

Destination Clubs Seek  
To Reassure Investors  
**In Wake of Bankruptcy Filing,  
Industry Invites Regulation  
And Opens Up Its Finances**

By AVERY JOHNSON  
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In the wake of a high-profile bankruptcy filing, "destination clubs" are scrambling to demonstrate they have sound financials and a willingness to be brought under government oversight.

The largely unregulated companies, which operate like hybrids between country clubs and time-shares, allow members to vacation in a variety of luxury homes around the world, in return for refundable deposits that can run as high as \$3 million or more, as well as annual dues. Though the industry has been growing in recent years, the problems at Tanner & Haley Resorts -- which filed for bankruptcy protection in July, jeopardizing its members' deposits -- have raised questions about the riskiness of this small but growing alternative to second-home ownership.



An Exclusive Resorts property in Real del Mar, Mexico, near Puerto Vallarta.

Though it's still far too soon to tell what the ultimate impact on the industry may be, for now, at least, consumers don't appear to be getting cold feet. At Exclusive Resorts -- the largest destination club, with about 2,400 members -- Chief Executive Donn Davis says this summer was the strongest in the four-year history of the company, with 400 new memberships sold. Private Escapes, with just over 300 members, says it had its best August in three years. And High Country Club, at the lower end of the market, with deposits starting at \$50,000, had its busiest month ever in August, with 35 new memberships sold.

A number of smaller clubs, meanwhile, are merging in order to cut expenses and bulk up their membership rosters. Others are rolling out new products and opening their financial statements to scrutiny.

David Larade, a human-resources executive who lives in Victoria, Canada, and has been considering joining a destination club, says he's likely to send in his money by the end of the year. "The problems at Tanner & Haley caused me to say to these clubs, 'Help me

understand how you are different.' And the responses have been reasonable. I've done my due diligence, and I'm not uncomfortable proceeding," he says.

Yet many members have been shaken. After Tanner & Haley filed for Chapter 11 bankruptcy protection, its nearly 900 members were left wondering whether they could get refunds on their deposits, which ranged from \$85,000 to \$1.3 million. The members are unsecured creditors, which means they're at the end of the line to get their money back.

Destination clubs have appealed to a growing number of well-to-do families and to baby boomers who want to travel without the upkeep and limitations of a traditional second home or time-share. The concept gained legitimacy in 2004, when AOL co-founder Steve Case bought a majority stake in Exclusive Resorts.

The membership deposit is supposed to be used in large part to purchase real estate, which serves as a guarantee that members will be able to get their money back. Members also pay dues in order to cover the club's operating expenses. The clubs make their profit on the cut of the deposit that they don't pledge to return and on real-estate appreciation.

Tanner & Haley ran into trouble partly because it hadn't bought enough real estate to back up its members' deposits. The club also promised members choice times in top locations, but it didn't always have enough properties in those locations to meet demand. As a result, it spent heavily on renting properties, especially during prime holiday periods.

For now, the club is meeting members' travel requests to destinations where it still operates. In bankruptcy proceedings, Tanner & Haley has said that the company is considering a sale or merger.

Destination clubs, unlike time-shares and other second-home ownership options, aren't regulated by specific laws other than those governing consumer protection, general contracts and fraud. In time-shares, vacationers actually own a piece of real estate -- and operate under rigorous regulation. With "fractional ownership," a somewhat higher-end version of a time-share, owners tend to be entitled to larger chunks of time per year at the property -- usually a month or so. There are also some newer destination clubs that give members a stake in their real estate, or the right to some of its appreciation; these companies call themselves "equity clubs."

Mindful of the credibility that regulation could bring, the destination-club industry is pushing to come under greater government oversight. The association is introducing legislation to regulate the industry in Hawaii, because of the state's leading role in the travel industry. Adam Wegner, general counsel at Exclusive Resorts and president of the Destination Club Association, says that the clubs operating today that are following these best practices are responsible and safe for consumers, and that members are protected by existing contract and fraud laws. The industry, he says, is trying to get legislation passed in order to make its voluntary best practices mandatory.

Until such regulation is passed, though, lawyers, real-estate industry consultants and financial advisers caution that would-be investors need to research a club's financial


health and business model themselves before putting down money. The major concern: that a club will not honor its word to put the majority of membership deposits into real estate. If sales slow and members want their deposit back, and a club hasn't put the money in trust or real estate, the members could lose a large portion of their original deposit.

Sherman Potvin, an industry consultant who runs the Web site [luxuryfractionalguide.com](http://luxuryfractionalguide.com), says that right now, "there's nothing stopping" destination clubs from renegeing on their promises to put membership deposits into real estate. **Don Martin**, president and owner of Mayflower Capital, a financial-planning firm in Los Altos, Calif., suggests simply renting a house instead of risking money on a destination club.

Jamie Cheng at the Helium Report, a blog for the wealthy that has published a guide to destination clubs, says the only way to be safe is to make sure a club can refund all of its membership deposits. He suggests avoiding clubs that refuse to disclose financial statements or cannot provide independent verification of their ability to meet the refund obligation.

**Inside Destination Clubs**  
A look at how some major clubs are structured—and what safeguards they offer members:

*A Quintess home in the Cabo region of Mexico, with five bedrooms and views of the Sea of Cortez.*



| CLUB                             | STRUCTURE  | SAFEGUARDS   | COMMENT  |
|----------------------------------|--|--|--|
| <b>Exclusive Resorts</b>         | Membership deposit starts at \$225,000 with \$10,500 annual dues, and goes up to \$425,000 with \$27,500 annual dues. Including its homes now in construction, the club owns just under 400 properties, or 85% of its portfolio. | Club promises 80% of the membership deposit back upon leaving the club. It will give members an annual accounting that shows the real estate assets at market value plus cash to be greater than or equal to debt plus total refundable member obligations. Ernst & Young audits the company's financial statements. | Steve Case, an AOL co-founder, is a majority shareholder. The club now has about 2,400 members.  |
| <b>Quintess, Catch the Dream</b> | Membership deposits start at \$175,000 and go up to \$345,000. Annual dues for the pricier plan are \$21,000. Eighty percent of the membership deposit is refundable.  | Next month, the club will revamp its membership so that the refundable 80% of the deposit becomes a "secured interest" in the real estate portfolio. That means that if the club files for bankruptcy, that deposit is second in line only to the bank mortgages to be repaid.                                       | As of Nov. 1, when the two clubs are fully integrated, members will have access to 38 homes in 24 locations. The club has 240 members.                                       |
| <b>Private Escapes</b>           | Clubs start at \$105,000 and go up to \$350,000. The deposit is 100% refundable when three new members join.   | The club's financial statements have always been audited, but it's now switching to audits by KPMG to give members assurance of a big-name firm. Members of the clubs' two highest tiers are entitled to some real estate appreciation.  | The club has 306 members and launched its high-tier Pinnacle membership during the same months in which the industry was rocked by the Tanner & Haley bankruptcy proceeding. |

Source:WSJ research

Exclusive Resorts doesn't show audited financials to its members or to prospective members. But it says it plans to produce documents that show its real-estate assets and cash are greater than or equal to its debt plus total refundable membership deposits. In the

worst-case scenario of a run on the bank, this would presumably show that the company has enough hard assets to redeem all the refundable membership deposits.

Private Escapes, another big player, is now having its financial statements audited by KPMG. Unlike most of its competitors, it promises members 100% of their deposits back and says it puts 65% of deposits into real estate. In the midst of all the turmoil late in the summer, the club launched its highest-tier membership yet, called Pinnacle, which asks members to put up \$350,000.

Ultimate Resort, which has about 80 members and 10 homes, is in the process of putting all its memberships into a trust that it calls a "warranty," which it says guarantees members their money back if they aren't satisfied with the club's services. The promise makes members secured creditors in the event of the bankruptcy, and puts their claims second behind the bank's mortgages in such a situation. The club is also starting to give any member who wants to leave 80% of the going rate for the membership deposit.

Clubs are also increasingly joining forces. Most recently, two midsize clubs -- Quintess and Dream Catcher Retreats -- have merged. In late October, Quintess plans to restructure its membership so that the refundable portion of all membership deposits has a secured interest in the club's real estate portfolio. This will ensure that if the club winds down its operations, the member deposits are second only to the debt owed to the bank through the mortgages, the club says. Also next month, members will also have access to a quarterly reports prepared by the club's auditors.

The Portofino Club has just acquired Signature Destinations Club, and will now operate as Portofino Destination Clubs with about 140 members. Havens, a club with 56 members, says it learned from the Tanner & Haley situation that it cannot overpromise its members "guaranteed" vacation time, and is reducing the number of guaranteed weeks from four at most to a new maximum of one, unless members opt to pay more.

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