<u>Aircraft Acquisition and the Value of Club Membership V4.0</u>

(Steve Bateman, 4/16/2019)

This article attempts to answer a number of questions that are frequently asked of the Flying Club Initiative staff:

- How does a club set its fee structure, especially the membership buy-in?
- How can a new club finance its first aircraft?
- How can an existing club finance an additional aircraft?
- What is the value of a club membership?
- How do members join and leave a club?
- Do members get money back if they leave?
- How does this change for equity and non-equity clubs?
- What happens if a club disbands?

There follows a detailed review of the above, with suggested best practices based on experience, but the key take-aways are:

- Members must realize that joining a club is not itself an investment. Over the life of a membership, its value may increase, but most likely will not.
- A member may decide to loan money to the club for it to purchase an aircraft, but such an arrangement should be quite separate from the membership itself. Further, there must be no special benefits extended to the loaning member in terms of lower fees, dues or rates, nor should the club pay back a member in kind, with lower operational incentives.
- The club will repay any loans from members based on the agreed terms and conditions. If the club cannot meet its obligations, then *all* members (including the loaning member) should be assessed to cover the shortfall. This is no different from paying back a loan from a bank, but in this case, a member is acting as the bank.
- Keep the membership buy-in to the club separate from any loans. Every member joins the club with the same buy in. Some members may loan money to the club, with agreed terms. The club will pay back loans from its monthly receipts.
- Write in the bylaws that, in the case of the club dissolving, it will first pay-off loans and other obligations and then members may get an equal distribution of anything left.
- Loan repayments should be considered as a fixed cost and all members should contribute equally through monthly dues.
- If the club coffers can pay off loans early, then great, but don't rely on meeting a membership goal to help pay off loans.
- Members join a club to get access to good aircraft at lower rates and to enjoy the benefits of a social organization. Whilst members will naturally want to understand the terms of membership, they should not be expecting to make money should they leave the club.
- Keep the "value" of a membership separate from the amount a member *might* get back if the club fails.

- The *club* should not be responsible for returning money to a leaving member. The member buys into the club at the current rate. The membership is theirs. If they want to leave, they should be responsible for selling their membership (to someone agreeable to the Board) or to relinquish the membership back to the club which will release them from further obligations such as dues and assessments.
- So, the recommendation is to keep things simple:
  a. Keep loans separate from membership fees.
  b. Pay back loans to an agreed plan, just as you would to a bank.
  c. Loans are not levers for members to manipulate their status in the club.
  d. Members buy a membership – it is not the club's responsibility to pay them back if they leave.
  e. Prospective members need to understand the terms and conditions of membership, but be wary if someone is trying to negotiate their way out of the club before they've even joined. We see this sometimes with "student pilots" who join a club to get "cheap flying" and then leave as soon as they have their certificate. The club should screen prospective members to determine their motivations and goals.

The Details

We will explore here two connected factors of flying club life – namely financing club operations and the related perceptions of the cost and value of a membership. The former is of interest when a club is forming or growing, and the latter when a member wants to leave the club, or it dissolves for some reason. As both involve large sums of money, it is important to define how the club is financed, and how members join and leave a club in order to avoid messy disputes. The place to do this is in the club's bylaws, and both member expectation and conformance can be managed by having all members agree, as part of their membership application, to abide by the latest bylaws (and not just the version that was current when they joined).

We have talked a lot in the new Club Resources about the three different types of costs and the sources of income that cover those costs. Two are straightforward—monthly dues cover fixed costs, and per-hour usage rates cover variable costs. The third, the club initiation fee or buy-in, is more complicated and depends greatly on the ownership model adopted by the club. We look here at different ways in which a club may determine the amount of buy-in/initiation fee, and how this relates to the value, real or perceived, of club membership. We do this for both newly forming and more mature flying clubs.

Before we dig into this, let's remind ourselves of the fundamental attributes of a flying club, as these are important when considering the concept of membership, and the ownership and financing of club equipment:

- Flying clubs are non-profit social organizations. Members share equally in the ownership and responsibility of the club.
- All members pay the same fees, dues and usage rates and all members receive the same benefits and access to equipment.
- Flying clubs may either own aircraft outright, may finance the purchase of aircraft, or may hold an exclusive lease that endows owner-like powers on the club.
- Governance is by the members, for the members.
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Membership

Although it sounds straightforward, it is important to understand the concept of "membership" in a flying club. On one hand, a club wants to be a caring and friendly organization, but on the other, it must have clear rules and definitions to ensure fair play by all members and to define members' responsibilities—financial and otherwise. As with membership to a gym or country club, flying clubs grant people access to shared equipment at a fraction of its full value, and membership comes with an initial entry cost as well as ongoing financial obligations and responsibilities. This is why it is important for flying clubs to have well researched and clearly articulated bylaws. Ironically, this is even more important for the case of a few friends clubbing together, as a solid set of rules allows disputes to be handled officially, rather than personally. Without doubt, the majority of disputes that arise in a flying club involve money (typically when people join and leave a club), so it is worth taking time to ensure that your bylaws are really clear about what is expected from members, and the course of action that will be taken if the rules and responsibilities are not followed. An example set of bylaws can be found in the Downloadable Documents section of the AOPA Flying Club Resource Library.

We have seen many variations on the theme of membership, many of which become messy to manage and control, especially if definitions and rules change but are not applied retrospectively. Of course, the beauty of your club is that you can reflect its culture in its structure and operations, but from experience, we strongly advise you to keep membership simple. Here a few well-proven guidelines:

- Every club member, including high-school students and student pilots, should pay the same fees, dues and rates, and all members will have equal access to equipment and resources.
- Avoid family memberships and other tiers, as these invariably mean that some people have access to equipment at a lower overall cost than others, and this is not fair or equitable.
- Keep club finances separate from club operations. If, for example, a club wishes to help underprivileged youth be involved in aviation, then the club may wish to work with (or establish) a separate foundation that can accept donations and provide scholarships. But, at the club level, all members pay the same, for the same privileges, whether they are high school students or business people.
- Clubs often open their doors to people who wish to be affiliated in order to enjoy the social and educational benefits but will not fly the club aircraft. Rather than confuse the issue by implying a class of membership, e.g. "Social Member", don't use the word "member" at all, and call then something like Club Associate, or Ground Crew.
- Think about a membership as being much more than just a share in the equipment. In a non-equity club, membership grants access to the club, its benefits, programs and access to club aircraft. In an equity club, membership grants all of the above, but also a share of the club's assets. People often confuse the last point as meaning they have a physical share in the club's aircraft, but the reality is that no member can decide to sell their 1/10th of an aircraft, and the only time that a member will actually share in the assets of a club is if it is disbanded and liquidated, at which time all members receive an equal distribution (or all owe an equal liability).
- The cost of membership is inclusive – that is, you are buying into the club, and not just its aircraft. Similarly, when a member sells their membership, they are selling a place in an exclusive club and not just access to, or a share in, the equipment. We'll look deeper at the case of members leaving a club later in this article.

- Flying clubs are not sound investment opportunities. Aircraft and clubs take money to operate, and the good thing about a club is that members have access to good equipment on a shared basis. A pilot-owner will rarely "make money" from the acquisition and operation of an aircraft, and neither will a flying club member. Members no doubt will do the math to see what club membership actually costs them on aggregate, but they should realize that flying at a lower overall rate hour is not the same as an investment.

New Club

Establishing the initiation/buy-in amount.

Rather than just lump everything together, we suggest that you consider the three main component parts of the club initiation fee:

1. The membership fee. This is usually a one-time fee permitting entry into the club and is separate from any other upfront fees, such as start-up costs and acquisition of equipment. The club, by definition, is a private organization and has a degree of exclusivity by virtue of its limited membership. This is similar to the initiation fee charged by a country club—it is the initial cost of entry into the organization and is generally non-refundable. Think of this also as a hurdle—if people don't feel engaged enough to pay the joining fee, then they probably won't be good club members. Additionally, through the payment of this fee, members will feel more invested in the club and have a sense of "skin in the game". Indeed, some clubs charge a high membership fee in order to separate tire kickers from seriously interested members—in other words, changing interest into commitment.
2. Start-up expenses. A new club will incur costs for things such as setting-up the club's business entity, filing for tax exemption, attorney fees, the first years' insurance payment, the first and last month's rental on the hangar, and so on. These are one-time, up-front expenses that must be funded by the club, and they are quickly and irrevocably disbursed. This is the price of establishing the club and again is non-refundable.
3. Equipment acquisition. An aircraft itself is clearly a big factor in the overall buy in, but don't forget to consider sales tax, legal fees, pre-buy inspections, ferrying, tools, hangar equipment, initial supplies, and so on.

The first two—membership fees and start-up cost—are pretty much independent of equipment acquisition, so it the last component that really marks-up the costs for founding members. The money collected to start the club will quickly be consumed and has no long term "value" from a resale perspective—not so the aircraft, of course.

Let’s look at a few options for aircraft acquisition:

- The club procures an aircraft outright.
    - Every member contributes the same amount to the club for the acquisition of the aircraft and associated fees such as the pre-buy, registration, sales tax, etc.
    - The buy-in will be calculated as the total of all up-front costs, divided by the number of members.
- The club finances the acquisition of the aircraft.
    - Each founding member contributes equally to the down payment, and the monthly dues include an equal contribution from all members to pay off the loan.
    - Over time, the aircraft will be owned by the club, and so equally by the members.
    - The buy-in will be calculated as the total of all up-front costs, divided by the number of members.

    Note: In all cases where the club is or becomes the owner of the aircraft, we suggest registering the aircraft in the name of the club, and not listing all members separately on the registration form. This makes it a lot easier when people join or leave the club.

- The club leases an airplane. For a more detailed discussion on this, see the March 2018 edition of the Club Connector.
    - The acquisition costs for a leased aircraft are generally less than the case for purchasing but ensure that you include the costs of legal services to prepare a lease agreement and the need for a pre-buy inspection, which is highly dependent on the club’s maintenance responsibility under the lease agreement.
    - The club leases an aircraft from some party (the owners) who may or may not be club members.
    - The club pays the owners a monthly base lease fee, which is treated as a fixed cost and is covered by monthly dues. Note that although the acquisition costs will be lower for a leased aircraft, the fixed costs will include the base lease fee, which is approximately the same order as a loan repayment if the aircraft was being financed. So, why lease rather than finance”? Well, leasing eliminates the need for a large down payment on the loan, which can allow a club to get started a lot quicker.
    - Members pay the club an hourly usage rate, some of which transfers to the aircraft owners. The actual per-hour amount paid to the owners depends on the lease agreement—and especially on the spilt of maintenance responsibilities between the owner and the club.
    - Can club members lease an aircraft to a club to which they belong? Yes, absolutely, but be sure to keep all transactions separated. If the aircraft owners are also club members—and recall that in order to fly the aircraft, they would have to be club members due to the exclusivity of the lease—then keep the accounting simple. Member-owners pay the same fees as every other club member, and the club will separately pay member-owners the agreed amounts defined in the lease agreement. Don’t be tempted to short-circuit the accounting by giving member-owners discounted rates in lieu of lease payments, as this complicates record keeping and may well cause grief if the club is audited for any reason.

There are two other cases worth exploring for a new club acquiring an aircraft. These are variations of the financing model where a few founding members have sufficient personal funds and either purchase an aircraft and lease it to the club, or loan money to the club.

- The simplest of these is when a few members join together, buy the aircraft and then lease it (on an exclusive basis) to the club, and the club never actually owns the aircraft. This results in the lowest "aircraft acquisition cost" and hence the lowest overall buy-in. We strongly advise these owners to establish a legal entity (typically an LLC) that is separate from the club's entity (preferably a corporation). The reason for selecting an LLC for the owners and a corporation for the club is beyond the scope of this article, but is to do with liability and taxation, both of which are explained in the "Guide to Starting a Flying Club".

- A more complicated case is where at least one member—but not all—pool their finances with the intention of the club buying the aircraft over some period of time. We've seen two main derivatives of this:

    - The owners and club agree to a "lease-to-buy" arrangement. This is similar to the straight lease in the need for a lease agreement and payments, but the payments are used to "pay-off" the owners, presumably with some agreed amount of interest. When the last payment is made, the aircraft title is transferred to the club. There are some considerable tax implications with this as the aircraft is effectively being bought a second time, just over a long period of time. Also, if interest is being received by the owners it will look like income to the IRS, and the club may well have to issue tax forms to the owners' LLC. We advise you to consult with a tax attorney or CPA to understand the tax implications in your state, as all states are different.

    - The second approach is where some number of members finance the acquisition of the aircraft by loaning money to the club. Some clubs call this "self-financing". Instead of working with a loan broker or bank, the financing members provide money to the club, either for the down payment, or the full purchase of the aircraft including ancillary costs such as sales tax, inspections, etc. As you can imagine, there are many permutations of this general arrangement, so it is important to clearly write down the terms and conditions for the loans, including payments, term, interest, defaulting and dissolution actions, etc., and we urge you to work closely with a lawyer to establish the legal side of the agreement. Although this method avoids the "twice-selling" problem mentioned with a lease-to-buy arrangement, the club will pay interest to the loan holders, so the appropriate tax forms will need to be filed with the IRS and other forms provided to the financing members.

Adding members (New Club)

Let's say that a club starts with five founding members in order to get it going, but fully intends to grow to ten members within 12-months, and the initial members each contribute $10,000. It seems fair that the new members should pay the same as the founding members for the establishment of the club. New members will pay the same dues as original members, although the actual size of dues (for all members) may be lower, as more people will be contributing to the fixed costs—which are somewhat insensitive to the number of members in the club.

If the club leases an aircraft, there is nothing much else to consider, apart from perhaps reducing the monthly dues as more people will be contributing to the fixed costs. But if the club purchased an aircraft, either outright or through financing, it has a couple of options depending on the growth aspirations of the club or its desire to keep costs low:

1. The club could keep the price of a new membership at $10,000. Everyone will have paid the same amount, but the club coffers will increase by $50,000. This can be really useful as a maintenance reserve, aircraft improvement fund, the acquisition of a second aircraft, etc. Perhaps the founders bought the aircraft knowing that the engine was close to overhaul, or that the panel will require upgrading, so the membership money from the new members can be used to bring the aircraft up to the desired standard.
2. Alternatively, the club could "rebalance" the equity. In our example, the five founders contributed $10,000 each to acquire a $50,000 aircraft and the club then accepts five additional members, so the new members pay the club $50,000/10 = $5,000 each. The club reimburses each founder $5,000, such that every member has contributed $5,000 towards the acquisition of the aircraft.

In the first case, all members pay $10,000, $5,000 of which is used to purchase the airplane, the other $5,000 is available in the bank. In the second case, the club has to rely on accrual of money from dues and mark-ups on the hourly rate for the cash buffer. Don't short change here. The unexpected will happen, so start off with a reasonable buffer to avoid frequent assessments on members, which always feels a bit like double-dipping.

In summary for a new club, the overall buy-in per member can be as low as just the sum of the membership fee and start-up costs divided by the number of initial members, or as high as the sum of the membership fee, start-up costs, aircraft acquisition and cash reserves, divided by the number of members.

Existing Club

As we saw above, when a club is first formed it is relatively easy to keep track of the start-up costs and distribute them amongst the founding and newer members. But what happens when a club is well established, and the start-up costs have been amortized over many years of operation? What happens if a member leaves the club, and what buy-in will be charged if the club decides to accept additional members? These questions are inexplicably linked, and they are related to the value and responsibility of a membership—both perceived and actual.

Let's try to break this down by first considering the case of a member wanting to leave a club—what happens to that membership, who is responsible for it and what is its value?

Members leaving a club

When members join a club, they are excited and happy to be involved in a fun aviation experience, and leaving the club is probably far from their minds. Situations change and at some stage a member my want or need to leave the club. If you haven't planned for this, you may well get caught up in a nasty dispute, as the member leaving may expect to get some money back from the club.

Members leave a flying club for many different reasons, including stopping flying, moving away for work, financial difficulties, and others. Clubs have different ways of handling this and some of them are remarkably convoluted, using complicated spreadsheets and equations based on the number of years a member has been in the club, etc. Our advice is to keep things simple. Members should not join a flying club as an investment, but rather to enjoy the benefits of being in a social setting with like-minded people and having access to cost-effective aircraft. Likewise, a flying club is not a bank. It shouldn't be keeping "deposits" from members and paying them back when they leave. Clubs consume money and must be continually funded by members through joining fees, dues, assessments and perhaps contributions from the per-hour usage fees, and members reap ongoing benefits of this by being involved in a vibrant, active and well-funded club.

Think about this another way.

A pilot purchases an aircraft for individual use—paying cash, or perhaps via financing. By buying an aircraft, they are on the hook to keep it in good condition in order to maintain its value. If they no longer wish to keep the aircraft, it is that owner's responsibility to sell it. They wouldn't expect the loan institution to "buy back" the aircraft, nor would they expect the original seller to buy it back. Neither would they just walk away from the aircraft and stop paying for its upkeep. They have responsibility for an asset, which they can part with it at the market price. Once they sell it, they divest themselves of responsibility for its upkeep.

A flying club provides the opportunity for aircraft access and perhaps "ownership" on a shared-cost basis. A flying club prices and sells its memberships at a given market value, and members buy/join because of that value. If a member wants to leave the club, they should be free to sell their membership at a price the market will bear. If the club is running effectively, the leaving member may be able to sell the membership for more than they paid for it—especially if the club has a membership cap. Just as an owner shouldn't expect the bank to "buy-back" the airplane, a club member shouldn't expect the club to "buy-back" a membership.

As we know, flying clubs consume money and must be frugal in order to balance expenses, reserves and cash flow at acceptable levels, while at the same time providing a cost structure that is attractive to members. Clubs should also consider equipment modernization and other factors that draw upon its accounts. Permitting membership "buy-backs" places a huge liability on the club's books, as it must always be in a position to pay-out leaving members, which effectively reduces the amount of working capital available for other purposes.

As you might imagine, there are myriad ways that flying clubs handle this issue. Some refund part of the membership fee, other clubs retain first right of refusal to buy back the membership, some place all responsibility on the leaving member. Whichever way you do it, do ensure that your bylaws clearly state the terms and conditions of members leaving the club and the consequences of not conforming. This topic ranks very highly on the list of frequently asked questions by existing clubs and after discussion and consideration, many take the opportunity to revise their bylaws (with the appropriate voting and approvals) to simplify any inherited and complicated processes.

Again, we advise simplicity, and offer as an example the following extracts from the bylaws of The Westminster Aerobats Flying Club, Inc.

Section 13: Membership is obtained by one of the following methods:

- If the club has not reached its membership cap, memberships shall be purchased from the club, in the amount specified in Addendum B "Club Memberships, Dues and Hourly Rates".
- Once the membership cap is reached, new members shall only be accommodated once an existing member leaves the club and in accordance with Section 16 of this Article.

Section 14: Membership fees are non-refundable.

Section 15: The club shall maintain a waiting list, that shall comprise an ordered list of vetted and pre-approved prospective members. To be placed on the waiting list, a prospective member shall follow the Club Membership Application process and shall be interviewed and approved by the Board of Directors.

Section 16: A member wishing to leave the club for reasons acceptable to the Board of Directors, may sell their membership using the following ordered approach:

1. The club shall have first option to purchase a membership for an amount agreeable to both the member and the Board of Directors.
2. If the club does not exercise the above option, and the club has an active member waiting list, the membership shall be sold to the person next on the waiting list, for an amount as negotiated between the leaving and arriving member.
3. In the case of the club not having an active member waiting list, the membership may be sold to an individual, with prior permission and approval of the Board of Directors.
4. If none of the above options can be met, and upon approval by majority vote of the Board of Directors, a member, after meeting financial and other obligations, may relinquish, for no reimbursement, the membership to the club so releasing the member from any further obligations to the club.

Establishing the initiation/buy-in amount for new members of an existing club

Consider the following situation. A club is 20-years old and owns the club aircraft, equipment and tools that it has purchased throughout its history. Membership has changed over the years, but the current group share equally in the assets and liabilities of the club. The club bylaws define the buy-in amount for new members, which may well have been adjusted over the years. Nevertheless, each new member has an equal share in the club and pays the same dues and fees as every other member. There is a really simple test to apply here to ensure that every member is an equal member—if the club is disbanded for any reason, each member will receive an equal distribution of the club's assets. Don't get too hung-up on "fairness" here—and as stated previously, don't think of a flying club as an investment plan. People who have been in the club since the start will likely have paid a different joining fee (both in actual dollars, as well as in present value), and they will have paid dues for many years. In return, they have enjoyed the benefits of the club for those years. A new member will join the club as defined in the current version of the bylaws and will become a joint owner. If the club is disbanded, both will receive the same distribution, which some might consider as being unfair, but the point is *not* to disband the club, so that everyone continues to benefit from its existence!

Simply put, a new member will join the club as described in the current version of the bylaws, based on some notion of "value". Some clubs calculate the overall valuation of the club on an annual basis, and then rebalance everyone's share when a new member joins the club. Others set an amount that reflects an ownership-like commitment in the club and may not be directly associated with the tangible value of club assets. Members need to understand that the cost of joining a club is not the same as the distribution they may receive if the club is disbanded. The former includes the intangible value of a vibrant social organization, while the latter is simply (liquidated assets – liabilities)/(number of members), and there can never be a guarantee that the number will be positive!

If the club grows its membership due to the acquisition of additional aircraft, then the determination of buy-in is similar to that of a new club—covering additional costs with additional members. If the club adds members to increase the overall number of hours flown, then it could consider rebalancing memberships as described earlier, or it could just determine a reasonable buy-in that balances money coming into the club while still being attractive to new members. Bear in mind that once a club owns its aircraft and has little debt, its fixed costs will be quite stable, so more members paying monthly dues may well allow the club to lower the dues for all members, making it even more attractive.

As you can guess from the above, it is really important to keep your bylaws up to date, to follow all procedures when making amendments, to keep copies of all previous revisions, and to clearly mark the number and date of the revision in case of future questions or challenges.

Members with different aircraft privileges

Another question we are frequently asked is how to handle the buy-in, dues and fees for members of a club that have a fleet of diverse aircraft. Basically, is it fair to charge all members exactly the same buy in, dues and rates, if some have access to the club's SR22, yet others only have access to the C152? There are many reasons why this might be the case, for example, the club started with the C152 and later expanded with the Cirrus SR22 (or vice versa)—but these are real questions that must be considered.

Firstly, the *membership* buy-in should be same for all members, as this reflects the equal ownership and responsibilities of all members, regardless of what they actually fly. If people don't like this—and there will be people who will want to negotiate based on their particular case—then perhaps they should join a club with less diversity of equipment.

We have heard of a couple of ways that clubs handle dues and per-hour usage rates and we'll share them here. We are not endorsing either one, just reporting on what we see in practice.

1. The hard line approach. Apart from training, skill level, motivation and money, there is no reason why the pilot of the C152 couldn't fly the Cirrus. The club will therefore charge all members the same fees and dues, as everyone has access to both aircraft. The dues cover the fixed costs for both aircraft combined. The usage rates will of course be very different as the per-hour costs (especially fuel) will be quite different. If a member only wants to fly the C152 and only pay membership fees and dues for that plane, they are probably not joining the right club.

2. A softer approach. The club provides different access privileges to different members. There is a subtle difference here between membership tiers and access privileges, so let's take a look at it.
    a. Tiers: Membership tiers (such as family memberships and student memberships) basically translate into some people having access to the club and its equipment at lower rates than others, which is simply not fair. Some clubs try to get around this by not only having different dues, but also different membership buy-ins. This means that members are not equal in the eyes of the club and this really complicates governance. For example, full members may have more voting rights than student members. Our strong advice is don't go there.

    b. Privileges: Access privileges relate not to membership and equality in the club and its governance, but to the actual costs incurred when using different equipment. All members pay the same membership buy-in for the same responsibility in the entity of the club. But we all know that different aircraft cost different amounts to operate, and that this extends beyond just the per-hour costs of fuel, maintenance reserves and so on. For example, we know that newer, more complicated aircraft will cost more to insure, that the basic cost of an annual inspection will be higher, and that bigger aircraft require larger and more expensive hangars.

So, let's again separate the three cost types of club membership: membership fees for equal participation, monthly dues to pay fixed costs, and per-hour rates for usage.

We know of several clubs that have diverse equipment and they establish a scale of dues-based access privileges to different aircraft. The cleanest way we have seen this done is where the club has a base amount for dues. All members pay this base rate, which keeps all members in good standing with the club and grants access to the most basic aircraft in the fleet—the C152 if we continue the example above. If members wish to use the more advanced aircraft, the SR22 here, they must receive appropriate training and sign-offs, and will pay a surcharge on their dues. In this way, the club accommodates different pilots and skill levels, whilst keeping all members equal in the club itself.

The important point about access privileges is that all members with the same privileges will pay the same fees, dues and rates as any other member with the same privileges.