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## Recreational club conversions can present challenges

In a previous column for this publication, we reviewed the benefits of adding a recreational amenity to resort property through various legal structures, such as easements, licenses and club agreements.\* Market pressures to maintain the high value of leisure property have only increased since then, which can lead to recreational club sales and conversions. For example, the town of Gypsum recently acquired from the lender of a distressed development and converted to public use The Cotton Ranch Club, an 18-hole Pete Dye championship golf course. The Heather Ridge golf course in Aurora was acquired late last year by a metro district specifically formed by surrounding owners' associations after foreclosure by the golf club's lender. In Steamboat Springs, the Catamount Golf and Lake Club recently completed a major internal modification adding the off-site slopeside community of One Steamboat Place to its membership.

Conversions to public ownership or turnover of club assets to the club members can be viewed as the sale of a multifaceted business. A sale or turnover agreement must incorporate an adequate period for due diligence of critical assets – most significantly, water rights, water delivery systems and continued capacity for water service. Back-of-course areas, such as machine shops and storage yards, are just as important as a well-appointed clubhouse. Most clubhouses include food and beverage services, and the usual "19th hole," so liquor licenses, food establishment inspections and sales tax applications must be processed. Recognize that golf courses have



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an agricultural component as well, with potential environmental liabilities related to fertilizer and pesticide use and with greenskeeper occupations subject to Occupational Safety and Health Administration's agricultural regulations. The wide range of successor liabilities facing club operators, from errant golf balls to immigration laws, make analysis of the predecessor's claims history, risk management policies and insurance policies of vital importance.

In transferring club assets, special care must be given to the unique balance sheets held by clubs and to their senior mortgages. Most private clubs offer members a nonequity revocable license to use the club facilities. The member makes an initial deposit that the club promises to refund, in whole or in part, upon the member's resignation. In short, the club promises to repay an interest-free loan made by the member. Memberships are shown as liabilities, not assets, on the club balance sheet. When club property is transferred back to the club members, the initial memberships may be exchanged or discharged by the transfer. When club assets are worth less than the club's refund obligations, the club and members should consider whether cancellation of indebtedness tax rules apply. Following turnover of a club to its members, the club

may become an "equity" club or Section 501(c)(7) association for tax purposes, and the members should closely watch the club's sources of nonmember income to maintain beneficial tax status.

Sale of club assets from a distressed development likely will involve the club developer's lender. Commonly, club owners/operators secure agreements from their lenders to honor club documents after foreclosure, but such practices are not mandatory. A 2010 decision by the Superior Court of Delaware, in *Saint Annes Club LLC*, highlights the risks to club members. In the foreclosure of Saint Annes Club assets, the court refused to grant standing to the club members and concluded the lender was not required to provide the members even with notice of the foreclosure sale. Since the membership documents granted only a revocable license to use the club facilities, such license was not a sufficient interest in real property to warrant protection in foreclosure. Colorado public trustees and courts would likely agree that holders of mere licenses or unsecured refund rights are not afforded notice or other rights in foreclosure.

Conversions involving a new membership class or the addition of a new community to the club create separate challenges; specifically, an emotional attachment of members to their club, regardless of written documentation. The New York case of *Country Pointe at Dix Hills Home Owners Association* is one example. When the small subdivision of Country Pointe was added to the golf membership plan of the nearby community of Greens at Half Hollow, the number of golf memberships at the Greens was

limited. So the Country Pointe owners were only offered social membership and use of the Greens clubhouse, pools, tennis courts and other non-golf amenities. Not satisfied, the Country Pointe homeowners brought a 15-count complaint against the club owner for failing to offer golf, alleging everything from violations of the state consumer protection act, fraud, breach of fiduciary duties and unjust enrichment to violations of state and federal antitrust laws. The court dismissed all claims.

The 2009 decision of the Colorado Court of Appeals, in *Founding Members of Catamount Ranch & Club*, faced the reverse scenario with existing club members challenging the rights of the Catamount Club to add a new community and new class of members from One Steamboat Place. The club's preexisting members claimed their membership agreement with the Catamount Club constituted a binding contract to keep the existing membership plan in place without modification. The court found that the members held only revocable licenses. Such rights, the court concluded, do not limit the club's ability to modify its plan to include new communities and new classes of members.

In summary, resort communities have increasing opportunities to add golf and other recreational amenities but should proceed with open eyes to the challenges ahead.

\* Resort Area Amenities Agreements, Clubs and Recreational Covenants, published April 15, 2009.▲