THE COLEBROOK CHRONICLE

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Your source of current trends and developments in the timeshare industry.

A Buyer's Guide to Used Timeshare Inventory

Four Industry Leaders Talk About Their Acquisition Strategies

The timeshare product has evolved over the years from a single project, fixed week and unit structure to one that consists primarily of networks of projects, or clubs comprised of inventory at various locations. These clubs provide greater flexibility for their members, with the option to vacation at numerous locations through "internal" exchanges. Members pay a maintenance fee to the club and the club in turn pays maintenance fees to the associations responsible for managing the resorts.

Nearly every project coming out of the ground today is part of a network, and much of the inventory that becomes available at older single-site properties due to owner attrition becomes part of a network or vacation club. If an older project experiences dues delinquency and has no viable option to resell the intervals, the property manager often approaches a club promoter that might be interested in acquiring large blocks of inventory.

Colebrook finances a number of developers that acquire inventory from various projects, and has often helped its clients identify acquisition opportunities. Many people wonder how these developers select inventory from the options presented to them and piece the blocks together to form a viable vacation club. In order to shed some light on the subject, the *Chronicle* spoke with four chief executives of timeshare clubs. Our expert panel included: Stuart Allen, General Manager of Vacation Internationale, Bellevue, Washington; Mike Muldoon, President of Starpoint Resort Group, Las Vegas, Nevada; Butch Patrick, President of Zealandia Holdings, Inc., Asheville, North Carolina, and; Rick Sargent, President of Global Exchange Vacation Club, Mission Viejo, California.

CHRONICLE: *When someone approaches you with a potential inventory acquisition, what are the first things you look at?*

ALLEN: The number one question is: "How likely is it to be used by our owners?" Then we weigh the cost to operate, the quality, and whether it is in a location that will support our sales operation. The question I ask myself is, "If we're taking inventory without owners attached to it, where will we get the owners to support and use that inventory?"

MULDOON: The first and, by far, most important question is whether my members will use it. I have to be confident that it will either be heavily used by the existing members, or that I can set up a small in-house sales program to generate new members who will use that product. The second factor is a combination of the economic condition of the homeowners' association and the quality of the guest experience. It's possible, however, that problems in those areas can be addressed by a refurbishment program financed by the dues we'll be paying. We did that at one California resort, where our dues supplied the refurbishment funds and our owners got to stay in newly renovated units. We generally avoid resorts with extreme seasonality. If you take on a year of maintenance fees and only get a dozen weeks of peak time, you're not really providing good value to your members.

PATRICK: We look at the demand we've had for that particular location, we look at the quality of the product, and price is always important. We also evaluate whether we can generate rental income at the resort as a backup plan in the event that owner usage isn't as robust as we anticipated.

SARGENT: For us, it has to be an RCI Points resort, or one that I can affiliate with RCI Points. Then the key is the relationship between the maintenance fees and the number of RCI points, which needs to be at a certain ratio to work for our club. We've walked away from a lot of good inventory because that ratio wasn't right. Resorts generally come to us because they have a fair amount of inventory that's not generating maintenance fees. Because of that, they've had to increase maintenance fees to those owners that are paying, and that often throws our formula out of balance. We dig pretty deeply into the association financials to see that they're sound, and that we won't be surprised with any special assessments. We recently bought some inventory at a resort that had depleted their reserves to replace elevators. We paid the first year's fees in advance on the condition that all the money be used to strengthen the reserves. Location isn't all that critical for us, because we're an exchange club, and people buy to get into the system. As long as the points are available, they don't really care where the resorts that support the points are.

CHRONICLE: *Roughly what percentage of the inventory that you're offered do you end up acquiring?*

ALLEN: Maybe 25%. About half of the inquiries we make about acquiring inventory never get past the initial call.

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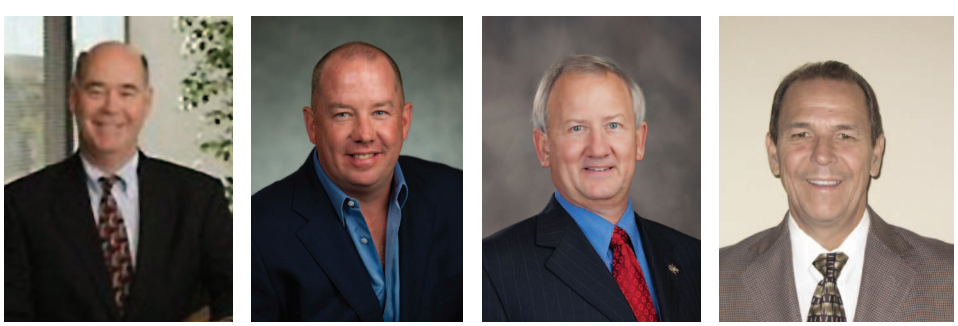

L to R: Stuart Allen, Vacation Internationale; Mike Muldoon, Starpoint Resort Group; Butch Patrick, Zealandia Holdings, Inc.; Rick Sargent, Global Exchange Vacation Club

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MULDOON: Probably one in ten.

PATRICK: It's a fairly low percentage—maybe 10%

SARGENT: Less than 10%.

CHRONICLE: *Do you ever dispose of inventory from your system?*

ALLEN: We look at all inventory that's in the lowest quartile of our owners' utilization table and evaluate whether it should continue to be part of our club. We don't look subjectively or judgmentally at our projects, because declining usage on the part of our members tells us when the inventory isn't meeting their needs. We let the market dictate to us.

MULDOON: We're very careful in selecting inventory, and thus far we haven't had the desire to unwind anything. I think the conditions under which we would look to shed inventory would be an Act of God where the resort was going to be off-line for some time or if the homeowners association did something that made the property non-compliant with regulations.

PATRICK: It all goes back to supply and demand in a location. Where do our consumers travel? We look at the cost per reservation and the maintenance fee generated as a result of that reservation.

SARGENT: Occasionally we do. The main reasons for de-annexing inventory are a steep increase in maintenance fees or a deterioration of the property or the financial condition of the association. We would then acquire new inventory to replace that product.

CHRONICLE: *Do you find more or less inventory available at the present time compared to the recent past?*

MULDOON: About the same. No change.

PATRICK: We're seeing fewer and fewer good opportunities, although there is plenty of inventory available in secondary resorts.

SARGENT: A couple of years ago, we were getting a call every other week. It's slowed down, but we still get a lot of interest.

ALLEN: The amount of inventory being offered is higher now because more resorts are showing an understanding that long-term delinquency keeps them from renovating and eventually prevents them from achieving the rental income that is used to offset delinquency. The urgency to find a sale solution leads to more interest in putting their excess or HOA inventory into a multi-site club.

CHRONICLE: *Is it important that you control the management of any property in which you own inventory?*

ALLEN: Control is not a threshold issue for us. We work with multiple management companies and also with self-managed resorts. Where our voting power is sufficient, we like to have at least one seat on the board so that we're at the table when key issues are being discussed.

PATRICK: It depends. If the project is of high quality, well-managed, and in a high-demand location where we're confident our owners will fill the time, we don't need to manage it. If we feel there's a little more risk, we want to manage the property, because if owner usage isn't there and we need to generate rental income, it's a lot easier to run a rental operation if you manage the property. We wouldn't take off-season inventory unless we had the management contract.

CHRONICLE: *How big of a block of inventory do you like to acquire?*

MULDOON: We like to get at least 500 intervals, although that could come over time. It's got to be enough to justify the legal cost of acquisition. If the inventory is in a uniquely positioned property, say, in Hawaii, I'd buy 100-200 intervals because I know they'd be full all the time.

SARGENT: Ideally, I'm looking for a good chain of inventory, where I can do multiple takedowns at the same resort over time. I'd love to find 3,000 weeks that I could take down in blocks of 500.

CHRONICLE: *When you acquire inventory, how do you establish point values?*

PATRICK: We analyze industry data from both the hotel and resort industry, and look at occupancy rates and travel patterns.

ALLEN: There are several parts to our valuation process. First, we set a conversion ratio from the resort's RCI Points or Interval trading power scores. Second, we look at the expected utilization by our member base, and then we create a points schedule based upon the demonstrated trading power of the inventory and our expectations about owner use.

The answers of our panelists are interesting for both their convergence and divergence. Global Exchange, as the name infers, is primarily an exchange club, and location is less important than trading value in comparison to the annual maintenance fee that is passed through to the club. The other three clubs rely primarily on their own inventory, and location is critical, as is the ability to have input into the management of the homeowners' association, or possibly overall management responsibility for the property. It's noteworthy that there was hardly any mention of price, which is usually a key component in the purchase of any commodity. Prices tend to be nominal, with the primary goal of the association being to generate maintenance fees associated with the inventory.

It is also interesting to note that inventory must sometimes be moved out of the club when it isn't experiencing sufficient usage. Assembling and maintaining a club, accommodating changing owner usage patterns, and creating a point system that balances demand with availability is a complex process that requires constant vigilance. Every club is a work in process, and the work is never done.

Timeshare Industry Follows a Strong 2013 with a Good First Quarter in 2014

After a strong 2013, during which timeshare sales increased 10.8%, the industry experienced a further 8.7% year-over-year increase during the first quarter of 2014. With the securitization markets very active, the financial constraints that hindered sales in 2009 and 2010 have been lifted, and consumer demand continues to grow. ARDA's first quarter Pulse Report, prepared by Deloitte & Touche, LLP, showed an increase in tours and Volume per Guest (sales volume/tours) and a slight decrease in closing percentages from 15.8% to 15.5%. The mix between upgrade sales and sales to new owners was essentially equal to the mix of a year earlier. Fee for service volume, which is now a significant component of overall sales, increased 24% from a year earlier. Most significant new transactions submitted to Colebrook are either club product with inventory from various projects or fee for service arrangements.

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Strong First Quarter, continued from page 2

The average price per transaction increased from $17,282 to $18,334. Since the majority of transactions are points-based, rather than related to a one week timeshare interval, the average is affected both by the price per unit and the number of units/points purchased.

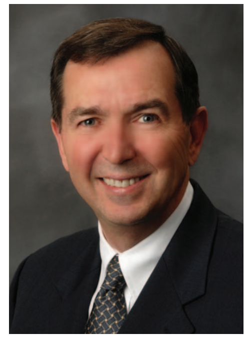
In conjunction with the upward sales trend, capital expenditures continue to increase dramatically, up 93% from the first quarter of 2013. Although there is a significant amount of unsold inventory in the system, much of it is fragmented blocks at older resorts best suited for club acquisition. Large developers are selling through their inventory and constructing new product. Some of the new construction is being built by companies not previously in the timeshare industry to be sold on a fee for service basis by large public companies.

Portfolio delinquency over 30 days increased slightly from 9.3% to 10.1%, while defaults decreased from 1.8% to 1.7%. Delinquency was down from the 10.3% reported at 12/31/13. The weighted average buyer FICO score of 693 was essentially unchanged from the 692 reported a year earlier.

The industry has had several good quarters in succession and, while the top line is not approaching the all time highs reached prior to the 2008 recession, the timeshare business is clearly back and growing. Financing is readily available, including hypothecation loans and construction loans, the latter of which was virtually unobtainable five years ago. Receivables performed well even during the depths of the recession, and continue to do well. The strong performance of Colebrook's portfolio is featured on page five in this issue, and the securitization markets have indicated their satisfaction by the attractive terms offered for recent transactions.

The Other Side of the Desk *By Sharon Scott, RRP*

Senior Vice President Charley Gorhan of Meredith Village Savings Bank (headquartered in Meredith, New Hampshire) and his wife started a business, constructed a commercial building, and operated their enterprise for several years before selling it in 2009. So when Charley returned to the banking business, he had been properly 'vetted' to deal with clients sitting across from him on the other side of the desk.



Charley Gorhan, Senior Vice President, Meredith Village Savings Bank

"I started in banking as an auditor in 1973," he says, "and switched to commercial lending in 1983. But I took a 'bank break' in the early 2000's to start up and operate a retail business. It gave me a totally different perspective."

Gorhan's more than five years of entrepreneurial enterprise gave him an appreciation of what a business owner goes through. "I had a true experience of starting up and running a business. There was the enjoyment that came from the successes, along with an appreciation of the challenges. Constructing a building in New England during the winter, for example, was just one of the issues that might not come to mind for a typical lender. It gave me a different perspective."

These days, when someone sits across from Charley, he can relate to what they're going through. "When someone talks to you about starting a business or constructing a building, I can advise them about the various issues to consider."

He explains he had no hands-on experience with timeshare or timeshare lending, prior to working on his first deal with Colebrook, although Meredith had ventured briefly into the industry. "At that time, Bill Ryczek and a few of his current partners were in banking. We were putting together a transaction with a local New Hampshire timeshare developer and they helped Meredith out and gave us some guidance."

The introduction proved timeshare resort paper to be a good addition to the bank's portfolio, and a few years later, after Colebrook was formed in 2003, Meredith Village began working with them on timeshare transactions. "While we look at timeshare from a commercial loan perspective, doing a transaction with a timeshare developer also entails handling a portfolio of consumer loans," explains Gorhan. "Thereby it enhances the consumer lending side of our business by diversifying our loan portfolio."

It's probably safe to say that without the assistance of Colebrook, Gorhan's group would never have taken a second look at timeshare paper. "Professionally, Colebrook's principals are on the same page as we are; we look at deals the same way and that's very important," adds Charley. "Working with the principals at Colebrook has been a good experience for me and for the bank. We've benefitted from their experience and learned from them. Plus, they always pick up the phone. When you call Colebrook, you always get one of the partners. As former bankers, they've also been on both sides of the desk, and they understand the banker's perspective."

Gorhan has attended Colebrook's annual lenders' education seminar for the last four or five years, he says. "They've been very helpful. I always come away with some new kernel of knowledge."

"My only complaint about the seminar is I never got the prize for coming the farthest distance," he quips. "Each time, I drove 300 miles for a half-day session. I never got a prize, but I did enjoy the free lunch."

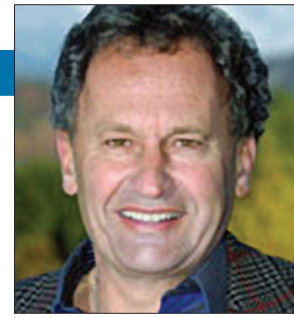
Gorhan is set to retire in September, and it's with mixed emotions that he leaves Meredith Village. Established in 1869, the bank has not permitted moss to grow on it, and Charley's tenure at the venerable institution has been anything but dull. In January 2013, Meredith combined with Merrimack County Savings Bank under a newly formed mutual holding company, New Hampshire Mutual Bancorp. The bank immediately benefitted by being able to significantly increase the size of the loans it could offer, and Merrimack has begun participating in timeshare loans with Meredith.

Charley may have a small twinge of regret about retiring, but he plans to compensate by moving to where "they have less than two inches of snow. We've got our house up for sale and plan to relocate in Charleston, South Carolina." Perhaps he'll be able to pay a number of 'site visits' to resorts as he and his wife cruise up and down the coast on his Yamaha motorcycle.

DEVELOPER SPOTLIGHT:

A New Englander, Through and Through

By Sharon Scott, RRP


Joseph Berry

Equally at home in a boardroom, on a ski slope, at the helm of a sailboat or on a construction site, Joseph L. Berry is the epitome of what one envisions a New Englander to be. Berry has successfully developed, operated and marketed vacation ownership to vacation-goers since he was actually in college!

River Run Company began in the '70s as the developer of ski homes at the Attitash Ski Area in the White Mountain National Forest of New Hampshire. Joe worked his way through school while at River Run as the company opened the first hotel condominium project in New England, Attitash Mountain Village Resort.

"I started selling real estate while I was in grad school and essentially took over when the original developer went bankrupt," he says. Undaunted by the huge challenges facing him and with that true New England work ethic, the young Berry still pursued his studies to obtain his Juris Doctor, all the while continuing to expand the enterprise. "I built my first model home in Attitash in 1975!"

Today, Berry is president and principal stockholder of River Run and is responsible for the company's ongoing development and operation of resorts. One of River Run's best-known projects in the vacation ownership world is the Eastern Slope Inn Resort. "It had closed and was on the market when we acquired it in 1980," Joe observes. Located in the center of New Hampshire's North Conway Village, it's listed on the National Register of Historic Places. More recently, Berry has constructed additional buildings within the property's 40-acre expanse. Today the Eastern Slope Inn complex offers more than 250 vacation ownership suites, along with five dozen shops, restaurants and 90 residential apartments. Another development, River Run Condominiums, is one of the largest resort hotels in New Hampshire and is located at the base of the Attitash Ski Area. In 1988, Berry undertook development of another vacation ownership development—the Suites at Attitash Mountain Village. In addition to River Run's vacation ownership properties, the company has developed a series of residential

Eastern Slope Inn Resort

trailside condominiums and houses. Berry has enjoyed long-lasting relationships with his lenders over the years. He was a customer of specialty-lender, the Finova Group, Inc., for much of the 1980's. After that, he became a client of Textron. When they withdrew from timeshare lending, he was provided with high recommendations for Colebrook Financial Company. "They stepped in quickly and ours was the first deal to close after Textron exited. The process was totally seamless for our buyers. It was a fairly easy transition thanks in large part to the responsiveness of Colebrook and several local banks."

Despite the recent recession, Berry says there is a new unit under construction at Eastern Slope Inn and a relatively new building at Attitash. His company continues to market to visitors coming to this popular vacation destination, although he admits that sales have been slower for the last few years. "The White Mountains of New Hampshire have historically been a great playground in the Northeast," says Berry. "We are encouraged to see traffic picking up and feel confident our numbers will be increasing significantly. Interestingly, even with seven major ski resorts and six cross-country ski centers, winter is still only our third best season! Summer holds first place and second is autumn with the incredibly rich fall foliage."

Strong crowds almost year-round prove to be River Run's best prospects, plus the company promotes their interests further through direct mail, telemarketing, local marketing programs and by offering hotel guests the opportunity to review vacation ownership opportunities. Berry comments that he prefers the term 'vacation ownership' over timeshare. "Over the years, bad players have spent millions of dollars ruining the name 'timesharing.' Disney, Starwood and other prominent hoteliers have helped improve the concept so that, today, we talk about quality vacation ownership, while 'timeshare' is still often thought of as being synonymous with bad marketing practices and poorly conceived projects," he observes.

Despite a hellish schedule that puts him in the thick of decision-making for everything from determining building codes to selecting paint color, Joe seemingly has no first or second gear. He is full-speed-ahead, being a world traveler and his hobbies include sailing, tennis, cycling, downhill and cross-country skiing. He is also a philanthropist. "We are about the largest company in this area, so naturally, we are expected to step up for a number of local causes," he says modestly.

Touted as one of the first environmentally sensitive developers in the 1970s, under Joe's direction, River Run has pledged to see that all current and future development will be done with minimal impact on the pristine natural landscape. Berry has been active with the American Resort Development Association (ARDA) since 1979, and was one of the original organizers for ARDA New Hampshire in 1981 and New England ARDA (since renamed ARDA Northeast) in 1992. He has been on the ARDA Board of Directors since 2005 and feels a keen responsibility to protect the image of the industry.

"Today, one of our greatest challenges is to help bring ARDA and other industry resources to aid more mature, independently managed resorts. Every developer in the industry should reach out and help legacy resorts. Together we can unite to do so much more," Joe affirms, echoing the gritty tones of New Hampshire's first sons who coined the motto 'live free or die.' After all, Joe is a New Englander, through and through.

The *Chronicle* Talks with Colebrook Counsel Harry Heller

When last seen in these pages, Attorney Heller was taking testimony from Dooby the miniature horse. In order to show that he is not just a "one-trick pony," the *Chronicle* dispatched its senior legal correspondent to speak with Harry about his nearly 30 years as a timeshare attorney.

CHRONICLE: *What's the most challenging aspect of representing lenders?*

HELLER: The biggest challenge is balancing the lender's desire to consummate the transaction with the need to see that the legal requirements are fulfilled and the lender is protected and perfected. You have to distinguish between items that are critical and those that can be waived without creating undue risk.

CHRONICLE: *What are the biggest changes you've seen in the timeshare legal community over the past 25 years?*

HELLER: There's been consolidation in the timeshare industry, and there's been a corresponding consolidation in the timeshare legal community. In the early days, I was often working with a general commercial attorney who happened to be representing a timeshare developer. Now, developers tend to be represented by one of the few firms that specialize in the industry. That's good in two respects. First, they're more knowledgeable, and second, when you deal with the same people over time, the trust factor increases. You gain insight into their expertise and competence, and know when you need to inquire further and when you don't. Because of the consolidation, you're dealing with true experts, and their opinion letters are more meaningful.

CHRONICLE: *It seems that in almost every deal, the opinion letter becomes a point of contention, with the borrower's attorney reluctant to opine to the satisfaction of lender's counsel. How do you view opinion letters?*

HELLER: I don't look at an opinion letter as an insurance policy from the law firm. Its greatest value is to ferret out issues prior to closing. A good opinion letter backed by solid research and diligence will bring out issues that need further investigation and resolution prior to closing.

CHRONICLE: *You spoke earlier about consolidation in the timeshare industry. You're now dealing with much larger companies than you were when you started. What is the main difference from a legal perspective?*

HELLER: It used to be extremely rare for a developer to have in-house counsel. Now nearly all do, although they may work in concert with outside counsel. The advantage of inside counsel is their greater knowledge and familiarity with the client's business. The disadvantage is their lack of independence. Outside counsel is independent, but they often need to rely on certificates or representations from the borrower for their opinion because they don't have direct knowledge. There are advantages and disadvantages from either perspective.

CHRONICLE: *What is the first thing you look for when you're given a new transaction?*

HELLER: The first thing I do is try to understand the underlying structure of the timeshare interest. Timeshare is a generic term that covers a wide array of structures. I need to understand how the project is structured in order to determine how to perfect the security interest. Another thing I look for quickly is whether there is any pending litigation involving the developer, and the potential implications.

CHRONICLE: *When you're reviewing due diligence materials, what key things do you look for?*

HELLER: I want to be sure that registrations are in place wherever they're needed. I look to see that the company has the legal right, under the law and their governing documents, to do what is contemplated by the transaction. For example, if the borrower is a homeowners' association, I want to make sure they have the right to borrow and to pledge assessments as collateral. I look at potential causes of future litigation, and for consistency between the company's governing documents and the way they actually operate. If the timeshare regime is structured a certain way, and the developer isn't adhering to that structure, there will probably be trouble somewhere down the road.

Attorney Harry Heller, Colebrook counsel

CHRONICLE: *For years, closings were done face-to-face. Now they're usually done by mail. How has that impacted you?*

HELLER: It creates a lot of angst for us. I send a long letter with execution instructions to accompany the document package, but despite our best efforts, there are almost always errors in execution or the delivery of documents that create post-closing follow up.

CHRONICLE: *Let's talk about something more pleasant. Anyone who knows you quickly learns that you are passionate about golf. What are your favorite courses?*

HELLER: Fisher's Island in New York and Old Head in Kinsale, Ireland.

CHRONICLE: *I understand you recently had a hole-in-one. Is that a product of increasing skill or more leisure time?*

HELLER: Neither. The luckiest part of the hole-in-one was that my club has a tradition where anyone who gets one has to buy drinks for everyone in the clubhouse. We finished in a driving rainstorm and when we got to the clubhouse there were only two people there. I got away cheaply.

Colebrook Financial Portfolio Update

Colebrook's consumer timeshare portfolios continue to perform extremely well, with minimal delinquency and no losses during the first six months of 2014. Since 12/31/11, there has been a pleasant consistency to the statistics, with the percentage of current accounts in the 96-97% range, while delinquencies in excess of 60 days have never exceeded 2%. The effective advance rate has declined during 2014, attributable to some accounts that are approaching payoff and have extremely low advance rates. The increasing liquidity of the timeshare market in general is indicated by the fact that these customers have not asked to draw on the availability. As most of you know, there are defaults in the consumer portfolios every month, but developer recourse and loan structure have insulated Colebrook from incurring material losses.

Portfolio performance is summarized below.

	12/31/10	12/31/11	12/31/12	12/31/13	3/31/14	6/30/14
Current (<30 days)	94.53%	96.18%	96.77%	96.22%	96.49%	96.48%
60+ days	2.97%	1.79%	1.09%	1.34%	1.33%	1.51%
Advance Rate	70%	67%	72%	68%	67%	65%
Losses on Receivable Loans and Loan Purchases	$6,000	$54,000	$27,000	$15,000	$0	$0