Diamond Resorts

Overview of Vacation Ownership Sales and Finance

Diamond Resorts International, Inc. (“DRII” or the “Company”) manages 108 resort properties worldwide and sells Vacation Ownership Interests (“VOI”) in the form of points at 57 sales locations. The owner of points receives an annual allocation of the number of points that they purchase which may be used at any of the DRII managed resorts as well as more than 250 affiliated resorts and hotels in our system.

DRII has sold a points-based product exclusively for almost a decade and the other large industry participants, including Wyndham and Marriott Vacation Club, also sell points-based vacation ownership products. In North America, we sell a lifetime subscription product whereby the annual points allocation may be used in perpetuity and may be gifted or inherited should the owner choose to do so.

DRII has achieved a significant increase in sales of VOI over the past 4 years. The growth has been both organic as well as from new sales centers that have been added in connection with recent acquisitions by the Company. Gross VOI revenue for the years ended December 31, 2012, 2013, and 2014 and the 9 month period ended September 30, 2015 are summarized as follows (in millions):

	Vacation Interest Sales, Gross
2012	318,555
2013	509,283
2014	589,208
2015 (through 9/30/15)	494,062

The sale of VOI is a regulated business which includes, among other things, a statutory rescission period that ranges from 5 to 10 days in the States in which we operate. Every VOI sale transaction is subject to these statutory provisions and all purchasers for any, or no, reason may cancel during the rescission period by contacting the Company by email as well as by telephone or fax numbers that are provided concurrent with the sale. For financial reporting purposes, a sale is recognized as revenue when a VOI transaction has passed the statutory rescission period and the customer has made at least a minimum down-payment of 10%. Deposits made at the time of purchase are held by an independent title company and the funds are released to the Company once the rescission period has passed and the customer has completed all required purchase documents. In the event that a customer rescinds the transaction during the rescission period, all monies are refunded to the customer directly by the title company. Like most large industry participants, we utilize a sales quality and assurance process, which is independent of the sales process, to confirm that the customer understands how the product works as well as their future financial obligations for both maintenance fee and loan payments.

Like most industry participants, DRII offers financing to customers who meet our approved credit criteria to facilitate the purchase of their VOI in North America. In Europe, with few exceptions, we do not originate loans but rather work with two financial institutions who independently make underwriting and credit decisions on the customers we refer. Accordingly, substantially all transactions in our European subsidiary are paid to us in cash. Our North American sales operations provide a large portion of our annual revenue.

During the years 2013-2015, approximately 75% to 80% (depending on the quarter) of our North American VOI sales have been to customers who utilize financing provided by the Company. During the last four years, we have consistently received a down-payment on financed transactions which averages 20% of the purchase price of the VOI. The cash down-payment is a “new” money down-payment and does not include any equity from the upgrade of a previous purchase. We report the percentage of cash versus financed sales in our annual report filed on Form 10-K. In reporting this number, we reflect the percentage of financed sales based on the total transactions with a financing component and do not include the cash down-payment as a cash sale. Certain industry participants provide cash sales information as the combination of 100% cash sales and the cash down-payment received. When combining cash sales and the cash down-payments received during those periods, approximately 35% to 40% of our annual VOI sales are made in cash at the time of closing of the transaction.

All financed transactions are underwritten and approved by our in-house finance department. Sales and marketing does not have any input into credit underwriting decisions. We utilize a central underwriting group that receives a loan request directly from one of our North American sales centers. The central underwriting group evaluates the customer’s credit profile, including their FICO score and credit file, and advises the sales center of the amount of DRII financing that the customer is eligible to receive. Since 2008, the average FICO score for new DRII loan originations has been 757. The loans that we offer consumers have a term of 10 years, a fixed rate of interest (which varies from 6.0% to 17.9% depending upon the amount of the down-payment and customer credit score) that is generally less than the rate of a credit card, with no hidden fees. Customer loan payments are due monthly and may be pre-paid, in whole or in part, at any time without penalty. The weighted average interest rate on our portfolio as of September 30, 2015, the last date of which such information was publicly provided, was 14.7%.

Like all large industry participants, we monetize loans originated on a quarterly basis in order to generate short-term working capital. We currently have two separate facilities that provide us with a total of $300 million in interim funding. These funding facilities are non-recourse to the Company. From an accounting perspective, when loans are deposited into one of the funding facilities, we receive a cash advance and we credit a non-recourse liability on our balance sheet. Our primary funding facility provides for an advance rate of 88% of the outstanding principal balance of the loans. As customer payments are received on the loans in each facility, the majority of the cash flow goes to the provider of the funding facility and the obligation on our balance sheet is reduced. As these are revolving facilities, loans are deposited at least quarterly, and customer payments are received monthly.

Again, like most large industry participants, we utilize the securitization market to provide permanent financing of our loan receivables portfolio. During 2015 we completed two term securitizations and anticipate two transactions in 2016. We became a programmatic issuer in 2011 and have essentially done one securitization per year through 2014 (some calendar years there were two). For the securitization process, loans are deposited into a special purpose entity (that is consolidated in our financial statements) and notes are issued to purchasers of the paper for which the loans serve as collateral. The majority of the cash generated from a securitization is used to pay down the warehouse funding facility where the loans were held after being generated until such time the securitization is complete. Our last two securitizations, which closed in July and November 2015, consisted of Class A notes (AA- rated) and Class B notes (A- rated). Both note classes are investment grade. Each of these term transactions included an advance rate of 96%, the highest in the industry, and a weighted average interest rates of 2.76% and 3.05%, respectively. Timeshare securitizations have been the best performing of the esoteric asset securitizations, and DRII has the highest rated securitizations in the industry based on the high FICO score of our customer base as well as outstanding performance of our receivables portfolios. Typical purchasers of timeshare backed securitization notes are insurance companies and fixed income funds.

Securitization transactions are balance sheet financings and the process does not impact the statement of operations including the reporting of Net Income or Adjusted EBITDA. Proceeds of the securitizations are primarily used to pay down the warehouse funding facility (and thus create new capacity) with cash going to the Company for the difference in the advance rates between the securitization and the warehouse facilities. The loans receivable continue to be reflected on the Company's balance sheet, net of the reserve for uncollectible accounts, and the obligation for this non-recourse liability is reflected in the liabilities of the Company. Our statement of operations reflects the interest earned on the loans and the underlying interest expense on the securitization notes.

Specific Questions

1. What is your historic prepayment rate? Have you seen prepayments increasing? If so, please specify how much and when.

   For the last 5 years, our prepayment rates have remained relatively constant and have averaged approximately 30% to 40% per year. Customers often use financing provided by the Company to complete the transaction while they are on vacation and prepay the loan upon returning to their home. Other customers choose to pay off their loans by making more than the minimum monthly payment or payment in full. There are no prepayment penalties on any of our consumer loans.

   The above prepayment rate reflects cash prepayments and does not include prepayments due to timeshare upgrade transactions.

2. What percentage of loans are prepaid in cash and what percentage is prepaid by refinancing existing loans (generating new loans)?

As indicated in number 1 above, customer prepayments in cash approximate 30% to 40% per year. We do not refinance existing loans except in connection with customer upgrades or the purchase of additional points as described below.

3. What percentage of new loan originations include pre-existing refinanced debt?

   Over the last 4 years, new loan originations included 20% to 40% of transactions associated with an upgrade. This amount varies by quarter and by year. When a customer upgrades, in addition to the trade in of the existing ownership and loan, the customer is required to meet the minimum down-payment requirements associated with the new transaction and such amounts are paid to us in cash.

4. What percentage of customers refinance their loans in connection with upgrade transaction prior to maturity?

   DRII's sales and finance platform launched in 2007 with the acquisition of Sunterra Corporation. The loans that we have underwritten have a 10 year maturity. Accordingly, we do not have the information on what percentage of loans will ultimately upgrade prior to maturity until 2017.

   Information provided in our 2014 10-K states that approximately 63% of our sales were to customers who were already DRII owners, 17% were to new DRII customers who were members of resort companies we have acquired since 2010, and the balance are to new customers with whom we did not have an existing member relationship. This data reflects both cash and financed transactions.

5. How do you account for delinquencies? Accountants tell me there are two methods available for use, so please note which one is used.

   I think you are actually referring to accounting for defaults rather than delinquencies; the following addresses both. Included in our quarterly statement of operations is a provision for uncollectible accounts. The amount of this charge is determined based on a historical static pool analysis which determines the probability of default by FICO band of each individual loan generated during the period. The provision is then further evaluated to determine if other circumstances (such as the general economic environment or changes in loan portfolio performance) would warrant an increase or decrease in the amount of the quarterly provision. We do reserve for each loan that we originate, even when the loan is current and ultimately pays in full. The bad debt provision, while non-cash, is included in both Net Income and Adjusted EBITDA as reported by the Company.

   The reserve for uncollectible accounts is determined each quarter based on the beginning balance of the reserve, plus the current quarterly loan loss provision as indicated in the previous paragraph, and reduced by loans that are charged off during the quarter. Our loan loss policy is to charge off all loans when they are in excess of 180 days past due. These loans are charged off against the reserve. Once a loan is charged off, it is not reflected in our financial statements.

In the event that we do have recoveries of charged off loans, they are generally reported on a cash basis.

As of September 30, 2015 we had total loans receivable of $708 million of which $673.5 million, or 95.1%, is less than 30 days past due. A total of 96.9% was less than 60 days past due, which is the general performance measure for an eligible loan in our warehouse funding facilities. $21.9 million, or 3.1% of the portfolio, was 61-180 days past due. All loans are charged off at 181 days past due. It is important to note that even though approximately 97% of our loans are less than 60 days past due, we carry a reserve against uncollectible loans of $153 million which is 21.7% of our entire receivables portfolio and is 7X the amount of loans that are over 60 days past due.

Receivables that have been sold into a securitization facility are included in our financial statements as indicated above. Each securitization facility anticipates that a certain number of receivables will default. These default assumptions are included, even stressed, by the rating agencies in determination of the facility rating. Securitization facilities for all industry participants include certain credit enhancements to ensure against losses to the purchasers of these notes. These credit enhancements include the spread between the weighted average consumer interest rate and the interest charged on the underlying bonds, the original balance of the outstanding loans as compared to the advance rate (e.g. a $100 million in securitized loans would be advanced $96 million based on our advance rates) and a reserve account. . In addition, the securitization documents provide that we have the obligation to re-market inventory related to defaulted loan receivables, which does not have any impact on our statement of operations, net income or Adjusted EBITDA. Further, at our option we may repurchase or replace defaulted loan receivables up to the allowable percentages of the various facilities.

There has never been a default in any timeshare securitization by any issuer.

6. What percentage of cash down payments are made with a credit card?

The majority of all loan down-payments are made by the consumer using a credit card. This often occurs based on the consumers' desire to earn "points" from the credit card issuer including airline points, hotel points, etc. Further, a consumer is usually on holiday and may not be traveling with a physical check to make the down payment.

7. Do you consider upgrade transactions with a refinancing component to be a prepayment of the old loan?

Timeshare owners have a propensity to purchase points multiple times over the life of their ownership. In the event that a current owner makes a decision to purchase additional points or to trade in an interval based week product for points, any existing loan is paid off and a new loan s entered into. In the event that the existing loan is included in one of our warehouse funding facilities or a securitization (most of which are), that payoff is made by DRII in cash to the holder of that loan. Any new loan would be eligible for inclusion in a future securitization transaction. In order for an upgrade to occur, the customer must be current on the underlying loan at the time the new transaction is entered into. As stated above, our publicly disclosed prepayment rates do not include upgrades as prepayments. From a sales perspective, only the value of the incremental points sale is reported as revenue.

8. What percentage of monthly loan payments are made with a credit card?

   The vast majority of monthly loan payments are made either by check or ACH; only a small number are made with a credit card.

9. Do you report new, refinanced, modified, or delinquent vacation loans to consumer credit rating agencies? If so new loans are reported, are late payments and defaults reported too?

   We do report new loans, payoffs, delinquencies, and defaults to consumer credit reporting agencies. Except in rare circumstances, we do not modify existing loans.

10. Are the FICO scores disclosed in your financial and securitization reports by bond credit agencies based on the customer's score before or after the loan was originated? (This assumes the loans are reported).

    As indicated above, FICO scores are confirmed as part of the underwriting of the loan. It is an integral part of the underwriting process and therefore is done concurrent with the origination of the loan. Further, we routinely update FICO scores for borrowers. At the time that a loan is placed into a securitization facility the FICO score associated with the loan is the FICO score as of the origination date.

11. How do you account for delinquencies? Same question as number 5.

    See response above.

12. In the NYT article, the company mentioned an accounting issue that would arise in the interests of vacation interest holders were repurchased. What is the issue?

    The sale of VOI points is a "right to use" or contract right. There is no real estate component of the purchase. A consumer is effectively buying a pre-paid subscription product which grants, among other things, the right to use their points for accommodations in the Diamond Resorts managed and affiliated resorts and hotels. We never sell our product as an investment. Further, no major participant in the industry sells the product with a repurchase obligation and, to our knowledge, no industry participant sells with the obligation to repurchase. VOI is a prepaid vacation plan which is attractive to many purchasers based on both its cost effectiveness as well as the comfort of the accommodations as compared to a standard hotel product.

The accounting issue to which you refer is related to revenue recognition. Whether in the vacation ownership industry, or any industry for that matter, full sale revenue recognition cannot be utilized if the seller has a future obligation to repurchase. Such an obligation would cause the transaction to be classified as a long-term lease, not a sale. Many industry participants, including DRII, do on occasion repurchase inventory on the open market or periodically through a coordinated program but are under no obligation to do either.

13. Why do consumers with above 750 FICO scores need to pay interest rates above 13% on vacation loans?

    While a substantial number of our annual transactions are paid in cash at the time the transaction is consummated, consumers frequently utilize financing provided by DRII as a matter of convenience at the time of purchase. Many of those purchasers pay off the loan in a short period of time; as noted above, these loans may be prepaid at any time without penalty. Other consumers utilize financing provided by DRII in lieu of using a credit card for the purchase as it frees up available credit on their revolving credit card line. Also, credit card interest rates are oftentimes substantially in excess of the rates charged by our captive finance company. The rates charged by DRII on its consumer loan transactions are comparable to others in the industry as well as those charged by companies in many other consumer-facing industries including retailers which offer their own credit facilities for purchases by their customers. In the 2015-2 Securitization completed in November 2015, 69% of the total receivables included in the pool had a FICO score in excess of 700.

14. Why did lawyers from Katten Muchin Rosenman issue a legal threat (via cease-and-desist letter) to a MBA student?

    The MBA student participated in a contest in which he used DRII as his thesis. While he was the winner of the contest, unfortunately his presentation was full of mistakes, misunderstandings, and blatant misstatements of facts. The WSJ then ran an article regarding the contest that included the blatant errors in facts and conclusions reached by the author. The individual continued to promote the story with disregard to his own errors. It is worth noting that the student's previous job experience included having served in a CFO capacity. The letter from Katten Muchin Rosenman was provided to advise the individual of the errors and the ramifications of his false presentation.