The Economy: A Time for Change

BY SHAWN BRYDGE, RRP

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As we wrap up 2019 and look ahead to 2020, our industry, economy, and political landscape are each going through periods of change. While change is inevitable, it often means uncertainty, which can produce a negative effect on the stock market, corporate growth, and bank lending. However, can anything slow down this 10-year period of economic expansion, the longest the U.S. economy has ever experienced?

As a principal at Wellington Financial, a firm that has supported the timeshare industry since 1981, and through our work as the exclusive resort finance correspondent for Liberty Bank, a lender that has financed the industry uninterrupted since 1983, we've experienced many economic booms and busts as our industry has evolved. Twelve years ago, the Great Recession taught our industry a lot about being proactive in the face of economic uncertainty and about the importance of working with the right lending partner. As we turn toward 2020, let's summarize where we are and how we got here. Then we'll look ahead to what changes may be coming, and the resulting effects on the lending market.

Vacation Ownership Industry*

According to the AIF *2019 State of the Vacation Timeshare Industry: United States Study*, the U.S. timeshare industry increased for the 9th straight year to $10.2 billion in sales. Our industry's diverse product offerings and timeshare providers' ability to adapt to changing buyer demographics and travel preferences is reflected with an 85% owner satisfaction rate and occupancy percentages exceeding those of hotels.

While the major consolidation wave we saw over much of the past decade has slowed in recent years, the number of timeshare developers in active sales continues to shrink. Combine that with the continued growth of the Fee-for-Service/Fee-Based-Service model, where a large timeshare developer provides sales and marketing services to a smaller timeshare operation in exchange for a commission, and a high percentage of industry sales has been significantly concentrated to a small number of large developers. This leads to market efficiencies and economies of scale for the leading developers. As a result, competition has increased for smaller established operators and there are high barriers for new entrants, which could ultimately lead to more consolidation.

With consolidation and concentration comes opportunity for market interrupters and new products, especially those that can be nimble and think creatively. The past few years have seen an increased interest in the industry's legacy resorts, as many are located in prime locations, but need help with sales, marketing, maintenance, and management. In addition to the very large, heavily-segmented legacy resort market, non-traditional offerings such as travel clubs, short-term membership clubs, experiential travel, and ownership with periodic opt-out options have entered the marketplace to take advantage of a new generation of buyers with a different set of travel priorities.

U.S. Economy*

Since World War II, the U.S. economy has averaged a recession every seven years, and the longest stretch between recessions was 10 years (March 1991 to March 2001)…until now. The current post-Great Recession economic expansion, which started in June 2009, is now the longest in U.S. history.

The stock market isn't the economy, but it's difficult to talk about the U.S. economy without looking at equities. The S&P 500 is up 16% this year, up 49 % the last five years, and up 277% over the last 10 years. This means that consumers with stock and retirement portfolios have seen their net worth on paper increase significantly since the Great Recession.

Unemployment is 3.7%, up slightly from recent lows of 3.6%, but still extremely low. In fact, unemployment has been at or below 4.0%, which is considered "full-employment," for 18 months. That's the longest sustained stretch in 50 years, and long periods of full employment (12 months or longer) are historically followed by an economic downturn. With a strong job market, Americans are very optimistic about their current and future prospects for economic prosperity. However, unusual for this type of low unemployment environment is the lack of real wage growth, which means that American workers are fully employed, but they're not making more money despite increased competition for their skills and low inflation.

Consumer Confidence and Sentiment remain very high by historic measures, eclipsed only by the irrational exuberance of the late 1990's. This is a function of a strong job market, strong equity markets, and an overall belief that next year will be better than this year, and this year is better than last year. In fact, in the July release, the *Surveys of Consumers* chief economist noted that "despite ongoing trade uncertainties" consumers display "a renewed sense of personal financial optimism." That sort of confidence typically leads to major purchases, and it has for much of the last decade. When Americans make major purchases, they usually finance them. Accordingly, consumer and household debt has risen steadily for close to 10 years. While it's no surprise that mortgage-related debt is the largest percentage of Americans' total debt (70%), we've seen the largest percentage in debt growth during the current expansion come from student loans.

Over the past 10 years, student debt has grown 225% (more than any other household debt type) and now makes up 15% of American consumers' total debt and 37% of non-mortgage debt. That means that the $1.49 trillion student loans market is larger than auto loans ($1.28T) and credit card debt ($0.85T). For the first time in eight years, in we saw a decrease in auto loan debt, credit card debt, and other household debt quarter-over-quarter (18Q4 to 19Q1). This drop is partially attributed to American consumers taking precautionary measures to increase savings and reduce debt, based on new expectations of limited income growth, little change in inflation and unemployment rates, and concerns about new tariffs. However, student loan debt continued to rise. Perhaps more worrisome is that the default rate for student loans was 10.9% in 19Q1, higher than credit cards (8.3%), auto (4.7%), and mortgages (1%). This means that the greatest source of non-mortgage consumer debt in the U.S. also has the highest default rate. More

than 25% of Americans have student debt for themselves or a family member, with an average debt amount of $27,000. Almost half of them are concerned they can't pay it back and 25% have been late on a payment more than once. There are no signs of this trend slowing down and its impact on discretionary spending during a recession has yet to be tested at these levels.

A prototypical treasury yield curve (a chart of U.S. Treasury yields for maturities 3-months to 30-years) slopes up steeply in the near term and more gently as duration increases. Over the past two years, the yield curve hasn't looked entirely normal, but it has remained upward-sloping, indicating the expectation of economic growth, moderate inflation, and a continued tightening by the FOMC to keep that inflation in check. The Federal Reserve was seeing GDP growth near its target and was slowly moving interest rates higher, toward to more traditional levels. However, recent volatility in trade policies and geopolitical relations, combined with tariffs that negatively affect the American consumer's pocketbook and depress GDP growth contributed to the FOMC cutting their benchmark rate in August. The current treasury yield curve looks a bowl right now, gently dipping down from 1-month to 5-years, then moving back up, with 1-month yields and 20-year yields essentially the same, which is both odd and portends near-term weakness. An inverted treasury yield curve has predicted the last seven recessions, and while we're not inverted yet, we're well on our way given the recent shift in the economy. The bond market is clearly pricing in an upcoming slowdown in the economy.

Political Landscape*

Campaigning is already well underway for an election that is still 13 months away, which typically means not much significant legislative work will get done in the next year. Couple that with the lack of bi-partisan teamwork the Democratic-led House and the Republican-run Senate demonstrated over the past year, and the only safe

bet is that Americans will continue to give Congress a lower satisfaction rating than their cable company's customer service.

The Trump administration's lack of a clear plan on economic, trade, domestic, or foreign policy creates a great deal of uncertainty, and this is exacerbated by periodic surprise declarations and fear of the unknown. The current administration's clearest path for re-election is that the economy remains robust through November of 2020. They have demonstrated an economic strategy that includes running huge spending deficits to get short-term returns, and exerting political influence over the FOMC, which most consider a neutral body. The odds are good that they'll continue to double-down on that approach until the election.

Lending Crystal Ball

With economic crisis usually comes a more conservative lending environment. The factors that led to the Great Recession also caused the number of timeshare lenders to shrink dramatically and for the securitization market for timeshare receivables to seize temporarily. This resulted in a significant liquidity crunch for timeshare developers and ultimately changed much about the vacation ownership industry. We all learned a lot. Since then, the number of lenders to the timeshare industry has grown, lending terms have become more aggressive, and the securitization market has flourished.

The economy has begun to show signs of a slowdown as consumers become more conservative. However, with strong stock portfolios and low mortgage rates, affluent Americans could continue to build wealth and accumulate assets. But we also need to consider how a slowdown hurt the lower and middle classes; two demographics with significant consumer debt and limited wage growth. How might a consumer-led recession change purchasing and payment habits for discretionary items, including vacation ownership and travel?

We all hope the current economic expansion continues for years to come, but history says that's unlikely to happen. While times are still good, take the opportunity to look at your business and personal finances and make sure you're working with the right partners for when times get tough. It's paramount to make sure that your lender will be there to weather the bad times, as well as the good. Working with an experienced lender with a strong track record of industry support and years of experience in economic booms and busts provides you and your business peace of mind and financial support during those uncertain times.

__Author's Note:__ This was written in early August 2019 using political, industry, and economic data available at that time. ■