

The Pricing of Equity Memberships

The Problem:

The price of club memberships on the secondary market, when allowed to “float, is driven by market forces. When many are selling and few are buying the price goes down and when few are selling and many are buying the price goes up. When the price of equity has topped out or bottomed out the Board has addressed the market mechanism and questioned whether these swings are in the best interest of the general membership. How do other clubs determine the price of memberships in the secondary marketplace? What factors drive the price of equity memberships? What have equity clubs done historically with the purchase and sale of equity memberships? What options now exist for the Board of Directors? The following analysis will help shed light on each of these issues.

The Issues:

a. How do other clubs determine the price of memberships in the secondary market.

Clubs have either the market or the Board of Directors determine the price of equity memberships in the secondary market whereas the Board almost exclusively sets the selling price of newly issued equity in every private club.

Some clubs who have the selling price determined by the Board of Directors set the price of membership artificially low to increase the diversity in the pool of candidates and to create a waiting list of qualified applicants for membership. Other private clubs set the price of membership artificially high to restrict the pool of potential candidates and to dramatize the affluence of the member community.

Regardless of the philosophy each club has toward secondary market equity transactions, there are a number of ways that clubs can influence the price of memberships. Each of these tactics has both intended and unintended consequences that need to be understood before choosing one procedure over the next.

- a. Clubs require that purchases be made through the club as the transactional agent. This controls the process and guarantees that the club derives a financial benefit from the equity transaction.
- b. Clubs require that purchasers be approved by a membership committee. Doing so ensures that a qualified candidate, appropriate to that community, is given the opportunity to purchase a membership.
- c. Clubs assess “transactional costs” for transferring memberships either with a transfer fee or with a with an admission fee. Some clubs use these dollars to subsidize operations and some use them to supplement the capital building program.
- d. Clubs can set the price of membership and then have the Board alter that price based on market forces. Boards are traditionally slow to alter prices since their philosophy for the price of membership usually dominates the “voice of the marketplace.” Therefore the equity price is usually below the market or above but rarely equals the market “clearing price.” Problem: members resent the Board and not the market if their equity goes down in value.
- e. The club can let the market set the price of membership, thereby putting the responsibility for establishing an asking price on the selling member. In a sellers market this might mean that the price spikes to a very high level and in a buyers market it might mean that it spikes to a very low level. The swings in the buying and the selling price are much sharper, quicker and more frequent than in a market where the board sets the price of membership.

- f. Clubs can increase the amount of saleable equity by allowing non-resident memberships for equity members thereby increasing the number of memberships for sale. Doing so allows additional equity to flow into the marketplace if the club has sufficient non-resident members. A spike *may* occur when the program is first introduced, driving down the equity price of memberships. This also increases the size of the membership base since the user population has effectively increased.
- g. Clubs can increase the number of saleable memberships by allowing seniors to sell their memberships. This puts more equity in the marketplace and can cause a depression in the market when first allowed. Since most clubs have a lot of seniors, the qualifications for membership need to be very high and the number allowed must be limited. Doing so can potentially cause dissatisfaction amongst the seniors who might pass away before they qualify. This also increases the size of the membership base since the purchasing family represents an additional user group for the club.
- h. Clubs sometimes have a special non-equity membership for those not interested in buying a full equity membership. This expands the membership base without increasing the amount of issued equity. The Special program at the Los Angeles Country Club is one example of this strategy.
- i. Clubs that offer Junior memberships and Associate memberships, control the number of each available and establish the ages appropriate for each thereby helping to reduce or to increase pressure on the equity marketplace. These categories become the “minor league” for future equity purchases. Once in the habit of using the club and once comfortable in the “member community,” these groups are natural future purchasers of equity.
- j. Clubs have waiting lists for those who have been approved but for whom no equity memberships are currently available. By so doing, the club maintains a pool of purchasers for any equity which enters the marketplace. The potential for abuse arises if a selling member, in a market sales environment, chooses to maximize their return during the sale to this “captive market.”
- k. Some clubs offer special arrangements for legacies--- either lowering the admissions fee or lowering the transfer fee. This can reduce or increase the number of purchasers, lower the cost for those buyers, facilitate the transfer of equity outside the marketplace and affirm that the club wants these people as future full equity members.
- l. Additional equity memberships can be authorized and issued thus increasing the size of the membership base. Doing so can reduce the value of existing equity and can increase the user group, potentially crowding the facility. Since the price of newly issued equity is set by the Board, this can work to the advantage of the buyer. In addition, all the proceeds go to the club and the money can be useful during capital building campaigns.
- m. The club can purchase memberships in the marketplace and place them in treasury stock for issuance at some future time. Doing so would require the use of considerable cash, depleting reserves and denying that cash to other needs within the club. This can support or raise the price of equity in the marketplace and it can buffer against price swings in the future. The club can potentially profit if it releases the equity into a rising market.
- n. Social memberships, which are usually clubhouse only memberships, are sometimes offered so that full equity memberships would be available to those who are using the entire facility and services. Doing so reduces the demand for full equity memberships and increases the size of the user base.

b. What factors drive the price of equity memberships?.

What factors actually impact the asking or the selling price of memberships?

Equity prices don't always follow the actual or “intrinsic” value of the membership as determined by renovations, programs, quality of staff and the like although most people have a tendency to suggest that they do. Other factors--- the timing of deaths, the non-resident migration, the recency of an assessment, the state of the national economy, the state of the local economy, the fashionability of private club memberships, the amount of club competition within the local community, the availability alternatives within the club's niche market, the distribution by age or sex within the club (i.e. Is the club considered a “men's club” or a “senior's club” as are some of the country clubs in the local community) and whether the surrounding community wants, needs or validates such a “distribution type,” the concept of family, the need for neighborhood and the like--- have an equally important effect on the market price of memberships.

When the prices rise people suggest their club is better than others and when it falls they suggest that evil days have arrived. It may well be that the offered product in both markets is identical but that other extraneous factors are at work. These rumblings can become self-fulfilling prophecies either driving up or depressing the selling price of equity.

The price of memberships is closely related to the strength or weakness of the surrounding economy. When “the boom is on” as it was in the mid eighties and late nineties here in Southern California, applications increased and the price went up. When the economy slides, as in the early through mid nineties, the number of applications goes down and with it the price of memberships. Macro issues such as this are beyond the control of the Board though their response to the changes--- as noted earlier--- can be extensive.

c. What have clubs done historically to control or to influence the equity price of memberships in the secondary marketplace?

The price of memberships go up and down over time. Since market oriented clubs let the market set the price of membership, when the price has gone up, at some point there is a reduction in the number of applications and, after a “lag period” where those “in the pipeline” are processed, the price of memberships has gone down. The opposite has also been true--- when the price of equity has gone down eventually, once the “word is out” about prices, the number of applications has gone up and the price has risen. In both rising and falling markets, the “intrinsic value” of the membership in terms of programs, facility and staffing has continued to rise.

Estates generally sell memberships at a lower “market clearing” figure than active members. Deaths are unpredictable and therefore market impact cannot be timed.

Members generally want the highest price they can get for their memberships when they finally decide to sell. Most will hold out longer, paying dues, if they feel they’re selling into a rising market. When they’re not selling they generally empathize with the plight of younger families who are buying into the market. This altruism evaporates when they decide to sell and their “vested self interest” takes over.

Members love to brag about high equity prices and decry low equity prices when enjoying drinks at a cocktail party. Rarely do they consider the pluses or the minuses of low market prices and high market prices and they almost never address “intrinsic value” during those conversations.

The club’s nearest competition, and the clubs to which members refer when addressing pricing issues, are the Bel Air Bay Club, which has a similar product and membership to our own, and the Los Angeles Country Club, which is the “opinion leader” in Southern California and which is the country club “home” to a large percentage of the Beach Club membership. Both clubs allow the market to determine the equity price of memberships in the secondary marketplace and both have experienced the pricing swings which accompany such a philosophy.

Many clubs, historically, have not used admissions fee adjustments as a tactic for reducing the total price to the buyer. What seems to have happened is that the club captured a higher transfer fee as the market rose, then when the market softened it maintained the same fee in order to maintain the income stream for its capital needs. In a declining market the buyer benefited at the expense of the seller while the club maintained its admissions fee. In rising markets the club has adjusted its admissions fee to take advantage of the increasing value of the equity by either increasing the fixed fee or establishing a percentage transfer fee that maximizes the “transactional return.”

To buffer younger members from rising prices the club introduced both the Junior and the Associate categories to both attract and to retain younger members. During the late eighties rising market the club added five years to the associate category--- from 35 to 40--- and four years to the Junior --- from 28 to 32--- thereby buffering that group from the rising market.

Associates are approved for Regular Membership but choose to “finance” and to delay their purchase of a full equity membership for several years. As a consequence of their right to purchase an equity membership at any time without further Membership Committee or Board review, they have been able to buy low priced equity quickly during down markets and to ride out increases in a rising market. Since they have eight years to “time the market,” most have done reasonably well with this purchase option. No Associate “bulge” has been caught in a rising market since they seem to have taken advantage of favorable changes in the market before that occurred. The possibility of this happening is on the horizon if all of those turning forty in 2004 (six people) and 2005 (five people) wait until the due date to purchase. However, there doesn’t appear to be any bulge, and therefore no Associate “panic,” for the intervening years.

d. What is the current situation for the secondary market?

Most clubs nationally have a problem attracting members in the current club environment while other clubs have had a problem finding equity to sell to those wanting to purchase memberships. This is certainly an enviable situation but should be considered a short term aberration, if history is any guide.

Several internal and external factors are currently impacting the secondary market .

External Factors:

- a. The strong national economy.
- b. The strong local economy.
- c. The movement of “the big money” to the west side.
- d. The increasing need for neighborhood in the Los Angeles community.
- e. The increasing need for a safe, structured, child friendly environment.
- f. The strong family focus of the club in a society seeking family focused clubs.
- g. The casual nature of the club in a society seeking a more casual club experience.
- h. The movement of the Jonathan Beach club away from a child focused beach program.
- i. The casual, flexible nature of the facility at a time when people are searching for a more casual club environment.
- j. The increase in the price of memberships at the Bel Air Bay Club.
- k. The more onerous Associate program at Bel Air which encourages their Juniors and Associates to consider the Beach Club.
- l. The possibility of an assessment at the Bay Club.
- m. The divisiveness amongst Bay Club members because of the Tom Hanks and renovation issues.
- n. The prospect of having the Bay Club lower facility partially shut down for a period of time during their proposed renovation of the lower club.
- o. “The In Crowd”, which is a particular attraction for younger members but is true for all age groups, may be more in evidence at the club just now than elsewhere.

Internal Factors:

- p. The timing of sales by the existing membership.
- q. Non-residents who wanted to sell their equity and become non-residents have already done so.
- r. The continued improvement in the youth program.
- s. The renovations which have significantly improved the facility.
- t. The reputation for a strong employee team.
- u. An improvement in the food and beverage operation.
- v. The “friendly toward older members” reputation of the club.
- w. The improvement in the basket of goods and services--- gym, mommie and me, etc.

e. What options now exist for the Board of Directors?

Circumstances are now such that the number of equity memberships for sale is low and may soon be non-existent, at least for a short while, and the prices are spiraling upward at an accelerating rate. Concerns have arisen that the Associates will be caught in an upward trending market, that the pool of qualified applicants will be reduced and that money will become a more important membership criteria than values.

As a consequence, should the club be looking to introduce short term mechanisms, which can be quickly added or removed as the market environment changes, which would slow the rise or fall of membership prices? Should it be searching for permanent “solutions,” formalized into Bylaws, to the gyrations of the market?

The following options are among those which exist for the Board of Directors to consider:

Note: The 1998-1999 Strategic Planning Committee reviewed the following options and offered their recommendations, each of which is noted to the right of the Pro / Con columns.

1. Do nothing--- let the market work and as the price rises the number of applicants will fall and the price will eventually come down.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. This system has worked successfully over the years. 2. The market will eventually correct imbalances either by reducing the number of applicants when prices are high or by increasing the number of applicants when the prices are low. 	<ol style="list-style-type: none"> 1. The market mechanism works slowly. 2. Swings in price can be dramatic in a short period of time. 3. When the price goes too high some qualified candidates are discouraged from applying, often joining other less expensive clubs. 	Let the market work with “conditions”

2. Set the price of membership at the current historically high price, therefore preventing a rising market and guaranteeing those who have already purchased memberships to at least equal their purchase price at the time of sale.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. No-one who has purchased a membership to date would lose anything if they were to sell after the price has been set. 2. The price would be unambiguous and therefore predictable for an applicant. 3. As inflation occurs, the price of the membership would appear to be a bargain in the years ahead. 	<ol style="list-style-type: none"> 1. Contrary to the “free market” approach used at the club since its founding in 1923. 2. Members who would be selling into a rising market would feel that they were being denied the opportunity to determine the selling price, therefore foregoing a profit they might otherwise make. 3. The Board usually lags the market in changing the selling price either up or down. 4. Would require a Bylaw change. 	No.

3. Extend the age to which associates can remain associates--- say to 45.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. The age change would keep the Associates out of the "purchase pool" longer, therefore reducing the "equity crunch." 2. These few extra years would put the Associates in a better financial position (it is assumed) than they would be at 40, thereby enabling them to afford whatever equity price then exists. 3. Doing so would attract more Associates, thereby increasing the total pool of qualified candidates. 	<ol style="list-style-type: none"> 1. Changing the Bylaws would take several months. 2. Doing so would increase the number of Associates. 3. The price for memberships would probably be lower than it would be if they were in the "purchase pool" at age 40. 4. Note: in 1992 the conversion age was changed from 35 to 40. 	NO.

4. Create a non-equity *Special* membership much like the LACC.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. Would take these candidates completely out of the "equity purchasing pool" and thereby reduce the "equity crunch." 2. Would attract a number of people who are indifferent to ownership. 3. Would net the club more dollars per "admission" than the regular procedure since the price of admission would be higher for this category of membership. 	<ol style="list-style-type: none"> 1. Would require a Bylaw change. 2. Would distinguish a group of members who are of an age to be regular equity members but are not. 3. Would change the nature of the membership base by making the decision making group, as a rule, older. 4. Pricing the Special at an appropriate price would be difficult. 	No.

5. Create senior memberships which would allow more equity to enter the marketplace. A "points system" combining age and years of membership or a simple "minimum age plus minimum years of membership" could be used to qualify seniors for such a membership

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. Would create a permanent source of new equity for the marketplace. 2. Would make a number of older members feel that their commitment to the club had been rewarded. 3. Would effectively increase the user base and the dues paying base. 4. Seniors generally use parts of the club which are not heavily used by the younger members. 5. Could be used to "honor" older members and therefore be considered a privilege and not a right. 6. Could hold down the price of membership in the future and thereby be a "plus" for those wanting to buy a membership. 	<ol style="list-style-type: none"> 1. Too many qualified seniors if the requirements for going senior are too low. 2. Will tend to hold down the price of membership which might anger those who are selling their memberships. 3. If the qualifications are too narrow then those who don't qualify might resent those who do or resent the Board for having made the qualifications too narrow. 4. The release of senior equity into the marketplace would have to be tightly controlled in the first few years to prevent excess downward pressure on the membership prices. 	Worth further consideration

6. Issue additional memberships and increase the size of the equity base.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. Could issue memberships whenever needed. 2. Newly issued memberships net the club large dollars 	<ol style="list-style-type: none"> 1. Would require a Bylaw change. 2. Would increase the number of memberships 	No.

both in the initial sale and in the long term revenue stream from their dues.	with potential complications for the facility and services. 3. Could be viewed unfavorably by the membership since it would dilute the value of their membership and the intimacy of the facility.	
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7. Solicit equity from current members who infrequently if ever use the club--- older members, non-resident members, etcetera.

Pro's	Con's	Comm.
1. Would help turn non-productive memberships into productive ones. 2. Might be perceived by the member as a gracious gesture by the club.	1. Members who are called might feel that the club is trying to "force them out."	Yes, continue doing so.

8. Stop accepting applications for membership.

Pro's	Con's	Comm.
1. Would reduce the number of people wanting to purchase memberships. 2. The "mystique" of the club might grow as the market learns of its growing exclusivity.	1. People wanting a beach club membership would probably go elsewhere. 2. People might suggest that the club is becoming too elitist. 3. Once new members were needed, it might be very difficult to attract new applicants.	No.

9. Process applicants, put them on the wait list and while there're on the wait list give them guest privileges to use the club until equity becomes available. Charge them the full admissions fee before putting on the wait list. Charge them regular monthly dues during this period. Do nothing to control the asking price once equity becomes available in the marketplace.

Pro's	Con's	Comm.
1. Candidates feel that they have been accepted and can use the club while waiting for equity to show up in the marketplace. 2. The club gets the admissions fee and the monthly dues even before the equity is sold. 3. The user base is expanded while the family waits for an equity purchase thereby increasing sales. 4. Qualified candidates are processed and are in line for the purchase of equity as soon as it is available.	1. A selling member can take advantage of the buyer since there is little incentive for them to lower their asking price. 2. The number of users increases, possibly cramping the facility. 3. Candidates might refuse to buy if the price is too high and simply drop out of the market and the club. 4. Buyers might be impatient and refuse to wait, exiting the wait list and applying elsewhere.	Yes.

10. Lower the threshold for expelling delinquent members from the club thereby releasing several memberships into the marketplace. ***The current "threshold" is \$7,500 or 50% of current equity value, whichever is less.***

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. Would increase cash flow marginally. 2. Would put a few memberships into the marketplace. 3. Most who are delinquent would pay up if they thought their membership was being sold thereby improving cash flow for the operation.. 	<ol style="list-style-type: none"> 1. Most who are delinquent would pay up if they thought their membership was being sold, thereby denying (rather than supplying) additional equity for the marketplace. 2. The club receives in excess of \$30,000 annually of "investment income" from those who are delinquent. 	No.

11. Slow down the processing of candidates.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. Fewer candidates would be approved and the demand for memberships would slacken. 	<ol style="list-style-type: none"> 1. People would resent a further slowing of the process and might antagonize people who are in the pipeline and are motivated to purchase memberships and use the club. 2. Potential candidates might be lost to other clubs if the process is further slowed. 3. Slowing approvals would prevent users from gaining access to the club and would keep non-users (since those who are selling are, in theory, non-users) in the membership who want to exit. 	No.

12. The club could allow a new form of "legacy transfer" to occur---- parents could transfer equity memberships to their adult children, who have been approved for membership by the Board, and then receive a non-equity membership paying full dues for their own use. ***Such a tactic would effectively create a senior membership category with the primary qualifying condition being the legacy child.***

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. The transfer would keep an approved candidate from having to purchase one of the memberships being sold in the secondary market. 2. This would dramatize the value of legacies to the future of the club. 3. The dues paying base would be increased. 4. This would emphasize the importance the club places on family. 	<ol style="list-style-type: none"> 1. This unduly favors those members with children. 2. Members who might be motivated to sell their memberships, thereby putting more equity in the marketplace and thereby lowering the price of memberships, might transfer their memberships instead to their children. If these children were not in the membership process, the transfer would effectively remove an equity membership from sale, thereby keeping the equity price higher than it might otherwise be. If, however, the parent had no intention of selling their membership in the first place, such a transfer would have no impact on the selling price of equity. 	No.

13. The club could have older qualifying members give their memberships to the club and then get free dues for the remainder of their life. These treasury shares could be used to buffer against upward price surges in the marketplace and could be profitable for the club in a rising market.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. The club could release equity into the marketplace as required, therefore correcting for upward price swings in the market. 2. The club could potentially profit from the release of the memberships into a rising market. 3. If the age restrictions are properly thought out, the free dues given the member would be less than the market price of the equity. 4. This strategy would help some of the older members who want to retain their relationship with the club but are having a difficult financial time doing so. 	<ol style="list-style-type: none"> 1. Unless the membership is resold quickly, the club would have less dues income. 2. The member might live longer than projected and the club would correspondingly "lose" in the exchange. 3. How would one handle the surviving spouse of such a member? Would the program only be available to widows or widowers? 	<p>Worth further consideration.</p>

14. A "penalty transfer fee" could be assessed for any amount over a given threshold, say (for example) a 100% transfer fee for any equity asking or selling price over \$20,000. Doing so would effectively cap the price of membership without taking away the option of removing the cap quickly if a future Board chooses to do so.

Pro's	Con's	Comm.
<ol style="list-style-type: none"> 1. The penalty would effectively cap the equity price of memberships. 2. The applicant could be told that the purchase price of a membership would not exceed a certain dollar amount. 3. The price of memberships could be held down in the future, thereby increasing the pool of potential candidates. 4. The Board could increase, reduce or eliminate the surcharge with little or no delay. 	<ol style="list-style-type: none"> 1. Sellers would be disturbed that the Board, and not the market, was determining the price of their memberships. 2. The true market value of the membership would increase over time and the Board would need to determine when to raise the maximum "untaxed" asking price. 	<p>No.</p>

Conclusions:

The market has changed from a buyer's to a seller's market and back again over the years. One can only suppose that it will continue to do so in the future. The market mechanism has successfully handled these changes over time, as is evidenced by the strength of the current club and its membership. Minor adjustments to the mechanism have been made when opportunities arose---- associate and junior memberships, the closed bid auction environment, the release of authorized but unissued equity and the creation of a non-resident membership.

The current market provides an opportunity to "tweak" the process and improve the market mechanism. A reasonable and easily implemented recommendation would be to create a wait list if there are no memberships for sale, offer those on the wait list "guest memberships" for the interim, charge these families a fee equal to the monthly dues of an equity member and have them purchase equity memberships once they are offered for sale in the marketplace. However, this might set these approved candidates up for "a fleecing" by members then choosing to sell their memberships at inflated prices. This could be countered by restricting access to the number of wait listed members, thereby providing the selling member

with a bit less information than they would like to have to “maximize their return” or by restricting new equity to a market price no greater than that which was most recently sold. This “restriction of information” is not all that different from what we currently offer the selling member: average selling price of the memberships most recently sold, number of people that we anticipate being approved at the next Board meeting, the number of candidates in process, range of prices for the memberships being offered and the number of Associates who are able to purchase memberships if they so choose. Restricting the sale price would be a bit more questionable though the transfer fee has been manipulated over time to prevent “profitering” by the selling member.

Such minor adjustments would avoid the need to alter the Bylaws and would acknowledge that, over time, the market is the most effective mechanism for the selling of equity memberships on the secondary market.