Methodology

Rating U.S. Timeshare Loan Securitizations

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CONTACT INFORMATION

Chris D’Onofrio
Senior Vice President, U.S. ABS
Global Structured Finance
Tel. +1 212 806 3284
cdonofrio@dbrs.com

Chuck Weilamann
Senior Vice President, Head of U.S. ABS
Global Structured Finance
Tel. +1 212 806 3226
cweilamann@dbrs.com

Kathleen Tillwitz
Managing Director, Head of U.S. & E.U. Operational Risk
Global Structured Finance
Tel. +1 212 806 3265
ktillwitz@dbrs.com

Claire Mezzanotte
Group Managing Director
Global Structured Finance
Tel. +1 212 806 3272
cmezzanotte@dbrs.com

Related Research

• Legal Criteria for U.S. Structured Finance
• Operational Risk Assessment for U.S. ABS Servicers
• Operational Risk Assessment for U.S. ABS Originators
• DBRS Unified Interest Rate Model for U.S. Timeshare Loan ABS Transactions
• DBRS Master U.S. ABS Surveillance Methodology

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TABLE OF CONTENTS
Scope and Limitations 4
Executive Summary 4
Introduction and Industry Overview 5
  Vacation Ownership Interests 5
  Exchange Systems 6
  Fractional Ownership 6
Timeshare Loan Structure 6
Operational Risk Review 7
  Resort Developer 7
  Property Manager 7
  Homeowner Association 8
  Originator Review 8
  Servicer Review 8
Legal Structure 9
  Other Legal Considerations 9
Collateral Quality 10
  Pool Characteristics 10
Data Request and Developing a Base Case Loss Expectation 10
  Static Pool Data 10
  Projecting Expected Losses 11
  Adjustments to the Expected Loss 11
  Seasoning Adjustment 12
ABS Financial Structure 12
  Types of Credit Enhancement 12
  Priority of Payments 13
  Rating Thresholds or Triggers 14
Cash Flow Analysis 15
  Stress-Case Cumulative Net Losses 15
  Other Cash Flow Assumptions 17
  Other Structural Considerations 18
Appendix I - DBRS Idealized Default Table 19
Scope and Limitations

DBRS evaluates both qualitative and quantitative factors when assigning ratings to a U.S. structured finance transaction. This methodology represents the current DBRS approach for rating timeshare loan securitizations issued in the United States with timeshare loan collateral originated in the United States. It describes the DBRS approach to analysis, which includes: (1) a focus on the quality of the sponsor/servicer, (2) evaluation of the collateral pool and (3) utilization of historically employed credit evaluation techniques. This report also outlines the asset class and discusses the methods DBRS typically employs when assessing a transaction and assigning a rating. It is important to note that the methods described herein may not be applicable in all cases. Further, this methodology is meant to provide guidance regarding the DBRS methods used in the sector and should not be interpreted as prescribing a rigid template, but understood in the context of the dynamic environment in which it is intended to be applied.

Executive Summary

DBRS evaluates both qualitative and quantitative factors when assigning and monitoring ratings for U.S. timeshare loan asset-backed securities (ABS) transactions including the following:
- Operational risk review,
- Quality of the resort properties and their amenities,
- Collateral quality of the proposed timeshare loan pool and historical performance of a sponsor’s timeshare loan portfolio,
- Transaction capital structure and priority of payments and
- Legal structure and opinions.

In the analysis of timeshare loan ABS transactions, DBRS evaluates the transaction based on the combination of the underlying timeshare loans as well as a review of the risk to the loans related to the performance of and reliance on a management company to manage the timeshare assets. DBRS performs an operational risk review and assessment of the key parties involved in origination and servicing. The operational risk review may also include a review of the quality of the timeshare properties and their amenities as well as the management company’s capabilities to manage the timeshare properties. The operational risk review provides insight into the process that affects timeshare loan performance. For each target rating, DBRS analyzes the proposed transaction cash flow structure under various stress scenarios to determine the ability of the transaction to repay timely interest and ultimate principal in accordance with the terms of the transactions.

DBRS reviews the transaction’s legal structure and opinions to assess that all necessary steps have been taken and that no subsequent actions are needed to protect the issuer’s ownership interest in the assets.

1. Refer to DBRS’s Operational Risk Assessment for U.S. ABS Servicers methodology.
Introduction and Industry Overview

The origins of timeshare products date back to the early 1970s when developers began to use real estate development technology imported from Europe to develop the first timeshare resorts in the United States. The timeshare technology was developed as a prepaid vacation and a way to encourage guests to become owners of a vacation experience versus renting hotel rooms. The timeshare industry caters to the vacation lifestyle and offers a variety of vacation options to the owner. Timeshare companies, depending on their size and the location of their resorts, target different demographics that may seek different desired vacation options such as drive-to and destination resort options. Timeshare owners can enjoy resorts that offer amenities including beach, golf, ski, theme-styled or other attractions. Timeshare resorts typically offer a wide range of services and the units are configured with a vacationing family in mind. Timeshare companies typically offer one- to three-bedroom units that contain fully equipped kitchens, dining and living areas with separate bedrooms.

VACATION OWNERSHIP INTERESTS

The buyer of a timeshare typically acquires an interest in a vacation property (Timeshare Interest). This Timeshare Interest typically comes in the form of a fee simple interest, a right-to-use lease or a membership in a points-based resort club system. The fee simple Timeshare Interest provides the owner a deed in respect of real property; the right-to-use lease Timeshare Interest provides the owner with a contractual right to use a unit in a resort, or a system of resorts; the points-based membership Timeshare Interest provides the owner with membership points that act as currency to be applied to use units at resorts within a timeshare company’s system. The fee simple and the points-based membership Timeshare Interests represent the most common forms of Timeshare Interests utilized today.

Initially, Timeshare Interests were created with respect to a specific property and gave the owner the right to use a specified unit during a defined week or other time period each year. As the industry evolved both in size and sophistication, more flexibility was given to the owner as offered via floating-week usage, vacation clubs and points-based systems. A description of each type of timeshare program is as follows:

• Fixed Week: Fixed-week programs allow the consumer to purchase the right to use a specific unit at a specific resort for a specific week each year.
• Floating Week: Floating-week programs offer the consumer the right to use a set unit type (number of bedrooms, number of bathrooms with a particular view and/or amenity) at a specific resort during any week in a specified season.
• Vacation Club: Vacation club programs allow the consumer to vacation at any resort within the timeshare company’s system at any time based on the value of the Timeshare Interest purchased. The value is determined based on the quality of resort, the duration and the season of the vacation purchased as well as the size and quality of the unit.
• Points-Based Memberships: Points-based systems offer the consumer the ability to purchase points based on the location and timing of a vacation as well as the size of the desired unit.

These points can be exchanged for usage at any resort within the timeshare company’s system. Additionally, points can be borrowed from future point allocations, banked for future usage or additional amounts can be purchased.

Vacation clubs and points-based memberships are the most common timeshare programs offered today. A points-based system offers consumers the most flexibility with regards to where and when to use their timeshare.
EXCHANGE SYSTEMS
Timeshare owners can typically trade their Timeshare Interests within the related timeshare company’s system or with other timeshare companies’ systems. Exchanges can often be facilitated through an exchange company. Exchange companies link Timeshare Interest owners to a worldwide network of participating resorts, allowing the owners to use their Timeshare Interests as currency to vacation at other destinations within the exchange system.

The two largest exchange companies in the timeshare industry are Resort Condominium International (RCI) and Interval International (II). RCI has been around since 1974 and boasts the largest network, with over 6,300 affiliated resorts in 101 countries worldwide. Interval International has been around since 1976 and has nearly 2,800 resorts located in 75 countries worldwide.

FRACTIONAL OWNERSHIP
The vacation ownership industry offers two additional products: fractional and private residence club ownerships. Both the fractional and private residence club ownerships are similar in concept to that of a timeshare, but each typically offers more luxurious properties with higher-end amenities, services and furnishings. In each of the fractional and private residence club ownerships, the resorts are generally smaller in size, contain fewer units and offer ownership interests for a longer period of time. Fractional ownership is viewed to be a second home alternative whereas private residence clubs offer ownership interest in a club structure similar to a country club membership.

Timeshare Loan Structure

To facilitate the sales of Timeshare Interests related to its development projects, it is common practice for timeshare companies or their affiliates to offer financing to prospective owners and to perform all collection activities on the loans. The typical timeshare loan is evidenced by a promissory note and secured by a mortgage or security interest on the related Timeshare Interest. The loans typically amortize, whereby the entire amount of the loan is repaid over the term of the loan.

Timeshare companies engage in comprehensive marketing strategies to generate sales. Timeshare companies may screen targeted prospective owners based on minimum income, job stability, past vacationing patterns and prior ownership of timeshare products. It is common for timeshare companies to invite prospective owners to visit one of their timeshare resorts, absorbing the cost associated with the visit which may include free night stays, reduced rates, vouchers for meals and entertainment as well as discounted airfare. The rate of conversion from prospect to a closed loan tends to be as low as 10% or less for new buyers and higher for upgrades of existing owners.

Historically, timeshare companies performed minimal credit underwriting of prospective owners. Some originators used risk-based pricing, charging a higher rate or requiring a greater down payment for a less qualified borrower, but would rarely turn a prospective owner away because of poor credit. More recently, the industry has tightened lending standards and it has become more common for originators to obtain and review prospective owner credit (FICO) scores for each loan.

Whether or not an owner finances the purchase of a timeshare, all owners are obligated to pay annual fees to cover maintenance, capital improvements, taxes and insurance costs of managing the resort where their Timeshare Interest is located. Owners will be responsible for payment of special assessments on an as-needed basis.

During the construction and prior to the sale of unsold Timeshare Interests, the unsold ownership interests are owned by the timeshare company. The timeshare company will bear the costs associated with the
maintenance on all unsold Timeshare Interests. The timeshare company is typically contracted to manage the property and the reservation system, although these responsibilities can sometimes be bifurcated and handled by a third party.

The owners’ vacation experience is influenced by the condition of the resort and their ability to make a reservation when and where desired. As a result, the management capabilities of the timeshare resort manager can have an impact on future timeshare loan performance.

Operational Risk Review

Given the nature of the financial and operating asset elements of a timeshare loan transaction, DBRS assesses the timeshare company and the key parties to the transaction for assigning a rating during its analysis. As part of this review, DBRS assesses the following entities:

- Resort developer,
- Property manager,
- Homeowner association,
- Loan originator and
- Loan servicer.

Timeshare companies typically have multiple functions in timeshare loan transactions. In some instances, the timeshare loans are originated by an independent finance company. In either case, DBRS assesses each of the key parties in its development of expected case- and stressed-case transaction cash flow scenarios.

RESORT DEVELOPER

DBRS performs a review of the resort developer in terms of its financial strength and operational capabilities to ascertain the stability of the resort developer and the quality of the product offered to the owner. DBRS believes that a contributing factor to timeshare loan default is owner dissatisfaction with the resort. The quality of construction is a key element to the timeshare owner’s overall satisfaction. As a result, in its review of a developer, DBRS assesses the quality of the resort construction and its amenities. Resort developers may sell and finance timeshare units before the resort, or a particular phase of development of the resort, has been completed (these loans are often referred to as Green Loans). Failure of a resort or phase of a resort to be completed as expected may affect owner satisfaction, in turn increasing the likelihood of default. DBRS reviews the developer’s plans for the remaining construction and may review project timelines and milestones to assess the additional risk of default related to the amount of Green Loans included in the transaction. DBRS may perform further analysis if Green Loan risk is determined to be material.

PROPERTY MANAGER

DBRS conducts a review of the manager of each of the properties included in the transaction. Property management and maintenance is a capital and operational intensive process. A property manager is responsible for: capital maintenance and improvements, reservation system management, property maintenance, security and all other property operational functions. DBRS believes that a well-managed property is critical to ensure that owners continue to use their timeshares and are willing to make remaining payments under their timeshare loan.

The property manager is typically an affiliated company of the timeshare company. Given this relationship, DBRS may perform a review of the terms of the management agreement to see if the management fees are sufficient to properly compensate and incentivize the property manager or to sufficiently compensate a replacement property manager. In the event that the management agreement is not arm’s length and contains below-market terms, DBRS believes that there is a risk that the manager will not be incentivized sufficiently to maintain the timeshare resort property.
HOMEOWNER ASSOCIATION
To ascertain the current and future management and maintenance of a timeshare resort property, DBRS analyzes the involvement and management of the resort’s Homeowner Association (HOA). An HOA is typically managed by a board of directors which comprises representatives from both the timeshare owners and the timeshare company. The timeshare company representative will have a more significant role when the resort, or phase of development in a resort, is not yet completed. The HOA represents the interests of timeshare owners and enters into and maintains the contractual arrangement with the property manager. DBRS reviews the interaction between the HOA and the property manager to assess the relationship and if the property manager is sufficiently being managed by the HOA.

A key responsibility of the HOA is to maintain the operating budget for the management of the property. The operating budget typically includes sufficient reserves for future capital improvement, maintenance, insurance and property management fees. Additionally, DBRS may evaluate the policies, procedures and authorities granted to the HOA and the management company to determine if appropriate financial controls are in place.

ORIGINATOR REVIEW
The originator review process evaluates the quality of the parties that originate the loans (leases or receivables) that are about to be securitized in a transaction rated by DBRS. While DBRS does not assign formal ratings to these processes, it typically conducts operational risk reviews to assess if an originator is acceptable and incorporates the results of the review into the rating process.

DBRS typically begins the initial originator review process by sending a questionnaire to the company that outlines the topics to be covered during the discussion with management and includes a list of documents to be provided such as organizational charts, financial statements and underwriting guidelines. In instances where DBRS determines that the originator is below average, issuers may incorporate certain structural enhancements into a proposed transaction such as additional credit support or a third-party firm to provide the requisite representations and warranties so that DBRS can rate the transaction. In the event that DBRS determines that an originator is unacceptable, it may refuse to rate the deal.

The originator review process typically involves a review and analysis of the following:
(1) Company and management
(2) Financial condition
(3) Controls and compliance
(4) Origination and sourcing
(5) Underwriting guidelines
(6) Technology

For details on the originator review process, please refer to the DBRS methodology Operational Risk Assessment for U.S. ABS Originators.

SERVICER REVIEW
The servicer review process evaluates the quality of the parties that service or may conduct backup servicing on the loans (leases or receivables) that are about to be securitized in a transaction rated by DBRS. While DBRS does not assign formal ratings to these processes, it typically conducts operational risk reviews to assess if a servicer is acceptable and incorporates the results of the review into the rating process.

DBRS typically begins the initial servicer review process by sending a questionnaire to the company that outlines the topics to be covered during the discussion with management and includes a list of documents to be provided such as organizational charts, financial statements and performance statistics. In instances where DBRS determines that the servicer is below average, issuers may incorporate certain structural
enhancements into a proposed transaction such as additional credit support, dynamic triggers or the presence of a warm or hot backup servicer so that DBRS can rate the transaction.

The servicer review process typically involves an analysis of the following:
(1) Company and management
(2) Financial condition
(3) Controls and compliance
(4) Loan administration
(5) Customer service
(6) Account maintenance
(7) Default management
  • Collections
  • Loss mitigation
  • Bankruptcy
  • Fraud
(8) Investor reporting
(9) Technology

For details on the servicing review process, please refer to the DBRS methodology Operational Risk Assessment for U.S. ABS Servicers.

Legal Structure

DBRS reviews a transaction’s legal structure to see that all steps have been taken to insulate the rated securities from the risk of bankruptcy of the timeshare company or its affiliated companies. For a description of the legal considerations for structured finance transactions, please refer to DBRS’s Legal Criteria for U.S. Structured Finance.

OTHER LEGAL CONSIDERATIONS
Timeshare Interests may be considered executory contracts and may, therefore, expose the owner of the Timeshare Interest to the financial strength, stability and potential bankruptcy of the timeshare company or its affiliated companies. The risk of rejection of an executory contract by the trustee in the bankruptcy of a timeshare company is somewhat mitigated as a result of the U.S. Bankruptcy Code (11 U.S.C. S 365(i)) allowing a purchaser to either terminate the contract or retain ownership in the Timeshare Interests and receive the benefits of the timeshare program if the trustee in fact rejects the contract, pursuant to specific language for Timeshare Interests.

Green Loans and right-to-use leases are examples of executory contracts that may be found in timeshare ABS transactions. The inclusion of Green Loans and right-to-use leases is typically limited and, under certain circumstances, structural mechanics are included in the transaction to mitigate the additional risks associated with the executory contracts. DBRS may perform additional analysis if the risk related to the executory contracts is material.

For club-type structures offered by timeshare companies, it is common that the legal entities are structured utilizing a quasi-bankruptcy-remote legal structure. DBRS believes that the utilization of this type of legal structure mitigates the risk of rejection by the bankruptcy trustee.
Collateral Quality

As part of the analysis of the transaction, DBRS analyzes the characteristics of the underlying collateral pool to assess the probability of default and loss severity expectation. In addition, as warranted, DBRS assesses the collateral pool statistics against the eligibility criteria set forth in the transaction legal documents. This step ensures that prescribed limits of certain collateral types are reflected in the analysis.

POOL CHARACTERISTICS
When rating a transaction backed by a pool of timeshare loans, DBRS typically receives pool stratifications that provide a summary of the pool’s characteristics, such as information related to timeshare products purchased, loan terms and obligor information. In general, the characteristics of the underlying loans that comprise the proposed collateral pool should mirror the static pool loss performance as closely as possible; however, DBRS recognizes that pools with similar summary characteristics can demonstrate significantly different performance. For instance, two portfolios may have identical remaining terms to maturity, but the underlying stratifications may indicate that one pool has a greater preponderance of longer term loans that are likely to have a higher loss profile. For this reason, it is important that issuers have the reporting capability to provide static pool performance data that can be stratified by attributes such as credit score, loan term or other relevant attributes necessary to assess a proposed pool’s risk of loss. In cases where sufficient loss performance detail has been provided, DBRS can refine its loss analysis by using the data to determine a loss estimate for each distinct component of the pool and then use this information to develop a weighted-average (WA) loss expectation for the securitized pool based upon the relative contribution of each segment.

Data Request and Developing a Base Case Loss Expectation

As part of the rating process, DBRS develops a base-case loss expectation (also referred to as expected loss) for each timeshare pool. DBRS analyzes issuer-specific performance history and pool-specific characteristics provided by an issuer. DBRS may also look to compare the issuer’s experience with the performance of other issuers within the timeshare market. DBRS utilizes this historical information to assess future performance. Preferably, DBRS expects issuers to provide loss information, as described below, that covers asset performance during various economic cycles. This enables DBRS to evaluate the impact that macroeconomic factors, such as unemployment levels, may have on collateral performance.

STATIC POOL DATA
DBRS uses a static pool approach to develop an expected loss for a transaction. Static pool analysis relies on historical loss data from discrete groups of loans originated over a relatively short period of time; ideally, these time periods should be monthly or quarterly, as annual vintage data may lack the precision to assess performance volatility during periods of economic stress. In this analysis, a ratio of losses to original loan balance is tracked on a monthly basis for a static pool of assets as they amortize. If the collateral composition is similar, static pool analysis is an effective tool for establishing loss expectations because, all else being equal, two pools of assets that have similar collateral composition during similar economic environments can be expected to have similar losses over their lives.

DBRS seeks to receive historical data with sufficient granularity across the key risk components of the pool. Sufficient granularity may include defining appropriate stratifications or pooling data by cohort relevance. While aggregate pool characteristics may differ by transaction, sub-pools within the aggregate
pool will likely share characteristics which aid in the determination of expected losses. DBRS may request an issuer to segregate historical static pool performance data and the proposed securitization portfolio into sub-pools of these common collateral characteristics. In cases where sufficient performance detail has been provided, DBRS can refine its loss analysis by using the data to determine a loss estimate for each distinct sub-pool, then use this information to develop a WA loss expectation for the securitized pool based on the relative contribution of each sub-pool.

Typically, DBRS receives at least five years of performance history from a timeshare ABS issuer to perform a rating analysis. In the absence of adequate performance history, DBRS may decline to rate the transaction because of the insufficiency of the provided data. For cases where static pool loss data is unavailable, DBRS may consider using managed portfolio loss data as a proxy; however, this approach has several shortcomings. First, portfolio figures are biased downwards during periods of portfolio growth. While it is possible to make adjustments to the data to address this phenomenon, these adjustments do not provide insight into the timing of losses, an important component of DBRS loss analysis during transaction cash flow modeling. In addition, utilizing portfolio figures makes it difficult to adjust for changes in asset composition. As a result, in the absence of static pool data, DBRS requests supplemental data to refine its loss projection. Where the performance history for the originator’s assets is insufficient, DBRS may consider proxy data such as the performance of similarly originated assets. In all cases where originator-specific static pool data is unavailable, DBRS is likely to reach a higher base-case loss projection than would otherwise be the case.

The static pool data should be presented such that loans are considered defaulted in a manner that is consistent with the definition of a defaulted loan in the transaction documentation to ensure that cash flow stresses are constructed in a manner that properly addresses the collateral’s loss profile. DBRS reviews static pool loss data for timeshare loan ABS transactions on a gross basis, without giving effect to any recoveries. In the event that the timeshare company can demonstrate compelling historical data quantifying and supporting consistent recoveries on liquidated inventory, DBRS may consider incorporating partial credit for recoveries.

PROJECTING EXPECTED LOSSES
DBRS assesses the data provided by the issuer based on the collateral statistics for the historical static pools versus the collateral pool to be financed in the transaction, assessing the degree to which the historical data is a relevant performance indicator for the transaction pool. If the collateral parameters are considered to be a good proxy, representing the potential performance of the transaction pool, DBRS uses the information to build a base-case loss curve.

In the case where the timeshare company’s data is sufficient to represent a complete lifetime loss curve, DBRS constructs a loss amortization vector (timing curve). To accomplish this, DBRS calculates the average incremental increase in losses on a month-over-month basis for all provided vintages. The average increase in losses on a month-over-month basis is then used to calculate the monthly cumulative loss rate. The percentage rate of change is calculated for each month, collectively resulting in the loss amortization vector. This loss amortization vector is used to project the expected lifetime loss for any pool which has not experienced 100% of its losses.

In the event that the provided static pool information does not contain a curve or curves that have fully experienced 100% of losses, DBRS may use an industry comparable or an average of industry-wide data or other forecasting methods, as applicable.

ADJUSTMENTS TO THE EXPECTED LOSS
In the determination of the expected loss, DBRS assesses the presence of other qualitative factors and may adjust the initial expected loss upward or downward based on DBRS assessment.
Adjustments to the expected loss may occur based on overall variability and trends of the provided performance data. If DBRS believes that historical performance information is not consistent over time, the pool may be subject to a higher expected loss. Performance trends are also considered in the determination of an expected loss figure. DBRS reviews origination characteristics to assess movements in key performance drivers. As a result of this analysis, DBRS may adjust the expected loss for a pool up or down, depending upon the directional trend of the performance indicators.

An adjustment to the expected loss may also occur as a result of changes in underwriting criteria and servicing practices utilized by the originator (e.g., static pool data for the most recent four and not five years may be used to better incorporate changes made four years ago to the underwriting practices that have materially affected performance). To the extent that DBRS determines that changes have occurred to the standards used in loan origination or in collection practices which may affect future performance, an adjustment to the expected loss may be made.

DBRS analyzes the loans in the transaction for geographic concentrations of obligors. DBRS believes that pools with concentrations in certain geographic areas within the United States and concentrations of foreign obligors may be subject to increased default risk. Pools that contain concentrations in any geographic area may be subject to future localized economic stress. Pools with concentrations of foreign obligors may be subject to additional risk such as future devaluation of obligor currencies relative to the dollar or a localized economic or geopolitical stress, which could lead to additional risk of default; therefore, pools with higher-than-average geographic concentrations typically have a higher expected loss.

SEASONING ADJUSTMENT
In the determination of an expected loss, DBRS may make an adjustment for seasoning. Since the loss amortization vector assumes losses occurring month over month for loans originated within a similar period and the collateral pool contains loans originated over different periods, some of which have already experienced losses, an adjustment is made to compensate for those losses already incurred by the pool.

To calculate the seasoning adjusted expected loss number, the expected loss is first converted into an expected dollar amount of loss. This is accomplished by multiplying the original pool balance by the expected loss figure. The realized dollar amount of losses to date is then subtracted from the expected dollar loss amount to determine the expected remaining dollar loss amount. In the event that realized loss information is not available, DBRS determines the amount using loss amortization vectors. The expected remaining dollar loss amount is divided by the remaining pool balance to arrive at the seasoning-adjusted expected loss.

To the extent possible, DBRS applies the seasoning adjustment based on collateral characteristics and corresponding performance information, applying the seasoning adjustment by collateral cohort.

A seasoning adjustment may be applied on collateral that is at least eight months seasoned. For pools with at least eight months of seasoning, the seasoning adjustment typically reduces the expected loss figure.

ABS Financial Structure

Typical timeshare ABS transactions utilize a financial structure whereby bondholders receive protection against pool losses from available credit enhancement and the transaction’s structural features.

TYPES OF CREDIT ENHANCEMENT
Accordingly, the rating analysis focuses on the analysis of proposed credit enhancement supporting the debt obligations issued in connection with the transaction. Credit support may be soft, which includes
enhancements that support the transaction’s obligations, if and when they are available, or hard, which are enhancements directly available to support the transaction obligations. Typical forms of credit support in a timeshare loan ABS transaction include excess spread, amounts on deposit in reserve accounts, over-collateralization (OC) and bond subordination.

**Excess spread**
Excess spread is a soft form of credit support that is created within the transaction. Excess spread is interest generated by the assets which exceeds the cost of funding on the securities offered. The difference, net of transaction expenses such as servicing, trustee and professional fees, is commonly referred to as excess spread and is available on a monthly basis to absorb losses. Any changes in cash flows because of losses are first covered by excess spread. After all obligations prescribed by the transaction structure are satisfied, remaining excess collections can be released. Consequently, monthly excess spread is only available to cover losses incurred during that period.

Since excess spread is based on anticipated but uncertain collateral collections, it is subject to variability based on the performance of the collateral relating to the underlying obligors failure to pay in a timely fashion. Consequently, DBRS takes a conservative approach in assessing the value of excess spread for rated transactions.

**Cash Reserve Accounts**
A cash reserve account is a form of hard credit support that is available to pay interest, and sometimes principal, on the transaction obligations. Reserve accounts are included in most timeshare loan transactions, are typically sized as a percentage of the collateral or debt outstanding and are funded either at the outset of a transaction or over time through the transaction cash flows. Reserved amounts provide additional liquidity to the transaction and may be included to allow the transaction to successfully perform under stressed scenarios or to address transaction specific risks or current market conditions. As principal amortizes and seasoning increases, reserve account balances may be permitted to decline over time.

**Overcollateralization**
OC is another form of hard credit support which acts as loss protection, absorbing losses before any shortfalls are allocated to transaction investors. OC is achieved by the issuance of obligations in a lesser amount than the value of the collateral securing those obligations. Proposed levels of OC are evaluated by DBRS after its review of the key parties to the transaction and application of its rating criteria to the proposed collateral pool.

**Subordination**
Subordination is also a form of hard credit support that creates a cushion for losses from the related collateral. Subordination is created by a more junior class of notes which is subordinate in the right to receive amounts available for payments. These junior classes are available to absorb losses and therefore act as additional support for the more senior classes. DBRS analyzes any mechanisms within a transaction that modify the availability of these junior classes to act as credit support for the more senior classes.

**PRIORITY OF PAYMENTS**
On a regular basis, collections on the assets are aggregated and then distributed to noteholders based on the priority of payments established in the transaction documents. Collections on the loans may be aggregated in a manner such that principal and interest collections are combined to create a pool of total available funds that are then subjected to a payment waterfall. Alternatively, principal and interest collections may be accounted for separately and then subjected to the payment waterfall.

Once the amount of collections on the loans is determined, the collections pass through a payment waterfall that allocates collections in descending order of priority. Recurring transaction expense items like servicing, trustee or transaction management fees are commonly senior in the waterfall, after which noteholders receive interest and principal. The allocation of interest to noteholders is sequential. To avoid
implications related to taxable mortgage pool rules, principal payments amongst noteholders is typically allocated on a pro rata basis.

A pro rata pay structure provides for all principal amortization and prepayments to be allocated to the noteholders whereby principal is allocated to maintain constant credit enhancement levels. Under such a payment mechanism, subordinate tranches can receive principal payments while senior notes are still outstanding.

An example of a typical payment priority under a pro-rata pay structure is provided below:
1. Servicing fees and any transition fees to any successor servicer (if applicable);
2. Trustee and other fees;
3. Net swap payment (if applicable);
4. Interest in order of seniority;
5. Principal paid pro-rata;
6. Amount, if any, to be deposited into the reserve account;
7. Any remaining amounts to the seller.

Pro rata structures typically contain performance triggers such that, should transaction performance deteriorate, subordinated tranches can be locked out and payments redirected to senior tranches. Losses in excess of credit enhancement provided by the reserve account and OC are absorbed by the lowest-rated class of notes. Once the lowest-rated tranche is written down, the losses are then absorbed by the next highest-rated class of notes in the structure.

**RATING THRESHOLDS OR TRIGGERS**

Timeshare ABS transactions may utilize rating threshold or trigger mechanisms whereby adverse performance of the underlying collateral results in a change to the initial cash flow structure. Triggers typically measure collateral performance and are designed as an early warning mechanism which may adjust the initial cash flow structure to protect against an erosion of credit support. To the extent that a trigger is breached, the reserve account required amount may be increased and excess spread may be directed to the reserve account. In addition, trigger events may cause available cash flow to be directed to pay down the most senior bonds outstanding more quickly. This mechanism will ensure that the more subordinate bonds remain outstanding longer, therefore continuing to act as credit support to the senior bonds.
Cash Flow Analysis

DBRS uses a proprietary cash flow model to test the ability of a transaction to pay timely interest and principal by the legal final maturity date in accordance with a transaction’s legal documents. The cash flow analysis assesses the form and sufficiency of proposed credit enhancement for each class of bonds and a transaction’s priority of payments as well as incorporates asset level assumptions. Cash flow analysis is completed for each target rating. The bases of the cash flows include the following:

**STRESS-CASE CUMULATIVE NET LOSSES**

To evaluate proposed credit enhancement levels that support a target rating, the adjusted expected loss figure, as previously described, is stressed. The stress is applied as a multiple of the specified loss figure, which in turn, results in losses for each target rating’s cash flow scenario.

The multiples serve to protect the rated securities from much harsher and more stressful conditions than assumed within the base-case cash flow scenario. The multiples below are representative of those that DBRS uses to assign ratings to timeshare loan ABS transactions and are designed to capture uncertainties and variables that may affect future transaction performance. The stress multiples are designed to ensure that the expected loss rate of the rated instrument, as assessed by DBRS, is commensurate with the DBRS Idealized Default Table (IDT)\(^2\). The DBRS IDT establishes benchmark levels of expected loss for each rating level. The following table represents the range of multiples utilized in the rating of a timeshare ABS transaction:

<table>
<thead>
<tr>
<th>Rating</th>
<th>Multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>3.00–4.50x</td>
</tr>
<tr>
<td>AA</td>
<td>2.50–3.75x</td>
</tr>
<tr>
<td>A</td>
<td>2.00–3.00x</td>
</tr>
<tr>
<td>BBB</td>
<td>1.50–2.25x</td>
</tr>
<tr>
<td>BB</td>
<td>1.25–1.50x</td>
</tr>
<tr>
<td>B</td>
<td>1.00–1.25x</td>
</tr>
</tbody>
</table>

DBRS considers various factors when selecting the stress multiples for each target rating including factors that are relevant to all securitization structures, factors specific to the timeshare industry and to each proposed timeshare ABS transaction. The following section describes the qualitative and quantitative factors that DBRS considers in the selection of the multiple from the prescribed ranges. The relative contribution of the factors may vary by transaction. For each transaction, each factor in isolation results in the multiple being at the lower or higher end or around the midpoint of the range; however, it is the combination of these factors that results in the multiple used for each target rating. As delineated in the table above, successively higher multiples are assumed for each successively higher target rating.

The factors include, but are not limited to, the following:
- Absolute level of a proposed pool’s base-case loss figure;
- Industry position of the sponsor;
- Desirability, quality and flexibility of the timeshare system;
- Operational risk assessment of the originator and/or servicer;
- Data volatility;
- Resort concentrations; and
- Macroeconomic conditions.

A description of these factors and the directional impact on the determination of the multiples within the prescribed ranges, when considering each factor in isolation, are discussed in the following sections.

\(^2\) Refer to Appendix II for DBRS Idealized Default Table.
Absolute Level of Base-Case Losses

DBRS has observed that higher loss pools generally exhibit greater volatility in terms of the absolute level of losses. As the expected loss assumption increases, the amount of available credit enhancement to achieve a target rating increases. In this case, a higher loss pool relative to the industry average results in the isolated multiple at the lower end of the prescribed ranges; however, when credit enhancement is expressed as a multiple of the base case, the multiple tends to decrease as the base-case loss increases. An example of the possible distribution of multiple related solely on the magnitude of the base-case loss expectation is demonstrated in the following table:

<table>
<thead>
<tr>
<th>Requested Rating</th>
<th>Base Case Loss</th>
<th>Possible Multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>5%</td>
<td>3.00x</td>
</tr>
<tr>
<td>A</td>
<td>15%</td>
<td>2.50x</td>
</tr>
<tr>
<td>A</td>
<td>25%</td>
<td>2.00x</td>
</tr>
</tbody>
</table>

Industry Position of Sponsor

The timeshare loan originator’s industry position is a factor which DBRS considers in the determination of the multiples. DBRS assesses the timeshare company’s relative size, financial strength, connection to or relationship with a hospitality company and the timeshare company’s perceived reputation within the industry. Timeshare companies which demonstrate overall strength in these categories typically results in multiples at the lower end of the prescribed ranges. An operator which is deemed to be less well positioned, on a relative basis, results in multiples at the higher end of the prescribed ranges.

Timeshare System

DBRS considers the desirability, quality and flexibility of the timeshare system in the selection of the multiples for a transaction. For transactions with timeshare operators who offer, from the DBRS perspective, a superior product relative to other industry participants, multiples at the lower end of the prescribed ranges are used. Conversely, a timeshare operator that provides an inferior product relative to its peers is assigned multiples at the higher end of the ranges. Directional trends in the desirability, quality and flexibility of the timeshare system are considered when determining the multiples. If a timeshare operator has made improvements to the overall timeshare system, including items such as the addition of resort properties, improved resort amenities and increased flexibility of owner usage, DBRS may select multiples at the lower end of the prescribed ranges.

Operational Risk Assessment

DBRS conducts an operational risk review of the key transaction parties including the originator and servicer as part of the rating analysis. With regard to this factor, the multiple(s) considers the potential for future operational risk. For timeshare companies with origination policies and procedures, which DBRS deems to be less robust compared with other industry participants, the multiple may be on the higher end of the prescribed ranges. This consideration may be mitigated in cases when the expected loss figure has been sufficiently adjusted for the inferior quality of origination standards. Conversely, a lower multiple may be used for originators that demonstrate standards that exceed those deemed by DBRS to be typical for operators in a similar sector.

For timeshare companies with servicing standards that DBRS determines to be inferior to other industry participants, loss multiples typically are selected at the higher end of the prescribed ranges. This factor may be considered as part of the adjustment to the expected loss or, in the case where sufficient structural features are in place, such as a backup servicer, there may be less impact on the multiples. Conversely, loss multiples at the lower end of the prescribed range may be used for servicers that demonstrate the utilization of standards that are deemed to be typical for, or better than, operators in a similar sector.
Data Volatility
DBRS considers the consistency of the performance across vintages in its assessment of the expected loss figure for the proposed collateral pool. In cases when an issuer’s performance exhibits inconsistent trends, which may be attributable to a variety of factors, such as a change in owner profile or underwriting criteria, DBRS may apply multiples at the higher end of the prescribed ranges. For issuers that demonstrate consistency in originations and performance trends, multiples at the lower end of the prescribed ranges may be used.

Resort Concentrations
DBRS assesses the presence of concentrations of loans related to a resort or resorts in the same geographic region. If concentrations of a resort or resorts are considered to be an additional risk to the transaction, multiples at the higher end of the prescribed ranges within each rating category may be selected. Conversely, transactions with a limited concentration of loans related to a resort or resorts in the same geographic region may be assigned multiples at the lower end of the prescribed ranges.

Macroeconomic Conditions
In determining the multiples, DBRS considers potential variability in future macroeconomic conditions. Macroeconomic conditions are considered with respect to the timeframe during which the issuer’s historical performance statistics cover and the degree of relevance of the historical performance data in the derivation of the expected loss figure. DBRS also considers macroeconomic conditions in terms of the presence of a benign or recessionary environment over the period of the issuer’s historical performance data in the derivation of the expected loss figure.

OTHER CASH FLOW ASSUMPTIONS

Loss Timing
Loss timing is an important component of the cash flow analysis as it affects the availability of excess spread to cover losses and other potential liquidity stresses. DBRS analyzes an issuer’s historical performance data to develop a customized loss timing curve that reflects when losses are expected to be experienced during the life of the transaction.

After the shape of the curve is determined, DBRS develops and applies front-ended and back-ended loss timing curves. The curves are developed to evaluate scenarios whereby losses materialize sooner or later than expected, as might be the case if the economy entered a recession shortly after a transaction closed or toward the tail end of the transaction’s life.

Interest Rate and Basis Risk
DBRS assesses the transaction to determine if there is an interest rate mismatch between the collateral and the bonds. If so, DBRS applies a stress to the forward interest rates consistent with the target rating. DBRS also applies interest rate stresses via its Unified Interest Rate Model (UIRM). For a complete description of the DBRS UIRM, see Unified Interest Rate Model for U.S. Timeshare ABS Transactions.

Prepayments
Prepayments add to cash flow uncertainty in a timeshare ABS transaction and can have a negative impact on excess spread. A high level of prepayments can shorten the average life of a transaction and reduce the amount of cushion available to absorb losses. DBRS uses an issuer-specific prepayment curve based on the historical performance of collateral originated by the issuer to determine prepayment stresses.
OTHER STRUCTURAL CONSIDERATIONS

Green Loans
Timeshare companies may sell and finance timeshare units prior to the completion of a resort or a phase of a resort. Considering this, DBRS assesses the amount of Green Loans that are contained in each transaction. DBRS reviews Green Loan concentrations relative to structural mechanics included in the transaction, such as cash reserves, which may negate the risk of increased loss rates that could result from a delay or a failure to complete construction.

Substitutions and/or Repurchase of Defaulted Loans
Another common transaction mechanism in timeshare ABS transactions is the ability of the timeshare company to substitute and/or repurchase defaulted loans. DBRS reviews the underlying transaction provisions to assess if there is a limit to the amount of substitutions and/or repurchases permitted under the transactions documents. DBRS typically does not reduce its loss expectation based on a timeshare company’s right to substitute and/or repurchase defaulted loans.

Upgrades
A common practice for timeshare companies is to upgrade existing customers to bigger units, longer intervals or more points within the system in which they are already owners. In most cases, loans for the purchase of the original timeshare ownership interest are prepaid in full, with a new loan issued to cover the cost of the original amount outstanding and incremental cost of the additional ownership interest. As a result, DBRS reviews the timeshare company’s upgrade policy and the manner in which it documents the changes and historical data to ascertain the impact of the rate of upgrades on the cash flows and the rated bonds.
### Appendix I - DBRS Idealized Default Table

<table>
<thead>
<tr>
<th>Rating</th>
<th>Maturity (Years)</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td></td>
<td>0.0110%</td>
<td>0.0264%</td>
<td>0.0460%</td>
<td>0.0699%</td>
<td>0.0987%</td>
<td>0.1330%</td>
<td>0.1736%</td>
<td>0.2212%</td>
<td>0.2756%</td>
<td>0.3405%</td>
</tr>
<tr>
<td>AA (high)</td>
<td></td>
<td>0.0161%</td>
<td>0.0390%</td>
<td>0.0691%</td>
<td>0.1071%</td>
<td>0.1539%</td>
<td>0.2107%</td>
<td>0.2784%</td>
<td>0.3580%</td>
<td>0.4501%</td>
<td>0.5554%</td>
</tr>
<tr>
<td>AA</td>
<td></td>
<td>0.0212%</td>
<td>0.0517%</td>
<td>0.0922%</td>
<td>0.1442%</td>
<td>0.2091%</td>
<td>0.2883%</td>
<td>0.3832%</td>
<td>0.4948%</td>
<td>0.6237%</td>
<td>0.7703%</td>
</tr>
<tr>
<td>AA (low)</td>
<td></td>
<td>0.0281%</td>
<td>0.0709%</td>
<td>0.1297%</td>
<td>0.2055%</td>
<td>0.2994%</td>
<td>0.4123%</td>
<td>0.5445%</td>
<td>0.6962%</td>
<td>0.8672%</td>
<td>1.0571%</td>
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<td>0.4801%</td>
<td>0.6602%</td>
<td>0.8671%</td>
<td>1.0991%</td>
<td>1.3543%</td>
<td>1.6306%</td>
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<td>0.0487%</td>
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<td>0.3893%</td>
<td>0.5704%</td>
<td>0.7841%</td>
<td>1.0283%</td>
<td>1.3005%</td>
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<td>1.9173%</td>
</tr>
<tr>
<td>A (low)</td>
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<td>0.0945%</td>
<td>0.2420%</td>
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<td>0.6815%</td>
<td>0.9643%</td>
<td>1.2825%</td>
<td>1.6309%</td>
<td>2.0045%</td>
<td>2.3990%</td>
<td>2.8101%</td>
</tr>
<tr>
<td>BBB (high)</td>
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<td>0.1860%</td>
<td>0.4685%</td>
<td>0.8333%</td>
<td>1.2659%</td>
<td>1.7521%</td>
<td>2.2792%</td>
<td>2.8359%</td>
<td>3.4126%</td>
<td>4.0013%</td>
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<tr>
<td>BBB</td>
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<td>0.5818%</td>
<td>1.0305%</td>
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<td>2.7776%</td>
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<td>4.8024%</td>
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</tr>
<tr>
<td>BBB (low)</td>
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<td>3.7230%</td>
<td>4.5053%</td>
<td>5.2884%</td>
<td>6.0636%</td>
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<tr>
<td>BB (high)</td>
<td></td>
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<td>2.4384%</td>
<td>3.9327%</td>
<td>5.4686%</td>
<td>6.9863%</td>
<td>8.4500%</td>
<td>9.8400%</td>
<td>11.1473%</td>
<td>12.3697%</td>
<td>13.5091%</td>
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<tr>
<td>BB</td>
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<td>1.3627%</td>
<td>3.0573%</td>
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<td>8.5997%</td>
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</tr>
<tr>
<td>BB (low)</td>
<td></td>
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<td>4.7297%</td>
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<tr>
<td>B (high)</td>
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</tr>
<tr>
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<td>9.7471%</td>
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<td>25.1805%</td>
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</tr>
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<td>34.9314%</td>
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</tr>
<tr>
<td>CCC (high)</td>
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<td>18.7898%</td>
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<td>38.8426%</td>
<td>44.3357%</td>
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<td>51.1831%</td>
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<td>100.0000%</td>
<td>100.0000%</td>
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<td>100.0000%</td>
<td>100.0000%</td>
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</tbody>
</table>