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.

In the reply above, you said that, "Over the last 4 years, new loan originations included 20% to 40% of transactions associated with an upgrade." If 20% to 40% of new loan originations are associated with an upgrade, it would appear that a significantly larger proportion or percentage of those loan originations are used to pay off loans from prior purchases when the customer upgrades. Is that correct? If so, can you quantify that amount. In other words, if DRII made $1,000,000 of loan originations, how much of that amount was used to pay-off loans from prior purchases?

I also base my question in part on the following DRII response:

"A customer who has a loan with us may also choose to purchase additional points to expand their ownership. In order to finance the new purchase, the customer must be current on their existing obligations and the new loan will go through underwriting the same as a customer who has no previous lending relationship with us. In the event of such a transaction, the balance of the existing loan is combined with the additional purchase to determine the financed amount. As an example: (i) a customer made a purchase in 2012 for $20,000 and the balance outstanding on the loan at the current time is $10,000; (ii) in 2016 the customer makes a decision to purchase additional points which cost $5,000 that she wants to finance; (iii) the total amount of the new loan, prior to the down-payment is $15,000, the sum of the old loan and the new purchase; (iv) the customer must make a cash down payment of a minimum of $1,500 (10% of the combined total) and a new loan is written for $13,500 ($15,000 combined total, less the cash down-payment). The customer may of course choose to make a down-payment in excess of the 10% minimum which often occurs."

Response:

As indicated above, approximately 20% to 40% of quarterly loan originations (sales that have a loan attached - excludes cash sales) are associated with an upgrade. The outstanding balance of the original loan at the time of the upgrade can vary significantly. For example, a customer loan outstanding at the time of an upgrade could be $10 or $50,000. The average outstanding loan balance that is refinanced into a new loan associated with an upgrade is not a statistic that we routinely track, nor is it a statistic that is disclosed by us, or any of the large industry participants. Please note:

1. Approximately 92% of Diamond's members do not have a loan with us. An add-on transaction with a customer who does not have a loan may be financed, subject to our underwriting criteria and approval, or paid in cash.

2. If a customer has an existing loan with Diamond and makes an additional purchase, as previously noted, a new loan is entered into with the customer. In that regard:

    a. The customer's existing loan must be current at the time the additional purchase is made. Further, an additional down payment is required in cash consistent with the example noted above. You should note that the amount of the cash down-payment is higher on an upgrade transaction than a new loan transaction. Using the example above, the minimum cash down payment requirement on the upgrade transaction is $1,500. A purchase transaction of $5,000 (the incremental purchase amount in this example) would require a minimum down-payment of $500 (10% of the purchase price).

    b. Diamond does not modify loans that are delinquent or in default by upgrading the customer with a new loan. An upgrade of a delinquent or defaulted loan would have the impact of changing the delinquency status of the loan. Our warehouse and term securitization facilities do not allow us to upgrade loans. Further, it is a poor business practice that we have never followed.

c. There are two primary reasons why a new loan agreement is entered into when a customer with an existing loan makes an additional purchase that we finance:

   i. First, the transaction is structured this way for the convenience of the customer. The customer could simply make an additional purchase, request financing for which he or she is approved, and enter into a new loan agreement. The customer would then have two loans, with potentially two different monthly due dates, and two monthly payments, etc. Combining the two purchases into one agreement consolidates the loan terms such that the interest rate, due dates, and maturity dates are consistent. It is probable that the monthly payment requirement under the new consolidated loan will be less than the sum of two monthly payments for the original loan and a second loan as the terms of the new loan is 10 years to maturity. Of course, the customer always has the opportunity to pre-pay the loan at any time in whole, or in part, with no prepayment penalty.

   ii. Second, it is probable that the loan has been placed into one of our warehouse or receivable securitization facilities. Those facilities are non-recourse loan sales for which a "true sale" opinion is rendered by external counsel. Accordingly, when a new loan is entered into as part of an upgrade transaction where a loan is in a term facility, it is required that Diamond pay off the underlying loan in cash. Diamond cannot change the terms of the loan once it has been placed into a facility. Again, you should note that the cash used to pay off the loan belongs to Diamond. In effect, Diamond has exchanged one asset (cash to pay off the old loan) for another asset (a new loan from the customer).

d. The impact of upgrading a customer loan has no effect on our statement of operations, loans receivable as reflected on our balance sheet, or portfolio aging statistics. Again, using the example from above:

   i. We only record the incremental sale in our financial statements which is $5,000 in this example. In accounting terms, this transaction would consist of a debit to cash of $1,500 reflecting the down payment, a debit to loans receivable of $3,500 and a credit to sales of $5,000.

   ii. The total amount of loans receivable on our balance sheet is exactly the same whether the two transactions are combined into one consolidated loan, or the customer has two loans – the original loan and a second loan. In this example, the balance sheet reflects a loan receivable from the customer for $13,500. This is the sum of the balance owing on the original transaction plus the additional transaction after the down-payment.

   iii. At the detailed loan level the old loan would no longer have any amounts due and payable. The new loan will be measured, including delinquency stats, solely on performance of the new loan.

e. The upgrade transaction does impact our cash flow and certain portfolio statistics – primarily the weighted average term to maturity.

   i. As previously indicated, if a loan has been placed into a securitized facility, when the upgrade occurs Diamond pays off the underlying loan at the face value of the note (even though the advance rate is 96%). Again, using the above example, the loan principal balance of $10,000 would paid in full in connection with the upgrade. The source of funds for the payoff is from Diamond's cash. The cash pay off of the loan will be distributed to the note holders pursuant to the waterfall provisions of the agreements. From an accounting perspective, we would debit the obligation under the securitized transaction (a reduction in the obligation) and we would credit cash.

ii. It is probable that the new loan of $13,500 (reflecting the combined balance of the old and new transaction) would be placed into a new securitization. Our most recent securitizations have a 96% advance rate. Assuming the same 96% advance rate in this example, we would receive $12,960 on the new loan.

iii. The portfolio aging and other default measures are not at all impacted by the upgrade transaction. The weighted average life to maturity of the portfolio will increase as the new loan for $13,500 has a 10 year maturity, which is greater than the remaining term of the original loan.

The loan receivable balance is *exactly* the same whether a new loan is entered into (and the customer has two loans) or a new, consolidated loan is entered into illustrated as follows:

Transaction assuming an upgrade transaction with a new loan, with payoff of old loan

	Cash		Loans Receivable		Securitization Obligations		Sales		Retained Earnings	
	Debits	Credits	Debits	Credits	Debits	Credits	Debits	Credits	Debits	Credits
Beginning Balance (A)			10,000			9,600				400
Record Upgrade sale of $5,000 (B), including payoff of old loan	1,500	10,000	13,500	10,000	10,000			5,000		
Place new loan in securitization (C)	12,960					12,960				
Net Balance	4,460		13,500			12,560		5,000		400

(A) Assumes an existing loan receivable of $10,000 which has previousy been placed into a securitization with a 96% advance rate
(B) Customer purchases additional points for $5,000 with a $1,500 down payment. New loan orginated for $13,500 and old loan in securitization paid off ($10,000)
(C) Assumes new loan put into a securitization with a 96% advance rate

Transaction assuming old loan remains in place, and new loan entered into with same cash down-payment

	Cash		Loans Receivable		Securitization Obligations		Sales		Retained Earnings	
	Debits	Credits	Debits	Credits	Debits	Credits	Debits	Credits	Debits	Credits
Beginning Balance (A)			10,000			9,600				400
New Sale for $5,000 (B)	1,500		3,500					5,000		
Pay off old loan		-			-					
Place new loan in Securitization (C)	3,360					3,360				
Net Balance	4,860		13,500			12,960		5,000		400

(A) Assumes an existing loan receivable of $10,000 which has previousy been placed into a securitization with a 96% advance rate
(B) Customer purchases additional points for $5,000 with a $1,500 down payment. New loan orginated for $3,500
(C) Assumes new loan put into a securitization with a 96% advance rate

You will note that the only difference in the two transactions is that when we do a loan upgrade, Diamond actually pays a larger amount of cash to pay down the outstanding securitization facility (a $400 difference in this example) as the old loan must be paid off in full.

Further, as previously indicated, the customer actually puts more money down in a consolidated loan than she would in two individual transactions (for simplicity's sake, the down payment above is assumed to be the same).

Because we do not modify loans or upgrade loans that are past due or delinquent, our portfolio statistics represent actual performance and delinquency status. Further, we only write loans associated with a customer purchase transaction. Diamond has the highest rated, and best performing securitizations in the timeshare industry. This is confirmed by our investment grade ratings (which we have achieved for many years) and is further evidenced by our 96% advance rate on recent securitizations which again, is the highest in the industry.

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10. Based on many Diamond loan (TiL) documents I've reviewed it appears that the first payment is not usually due for six weeks--and in some cases three or four months--after the loan's closing. Is the six week to first payment Diamond policy? If so, then it would appear Diamond's reported 31-60 day delinquency rates are inaccurate.

I do not know what specific documents you are reviewing, but your evaluation of those terms is incorrect. Sales transactions, whether financed or not, are subject to statutory rescission periods which generally range from 5 to 10 days from the date of purchase. Once a transaction has passed the rescission period, the purchase transaction is closed. In the event that a purchase transaction is financed through DRII, the loan is integral to the transaction and closes simultaneously with the purchase.

The Truth-In-Lending documents provided to the customer at the time of sale indicate that the estimated first payment date is generally 45 days from the date the purchase agreement is entered into. This accounts for an assumed 15 days to close (which includes the time required for the statutory rescission period) and 30 days after close of the transaction for the first loan payment due. Further, the promissory note signed by the customer indicates that the first payment is due in 30 days. All loans require the first payment within 30 days from closing. Accordingly, all aging data provided is completely correct without exception.

If the first payment date is generally due "45 days from the date the purchase agreement is entered into" is it also accurate that any loan originated 44 days (or less) before the balance sheet date cannot be 1 day past due?

Likewise, it would appear that any loans issued during a given quarter cannot be more than 60 days past due. For example, if a loan is issued on the first day of the quarter and the first payment is generally due in 45 days, only 45 days remain in that quarter. Therefore, that loan cannot be more than 60 days past due. Am I correct?

Response:

As previously indicated, the Truth-In-Lending document provides an *estimate* of the number of days from the date when the customer enters into a purchase agreement and applies for a loan until the first loan payment is due. This is an *estimate* as the exact closing date of the loan is not established at the time of purchase and the loan application. The 45 day period is used in the Truth-In-Lending documents based on: (i) an assumed 15 days for the transaction to *close* (which includes the statutory rescission date which varies by State), PLUS (ii) 30 days from the estimated closing date to first payment due date.

The actual due date of the first payment on the loan is 30 days from the date the loan CLOSES not from the date of the purchase transaction and the submission of a loan application. The loan origination date is the *closing date*, again, not the loan application date. The loan application is completed by the customer at the time of the purchase, but no credit has been extended to the customer until a loan actually closes (not different than any bank loan). We close loans multiple times during each week. When a loan is closed, the first payment due date is established (30 days) and that is the date upon which we measure the aging of a loan (current, 31-60, etc.) going forward. The loan closing date rarely coincides with a quarter end balance sheet date. The aging of each individual loan is determined based on the current status of each loan as of the balance sheet measurement date. Accordingly, a loan that is listed as current reflects all loans as of the specific *balance sheet date* where there is currently no payment due and the next payment is due between 1 and 30 days from the balance sheet date. For example, as of December 31, 2015 all loans reflected in the "current" category have no payment currently due. These customers will make their next payment within 1 to 30 days of the balance sheet date depending upon the exact payment date of each individual loan.

Accordingly, it is NOT accurate to say *"If the first payment date is generally due "45 days from the date the purchase agreement is entered into" is it also accurate that any loan originated 44 days (or less) before the balance sheet date cannot be 1 day past due?* The aging of our portfolio as included in the notes to the financial statements is as of the balance sheet measurement date. The aging is reflective as of the data at a specific point in time (i.e., as of quarter or year-end). It is based on the date the loan was entered into, the payment due date, whether the customer has made the required payment when due, and is measured from the date the loan closes (i.e., origination date) not the date the application date.

The same measurement date also applies to loans that are included in the aging bucket of 1 – 30. This means that the customer is from 1 to 30 days past due. Loans in this bucket have one payment that is currently due, but which has not yet been made. The number of days that the loan can be past the due date is from 1 to 30 days. For example, if a customer had a loan that a payment was due on 12/15/2015 but the payment from the customer had not been received as of 12/31/15 (the balance sheet measurement date), the loan would be included in the bucket of loans that are from 1 to 30 days past due as the customer's payment is 16 days late (due on 12/31/15, but not paid as of 12/31/15). The same logic applies to all the remaining baskets such as from 31 to 60 days past due.

Accordingly your comment: *"Likewise, it would appear that any loans issued during a given quarter cannot be more than 60 days past due. For example, if a loan is issued on the first day of the quarter and the first payment is generally due in 45 days, only 45 days remain in that quarter. Therefore, that loan cannot be more than 60 days past due. Am I correct?"* is NOT correct. For example, assume that a loan closed on October 1st, the first day of the 4th quarter, and the first payment was due on November 1st (which the customer made) and the second payment was due on December 1st which the customer had not made as of the balance sheet measurement date of 12/31/15. That loan would be in the 1-30 aging bucket as the customer was 30 days past due as of 12/31/15.

This is consistent with other industry participants and of course with lending practices for any consumer finance entity or bank loan.

In your earnings release DRII discussed a spike in provision for uncollectible sales as emerging from "**a change of certain portfolio statistics during the quarter."**

Which specific portfolio statistics changed and by how much relative to prior periods? Why?

Response:

As indicated in a previous response, we provide for estimated uncollectible loan losses quarterly. We provide for each loan based on the amount of each individual loan, the FICO score of the borrower, and the amount of the down payment. The higher the FICO score, the lower the % of the loan loss provision and thus a reduced reserve against that loan. Accordingly, between quarters and years we may write a loan for exactly the same amount but have a different provision amount. Changes in the FICO band mix of loans is an example of changes in portfolio statistics that impacts the amount of the provision.

The initial basis for determination of the loan loss provision is the static pool analysis which tracks actual losses for loans we originated over a multi-year basis. This analysis looks at how loans originated over a long-term period perform based on the FICO score of the customer. FICO score is a good indicator of projected future uncollectible loans for the timeshare industry; a static pool analysis is required by GAAP in the timeshare industry in evaluating the provision for uncollectible loans and the reserve for uncollectible loans. However, this information is based on actual historical performance and may not yet reflect current trends. Accordingly, we also look at factors such as reported industry data from recognized rating agencies for default and general economic trend data. Further, we look at our own portfolio performance and statistics such as changes in the "roll forward" and "roll back" rates, changes in the aging of the portfolio etc., which may be an indicator of future defaults. We look for trends (both positive and negative) that may be indicative of future performance and evaluate the provision accordingly. These are also examples of changes in portfolio statistics which may drive the change in the provision for uncollectible accounts.