# Industry Lending Turns the Corner

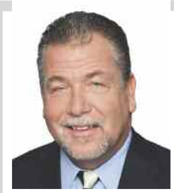
## Lower interest rates and high levels of liquidity lead to an optimistic outlook for vacation ownership.


Frank Morrisroe


Shawn Brydge


Carisa Azzi


Bill Ward


Jim Casey

By Betsy Sheldon

**It's been called turbulent.** The changing of the guard. And a roller coaster. However you describe the past few years in the vacation ownership lending market, it's been nothing short of a wild ride. But according to those we spoke to — including leaders with lending institutions as well as successful resort developers and servicing companies — that ride is gaining altitude. In fact, it wouldn't be wrong to say that lenders are competing for opportunities to lend to qualified vacation ownership developers, providing everything from construction and acquisition financing to inventory loans and receivables. What we're hearing is optimism and confidence that vacation ownership has emerged and will remain a desirable investment and that the outlook for developer borrowing is favorable. Read on to learn what the pundits are predicting for the near-future lending market.

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### 1. In a phrase, how would you describe the past seven years for the lending market for vacation ownership?

**Frank Morrisroe, president, Equiant Financial Services Inc.:** Turbulent! With major players such as Textron leaving the market space, a major shift in the timeshare sales/marketing business model (focusing on profitability and lowering excessive marketing costs), and a general recession in the country, only a vibrant self-sustaining business could and did survive.

**Shawn Brydge, senior vice president, Wellington Financial:** A roller coaster. In the past seven years, credit terms to vacation ownership developers have vacillated tremendously from very liberal (2007/2008) to very conservative (2009/2010), and everything in between. Perhaps the biggest change in the last seven years is the tremendous increase in government regulation of lenders, and the significant costs associated with meeting those requirements.

**Carisa Azzi, senior vice president and chief financial officer, Welk Resorts:** A pendulum. Prior to the recession, there was a free flow of liquidity. Lenders required minimal underwriting guidelines by developers and offered high advance rates, and developers were heavily leveraged while operating on thin margins. Given the credit crises and the volume generated by our industry, the free flow of liquidity took a quick turn and no new lines were being offered.

**Bill Ward, vice president, Ward Financial Company:** The changing of the guard. The roster of vacation ownership lenders serving the industry today is significantly different than in 2007.

### 2. How has the scenario changed for our industry in the past year or so?

**Jim Casey, senior vice president and managing director of vacation ownership, Capital One:** The past year has been strong, and the market appears to be getting stronger. More liquidity and sources of financing are available, and more developers are accessing the capital markets. The industry saw more securitization activity in 2014 than in previous years.

**Morrisroe:** Multiple new lenders have entered our space, driving interest rates to affordable rates for developers, and the growth of the major players/brands has helped stabilize our market space.

**Ward:** By the beginning of 2012, the roster of new lenders had been established. The last two years saw those lenders jockeying for client relationships. The timeshare companies have benefited as lenders fight hard to provide loan facilities to established developers. The most significant consequence has been lower interest rates to developers, even though the U.S. interest-rate market has been flat over that same period.

### 3. Timeshare consumer receivables, among many others, were once described as "toxic assets." Was that a fair description?

**Morrisroe:** I don't believe that to be a fair description then, and definitely not now. There have been multiple investors coming into the receivables space and that would not be the case if receivables were toxic. I believe another contributing factor to recognizing receivables as a good investment asset is the continuing portfolio experience brought forth from the lenders, and the ever-expanding analytical tools to understand aging and being able to forecast timeshare consumers' buying and spending behavior.

**Ward:** Lumping timeshare consumer receivables into the junk pile of toxic assets was unwarranted. There were plenty of toxic assets created leading up to 2008 and 2009, and many of those assets were tied to a consumer obligation, so it is understandable why timeshare was painted with the same brush.

When the recession hit, many critics expected timeshare receivables to tank, but the actual data proved otherwise. Timeshare experienced less delinquency than credit-card obligations and home equity loans.

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More importantly, the securitization issues and loans made against timeshare notes performed, whereas poorly underwritten and over-leveraged residential loans nearly crippled the global economy.

Perhaps it was consumers' determination to not lose their investment in their vacation, but ultimately the performance of timeshare receivables proved the naysayers wrong.

**Brydge:** I don't recall any widespread discussion specific to timeshare consumer receivables being considered toxic assets, but it wouldn't be an illogical leap for generalists to lump timeshare consumer receivables with credit-card receivables, auto receivables, and even some mortgage receivables.

However, anyone who tracked the historic performance of timeshare consumer receivables pledged to securitizations and to commercial lenders would see that the vast majority of portfolios performed extremely well during even the height of the financial crisis. Lenders and investors learned what many of us already believed: that the structure of a timeshare consumer receivables portfolio, which usually includes the combination of a geographically and socioeconomically diverse portfolio of consumer loans with relatively small loan balances, is a reasonably efficient hedge against many economic downturns.

**Azzi:** For the most part, I would not call consumer receivables toxic assets. If you have a sound developer who has good business practices operating with underwriting guidelines, the performance of the portfolios generated really held up during the recession. In addition, if a developer takes care of its owners and focuses on the quality of the guest experience, then owners will continue to pay and enjoy using the product.

**Casey:** In the past, developers did not always conduct careful consumer credit screening. Thanks to the tough lessons learned in the recession, developers and lenders are doing a better job of prescreening for creditworthiness. For example, many lenders and developers now require minimum FICO scores in their credit base.

### 4. As a lender, how has your appetite for lending in the timeshare sector changed? Has it increased?

**Casey:** Our appetite continues to be strong. Since we entered this market in 2011, we have continued to see an opportunity for growth. Although there are challenges as developers consolidate and more financing options are available, we believe our flexible approach will continue to help us strategically grow our portfolio.

**Brydge:** We've been lending to the timeshare industry for 33 years and Liberty Bank (for whom we are the exclusive resort finance correspondent) has been lending to the industry for 36 years, so we continue our focus on building long-term relationships that grow over time. We added significant market share in 2008 and 2009, when most other industry lenders were leaving the industry or taking a break, and we've continued to grow since then. Our philosophy and appetite haven't changed. We support our existing borrowers' growth, and we're always looking to add new borrowers who are looking for a strong, steady lending partner.

**Ward:** Speaking for our lender, National Bank of Arizona, they were the first new bank to step into the timeshare lending void in 2010. They were rewarded with and continue to experience flawless performance on their timeshare loans. Their appetite is to continue to increase the portfolio.

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### 5. What types of products are you lending on?

**Casey:** We are primarily focused on notes receivable financing, as well as inventory and construction loans.

**Brydge:** We provide acquisition, development, construction, inventory, and receivables financing for vacation ownership developers with projects in the U.S. and U.S. territories. We have experience lending to resorts that sell contract-for-deed, deeded, and most points-based and related club structures.

**Ward:** All vacation ownership products are suitable, provided that the requested debt is supportable. National Bank of Arizona provides the full menu of loan types for timeshare developers, including construction financing, acquisition financing, inventory loans, and notes receivable financing, as well as loans to homeowners' associations.

### 6. And where are you lending? The U.S.? Farther afield?

**Casey:** We are currently focused on the U.S. market. However, we are looking at selected opportunities in the Caribbean, Mexico, and Canada. Our annual survey at the ARDA World conference in April [2014] found that professionals see the Florida market as the most competitive, followed by Nevada/Las Vegas and California.

**Brydge:** In addition to the U.S. and U.S. territories, we are also able to lend to various club structures that include some inventory outside of the United States.

**Ward:** To date, all the timeshare loan activity has been nationwide in the U.S. However, the National Bank of Arizona personnel also have experience in Canada, Mexico, and the Caribbean. Opportunities in those destinations are not out of the question.

### 7. In terms of credit qualifications, how have your criteria changed since the recession?

**Brydge:** In general, in response to the financial crisis in 2007/2008, advance rates dropped from 90 percent to 85 percent, interest rates increased, and portfolio FICO requirements became more conservative. With the increase in competition, we've seen interest rates decrease and some FICO requirements have become more flexible, though in general, developers have maintained their more conservative credit underwriting.

**Ward:** Since the recession, developers were quick to either decline credit to low-FICO consumers or require higher down payments to mitigate the default risk. We simply assimilated the revised approach into our note receivable loan structures. Since then, the performance of the note portfolios has been so stellar that discussions of slightly more generous credit criteria have started to occur. No one wants it to swing back to the pre-recession conduct, but if justified, a little more lenient criteria will probably occur.

**Azzi:** At Welk, we have always had credit qualifications. Since the recession, we have tightened them and focused on tracking the performance of specific FICO bands, size of the loan, and risk profile based upon specific items in the credit report, such as judgments, tax liens, etc.

**Casey:** Capital One has not made any major changes in our criteria, because we became active in the market after the recession. Across the industry, we have seen additional scrutiny by both developers and lenders when it comes to reviewing consumer creditworthiness.

## 8. Can you give a prediction for the near future about lending markets?

**Morrisroe:** I cannot predict the future, but I can tell you that I have noticed a very positive and optimistic feeling expressed by developers, lenders, and vendors beginning in the fall of 2013.

**Azzi:** Given the high levels of liquidity still out in the market and financial institutions needing to deploy capital, I feel that the near future for borrowing funds as a developer is very favorable.

**Casey:** We expect to see continued access to capital and strong liquidity in the coming year, as well as consolidation among developers, who will continue to access the capital markets.

**Brydge:** I don't see much change away from the current trends in the immediate future. Eventually, we'll see interest rates increase to more traditional levels. This will have a muted effect for most commercial lenders, but could be a significant game-changer for institutions that source their funds through means other than consumer deposits. Depending on the speed of that increase, it could pose problems for lenders who offered low long-term rates without properly hedging on the back end. Government regulation of lenders will continue to expand, with the next two areas of focus possibly being credit unions and enhanced protection of consumer data.

**Ward:** The current issue for lenders is the difficulty attaining portfolio growth. The performance of the timeshare receivables also accelerates repayment to the lender. Add to that a wider use of securitizations by timeshare companies and repayment is occurring faster than lenders want. Therefore, the competition for new relationships is very intense. History tells us that, sometimes, that can lead to lenders reaching a little beyond their comfort zone. So perhaps the future has lenders a little more aggressive than today.

A wildcard to throw in is the inevitable increase in U.S. interest rates. A modest interest-rate increase will have very little impact on timeshare lenders, but more substantial rate increases combined with any economic turmoil might backfire on an aggressive loan structure.

## 9. What have you learned from this market cycle? In other words, what are you now doing differently?

**Azzi:** We have been in the timeshare business for over 30 years and realize the importance of having underwriting guidelines, evaluating the quality of your marketing channels that generate new tours, and maintaining multiple relationships with financial institutions that understand your business and industry.

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**Casey:** The recession was clearly a major force in the industry's development. The financing difficulties that developers faced have made them better and stronger. As the number of lenders increases, we will take a flexible approach to loan structures, while focusing on our clients' needs and maintaining quality in our portfolio.

**Brydge:** What we learned most was that our philosophy and way of doing business works during even the most difficult of times. Though the Great Recession caused a very significant economic adjustment worldwide, the performance of our timeshare loan portfolio and our support of our borrowers didn't waiver. We were lending to timeshare developers when prime was at 20 percent, and we're still lending today with prime at 3.25 percent. We can't predict when the next great crisis or opportunity will occur, but we know we've got the right foundation and the right partners to handle whatever comes next.

**Ward:** For lenders who are involved in timeshare, they continue to understand it is a safer bet than other more commonplace lending to conventional industries. The current market cycle resulted in some consolidation that produced larger and stronger vacation ownership companies. So the lesson learned is to enjoy this sweet spot in the cycle. Proceed confidently, but not undisciplined, to better ride out the next downturn in the cycle.

**Morrisroe:** We have learned a few things from the market cycle: The first is that lenders and developers are now more in tune with each other and understand that partnership more than ever. I've also learned that we can ride through a tough business cycle if we keep our heads down and do what we do best, focusing on exceeding clients' expectations and providing unparalleled customer service.