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Club Membership Deposits – from Gold to Paper

The club industry has dramatically changed its perception of refundable membership deposit structures for clubs. Once viewed as the preferred structure, refundable membership deposit structures are avoided like the plague.

Under the traditional refundable membership deposit structure, a club charges a membership deposit to join the club, which is repaid in 30 years or after the member resigns or dies and the membership is reissued. Club owners implemented variations of this structure, with transfer fees or sharing in membership appreciation.

Membership deposits were hugely popular with for-profit club owners because of the income tax advantages and their popularity among potential members who liked the idea of getting their money back. Membership deposits are treated as debt, and therefore, club owners are not required to pay federal income tax on membership deposit proceeds. The result was that many club owners were able to raise huge amounts of funds, tax free, which the club owner was able to use for any purpose, including reimbursement for development, reserves or even distributions to partners. Although the membership deposits are debt, they were generally not viewed as regular debt in the valuation of clubs, because membership deposits were continually being refinanced as memberships were turned over. When club facilities were sold to third parties, the purchasers generally assumed the debt, without corresponding reductions in the purchase price.

The perception of membership deposit programs began to change in the early 2000's when resigned member sell lists grew. Members complained about having to wait years for their refunds. Membership deposits became a major problem when membership market prices plummeted in 2007. Club owners who assumed that resigned membership reissuance prices would at least cover the membership deposit refunds of the resigned members instead found themselves having to repay membership deposits from their own funds.

These problems significantly affected the market for club properties, as prospective club purchasers, investors and appraisers began to view membership deposit debt, the same as any other unsecured debt. Club owners with significant membership deposit liability found that the amount of the membership deposit debt exceeded the value of the property, often limiting or even eliminating a club sale as an exit strategy. Many owners of membership deposit clubs have resorted to bankruptcy or transferring the club property to their lenders to address the membership deposit debt problem.

Is the membership deposit structure dead as an option for a club? In the near term, the answer is yes, because they are perceived so negatively in the marketplace. However, as membership prices stabilize, club owners may be attracted to the programs for same reasons they became popular in the first place: income tax benefits.

Any club owner that implements a membership deposit structure should learn from the past, and incorporate the following into the program:

- Prominent disclosure that members may have to wait a long time for refunds;
- Flexibility in being able to amend resigned membership reissuance;
- Reissuance provisions tied to dollars received, not membership sales; and
- Possible reserves to allow for sell list buy downs.

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