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Private Residence Clubs - Exclusivity Within The Leisure Market

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As demand in today's luxury residential real estate market continues to increase, private residence clubs ("PRCs") are offering fractional real estate owners the best of several worlds: luxurious accommodations with five-star amenities and services, and exclusively shared real estate ownership. PRCs represent the highest tier of the timesharing evolution, which began over 30 years ago. Unlike timeshare product, however, PRCs offer owners luxurious, (typically) purpose-built product in select markets with larger, fully-appointed units, longer share time (1/4 shares, etc.), and a wide-array of additional member benefits (including, but not limited to, concierge services, private storage, and room service). Examples of existing PRC projects include the Ritz-Carlton Club Bachelor Gulch (Avon, CO), Four Seasons Residence Club Jackson Hole (Jackson Hole, WY), and At Nature's Door (Whistler, BC, Canada). Several successful PRC models have incorporated a "sell it and it will be built" strategy. This entails aggressive market research and presales efforts. In addition to serving as an early indication of a given PRC's future success, presales are also key for attracting the necessary financing with which to launch a PRC development project. Required construction financing may be subject to hypothecating PRC presales contracts to the lender. Further, once certain statutory timelines in various states are met (i.e., Department of Real Estate approval), any prior and/or future presales deposits collected from to-be owners become a usable form of cash equity for the developer. However, oftentimes, this, coupled with other types of developer equity (land, etc.) does not satisfy a PRC project's total capital needs. Several options exist to fill-in these capitalization gaps. Mezzanine financing can offer one solution. Due to the phased timeline of a PRC development project (including pre-development/lead generation marketing, presales, project development, and fractional share closings), developers will typically not have in-place cashflows (other than from funded interest reserves and/or usable owner deposits) with which to satisfy current debt service requirements (prior to individual share closings). However, the ability for mezzanine lenders to structure their debt pieces with "softer" debt service requirements (e.g., low- or no-current pay interest and/or accrual features) can often supplement a developer's equity position by providing the balance of necessary capital required for these development projects. Mezzanine lenders, in these instances, are mostly concerned with their exit strategies, which effectively translate into the timing and velocity of PRC unit/share closings. For such underwriting purposes, proforma models that appropriately detail the flow of presale "soft" and "hard" deposits (aka, those that are refundable/non-usable versus those that can be used by developers as cash equity), development costs, and subsequent cash closings are critical. Successful PRC projects usually sellout at very high retail prices, affording developers the opportunity to encumber their projects with these higher yielding, accrual debt pieces, while still enjoying favorable equity returns. Due to the inherent risks associated with PRC development projects (construction, residential real estate and leisure travel indices, consumer spending, etc.) and anticipated ramp-ups in short-term values once these projects begin to sell, it is not uncommon for mezzanine lenders to receive equity-nearing rates of return and/or equity "kickers" on their funded investments. Recently, developers have looked to private "destination clubs" to help mitigate some of these front-end risks. Such companies offer their members exclusive access to extremely high-end vacation homes in the most luxurious of destinations (typically, on an exchange system basis). Certain PRC projects which fit these clubs' profiles may offer an opportunity for these companies to "bulk buy" large areas within the planned developments. Developers may pre-sell a substantial percentage of PRC projects to such clubs in an effort to bring additional creditworthiness to the table for potential lenders to consider (e.g., hypothecation of large, bulk buy, presale contracts, pledge of additional cash collateral, etc.), while taking large cash deposits from the clubs to further assist in the commencement of a PRC development project. The destination clubs may receive some level of custom-built product for their share of a PRC project (to satisfy internal requirements, if necessary, while still blending into the overall development project) and are granted exclusive rights-of-usage carve-outs which are then passed onto their members who utilize such vacation

Summary

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properties. Additionally, these clubs' members may also share in all of the amenities offered at the PRCs, including, but not limited to, F&B, room service, and spas. While the demand for exclusive, high-end fractional real estate increases throughout the world, PRC developers are continuously searching for the most prime of destination locations on which to build. Whether built in conjunction with luxury hotels or as standalone properties, PRCs continue to satisfy the most demanding high-end vacationers who seek nothing less than the array of amenities offered by the finest country clubs, while also enjoying the benefits of fractional real estate ownership. These wealthy travelers continue to command the highest levels of vacation real estate product, located in the most exclusive corners of the world. In order to keep pace, PRC developers continue to further tailor the luxurious "owner experience" to satisfy the wealthiest and most demanding of the leisure market's high-end vacationers and fractional owners.