat as a liability all or a portion of the initiation fee paid by the new member.

Many of the clubs that refund fees to resigning members must first sell several new memberships before returning one. If the club's membership is full, there will be no return until others have resigned and until such time as the required number of new members have been enrolled. As a result, resigning members may be placed on a transfer or waiting list until their money can be refunded, a process that in some instances may take years. If the transfer list continues to grow, real debt increases, making the club less attractive to potential new members and buyers.

In order to charge higher initiation fees, developers, owners and clubs themselves have created equity or initiation deposit memberships. As stated earlier, the promise of equity return or return of deposit, no matter the amount, depends on the length of the transfer list; the shorter the better. For example, if a resigning member is number 30 on the transfer list, the club only enrolls 10 new members per year, and there is a four-for-one clause in the refund agreement, the resigning member will wait for more than a decade before he or she receives a refund.

In many instances, the resigned member may be required to continue paying dues while waiting for a refund. For this reason, many equity returns are never made because the resigned member realizes that he or she will pay more in dues than the value of the return while waiting on a transfer list.

In fact, traditional old line clubs may be the only true equity clubs. If a member-owned



club were disbanded, the land and assets would be sold, obligations met, and the balance, if any, returned to the members in the form of an equity distribution.

Relocation a Major Concern

Not only do many refund programs erode the balance sheets of clubs, they may not actually address members' true concerns.

Owners & Members sponsored a nationwide market survey in 2001 that targeted affluent neighborhoods. More than 70 percent of respondents who were not presently members of a private club, but had indicated that they had considered joining such a club, were concerned about the refundability of the initiation fee. Within this group, more than 50 percent (unprompted) cited the possibility of relocation as a specific concern.

In addition, 65 percent of those who had considered joining a club but did not, said they would be more likely to join a club with a membership option that would ensure they could recover immediately all or some of their initiation fee if they had to resign due to a relocation. Forty-six percent of these respondents would be willing to pay more toward their initiation fee to protect their investment in this manner for a period of up to eight years.

Current Refund Programs Offer Too Much

In contrast to these statistics, most of today's initiation fee refund programs may be offering too much for too long. New club members feel the sting of their initiation fee payment only in the first few years of their membership. Once the member starts using the club, he or she begins amortizing the initiation fee. Within a few years, the member feels he or she has "used up" the initiation fee and the club membership has been well worth the original outlay.

Furthermore, clubs may be too permissive when they allow refunds for any and all resignation reasons. As one survey respondent noted, "If you join a club, you must want to be a part of it, and you invest in it. Why would you try to take your money back? If you join, it's final." Thus, allowing refunds for any reason at any time may prevent the establishment of a loyal membership; the practice may actually breed uncommitted, aloof members.

In addition, there are many examples of members putting their names on the transfer list just to reserve a place in line. They may, in fact, have no intention of resigning from the club; however, their actions hurt and delay a refund to another member who has resigned for legitimate reasons, including relocation.

The question, then, is this: Why would a club refund an initiation fee for any reason when data suggests that relocation is the primary concern of members and prospective members? The look and feel of equity can be achieved with Initiation Fee insurance, and the club does not have to contract for the debt.

Competition Heats Up

Thus far, traditional member-owned clubs have been able to resist the trend toward refunding initiation fees; most do not offer a refundability feature. However, due to the growing popularity of such programs, even these clubs may eventually want to consider some type of refund plan.

Due to intense competition from new facilities, some traditional clubs may also find they are no longer the only game in town. Many may see their waiting lists erode as people join other newer facilities, including those that do offer an initiation fee refund program. Traditional clubs are also experiencing competition from high-end restaurants and daily fee courses. In short, the club without some form of refundable initiation fee program may be missing some very desirable prospective members.

Finally, many of the older traditional clubs no longer have a reliable flow of legacy members. Young, potential junior members are not coming home from college immediately and are taking jobs in other parts of the country. In order to attract younger members who are not legacies, a refundability feature may be needed.

Refund the Fee and Avoid the Debt

Initiation Fee insurance may be the answer for many clubs and their members. This new product is purchased by a club or its owners or developers to reimburse the insured club all or a percentage of the initiation fee refund promised if the member resigns due to a relocation of more than a pre-established number of miles from his or her residence of record with the club.

The policy is issued on an annual basis with coverage available for a period of up to nine years, including waiting periods that apply to existing members and all new members as they join. The reimbursement percentage and the length of time that benefits are paid will vary by club.

Purchasing Initiation Fee insurance allows clubs to reduce or eliminate debt and reduce the number of resigned members on lengthy reimbursement waiting lists. In addition, Initiation Fee insurance can help clubs recruit new members by addressing a primary concern—relocation for any reason.

How Does it Work?

Working with Owners & Members National Insurance Services, LLC, or with their own insurance broker, a club can design a refund program that best suits its needs. The plan can be designed to capture all new members, all or some existing members, or both. It can also be used in the event a club levies an assessment on its membership. The benefit period can be as long as nine years.

There is a one-year waiting period before benefits begin for new members and a two-year waiting period for existing members. Based on the refund promises made by the club, the insurance program reimburses the club for those initiation fees that they have paid to resigning, relocating members. Typically, the amount of the initiation fee return is based on a declining scale over the full nine-year period.

For example, a club might purchase insurance so that 80 percent of the initiation fee is returned in the second year of membership (after the one-year waiting period for the new member), 70 percent in the third year, 60 percent in the fourth year, and so on. If a member should resign and relocate in the third year of his or her membership, the club would refund 70 percent of the initiation fee and then would be reimbursed for that amount by Chubb, the insurance provider.

With Initiation Fee insurance, there is no cost to the club because the premium for the insurance has been incorporated into the initiation fee. That is, the premium is paid at the time a new member joins. Premiums can also be paid monthly if a policy is purchased to protect the club from resignations of existing members.

Clubs that already have a refund program of some sort may also benefit. Initiation Fee insurance reimburses the club for the equity/refund paid when the member resigns and relocates, and this allows the club to keep all or at least a portion of the proceeds of the next new member's initiation fee. In addition, if the reimbursement equals the amount promised when the membership was sold, it keeps that member from joining the transfer list.

Initiation Fee insurance will not totally eliminate all of the debt incurred at clubs that already promise refunds. This insurance is designed to reimburse the club for those refunds to members who have resigned and moved away from the area.

However, it is estimated that on average, 30 percent or more of attrition at private clubs is due to reolcation. (Other reasons include death, dissatisfaction/lack of use, health, financial hardship, and divorce; see pie chart on p. 26). Relocation is most often the reason for resignation; therefore, Initiation Fee insurance allows the club to better manage and predict its member-related debt.

Another distinct advantage to using Initiation Fee insurance for the equity club is that it offers a method of keeping the dues line intact while a resigned, relocated member is waiting for a refund. Consider a club that has purchased a declining scale of reimbursement benefits. The member that resigns in the sixth year and receives perhaps 40 percent of the promised refund will have the money to continue paying dues while waiting on the transfer list.

Clubs may also utilize Initiation Fee insurance for member assessments, assuring members that all or a portion of the assessment will be refunded for a fixed number of years if they leave the club due to relocation. The cost of the insurance is incorporated in the assessment amount. This is particularly important for members who are considering retirement or relocation within a relatively short period of time and who are concerned that they will not be able to fully utilize the capital improvements funded by the assessment.

Members and Club Benefit

Initiation Fee insurance offers a cost-effective alternative or complement to a club's current initiation fee reimbursement program. The club can either reduce or eliminate the debt incurred with an initiation fee refund guarantee; it can reduce or eliminate its transfer list; and it can continue to attract young mobile members by offering them the assurance that their initiation fee will be refunded if they must leave the area due to relocation.

Initiation Fee insurance can help if your club:

- Is having difficulty attracting new members because it lacks a refund program.
- Has a transfer list.
- Has significant debt related to refundable initiation fees.

With Initiation Fee insurance your club can create a refund program that:

- Satisfies member needs.
- Is paid for by the members within their initiation fees.
- Enhances the value of an individual membership.
- Limits the club's debt and potential liability.

Fonda Hereford is a managing member of Owners & Members National Insurance Services, LLC, a St. Louis-based company. Drew Feldman is an underwriting manager in Chubb's St. Louis office. The Chubb Group of Insurance Companies offers property/casualty insurance to personal and commercial customers through independent agents and brokers.