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Timeshare ABS: Exposure to Favorable Hospitality Segments

Stav Gaon
+1 (646) 768-9173
sgaon@academysecurities.com

Headquarters Address:
Academy Securities, Inc.
622 Third Avenue, 12th Fl
New York, NY 10017

Granular Timeshare Collateral Offers an Alternative to Hotel Positions

Timeshare ABS offer investors exposure to hospitality sub-segments we view as favorable – leisure travel, drive-to locations, and resort destinations. This could be an alternative to the mixed hotel collateral investors typically see on CMBS deals. To be sure, hotel performance has noticeably improved since the height of the pandemic. Hotel loans delinquency rate currently stands at 4.44%, compared to 8.17% a year ago, the largest decline across all property types, according to MCIA. But we still see clear pockets of weakness across the sector, especially in business travel-dependent urban hotels in markets such as Chicago or San Francisco. The $328.9 million Palmer House Hilton (JPMCC 2018-PHH, in receivership and foreclosure) and the $273.7 million Club Quarters Hotel Portfolio (BX 2017-CQHP, matured non-performing) are cases in point.[1]

Timeshare ABS collateral may also provide landlords better insulation from inflationary pressures, compared to other hospitality segments. Unit owners are typically responsible for maintenance capital expenditures and operating costs of the property. Interestingly, the owners of the timeshares (aka vacation ownership interest, or VOI) may also benefit from some inflation protection on their ownership. VOIs are essentially pre-paid vacations, shielding owners from potential inflation- or demand-driven sharp increases of vacation prices.

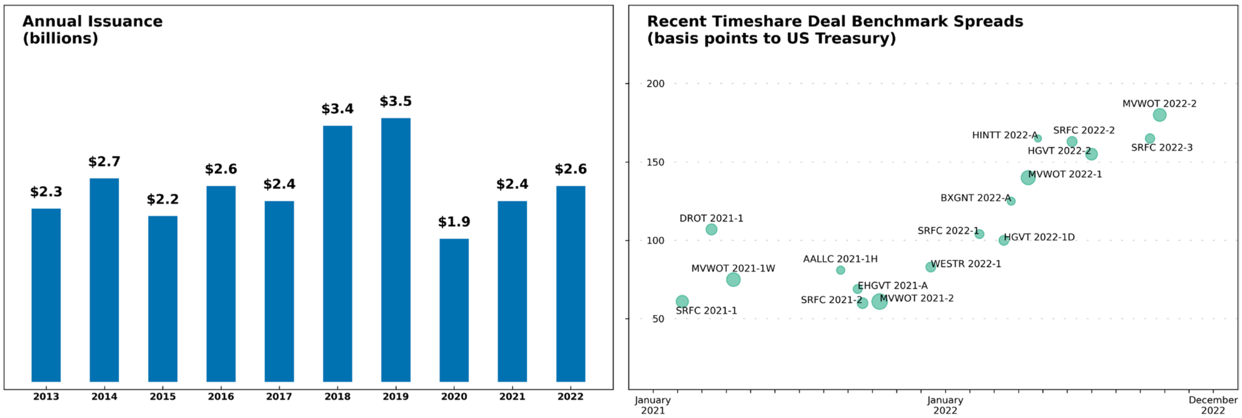
On the flip side, timeshare delinquencies may ramp up in a recessionary environment or a softening job market. In distress, owners may not prioritize timeshare loan payments versus other debt obligations such as mortgage or auto loan payments. Historical delinquency trends suggest a relationship between unemployment levels and timeshare defaults, according to rating agencies.

Timeshare ABS Issuance and Spreads

Timeshare ABS issuance reached $2.6 billion in 2022 (Figure 1). The most recent deal, the $280 million MVWOT 2022-2A priced its benchmark triple-A class at I+180bp. The spread on the subordinated triple-B class was 335bp. The consistent timeshare spread widened over 2022, along with other securitized products, potentially offers a good entry point to the sector.

1 See "Hotel Receiverships: Palmer House Hilton Spotlights Stabilization Efforts," CMBS Credit Focus, Academy Securities, November 17, 2022

Figure 1. Timeshare ABS Issuance and Spreads



Source: Bloomberg and Academy Securities

Unique Timeshare Features Support Collateral Performance

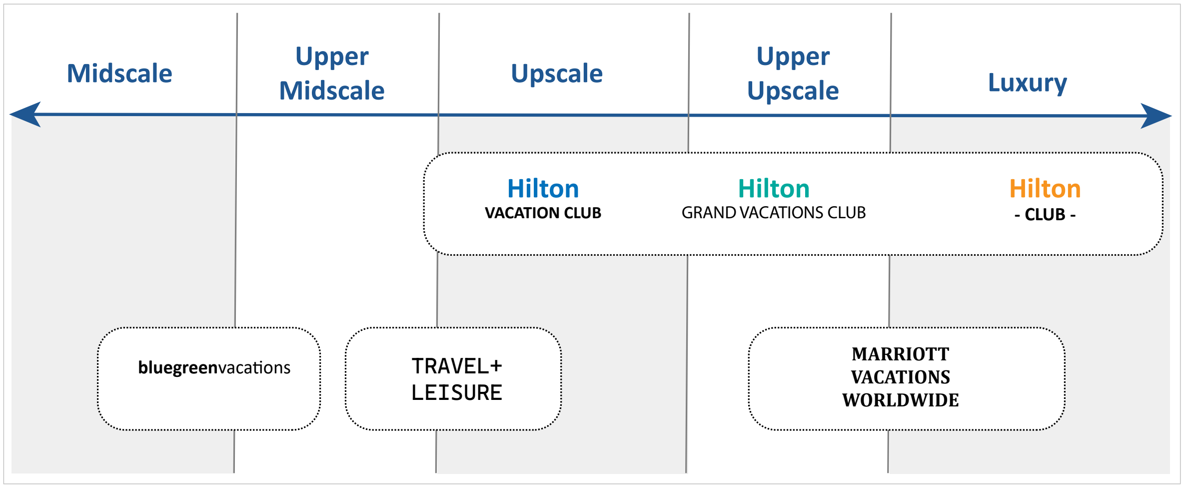
We highlight a few aspects we believe are relevant for timeshare ABS analysis:

- **Points programs may reduce property risk.** Timeshares, or VOI, were historically sold on a fixed-week, fixed-unit basis. Owners purchased the right to access a specific unit in a specified property for a defined time period each year in perpetuity. Over time some VOIs shifted into points programs. Owners purchase points that entitle them to use any of the program's properties at any time during the year, based on tiering, availability, and the number of purchased points. Such programs alleviate property-specific risks, in our view. For example, natural disasters or other geography-concentrated developments that may render particular timeshare properties inoperable for some time could simply shift VOI owners to other properties in the system. Hurricane Ian's impact on timeshare ABS is a case in point. While nearly all timeshare issuers have properties in Florida where Ian made a landfall in September 2022, there appears to have been minimal impact on loan delinquencies, according to rating agencies. More broadly, a points-based system diversifies market exposure – a key aspect especially as the market is seeing growing bifurcation in hospitality performance across geographies.

- **Distinct chain-scale positioning.** Timeshare programs stretch a wide spectrum of the hospitality chain-scale, based on deal documents and developer presentations (Figure 2). Investors can focus on exposure to the luxury or upper upscale segments (for example, Hilton Club and Marriott Vacations), upscale (Hilton Vacation Club or Travel + Leisure), or midscale (Bluegreen Vacations).

Timeshare ABS: Exposure to Favorable Hospitality Segments

Figure 2. Timeshare Programs Across Hospitality Chain-scale



Source: Investor Presentations and Academy Securities

- **Chain-scale segmentation could drive owner characteristics.** Timeshare deals diverge in their pool-level owner characteristics. For example, Hilton 2022-2 features 746 weighted average FICO score, and a range of 600-843 (Figure 3). In contrast, in BXG 2022-A the levels are 724, and 570-844, respectively.

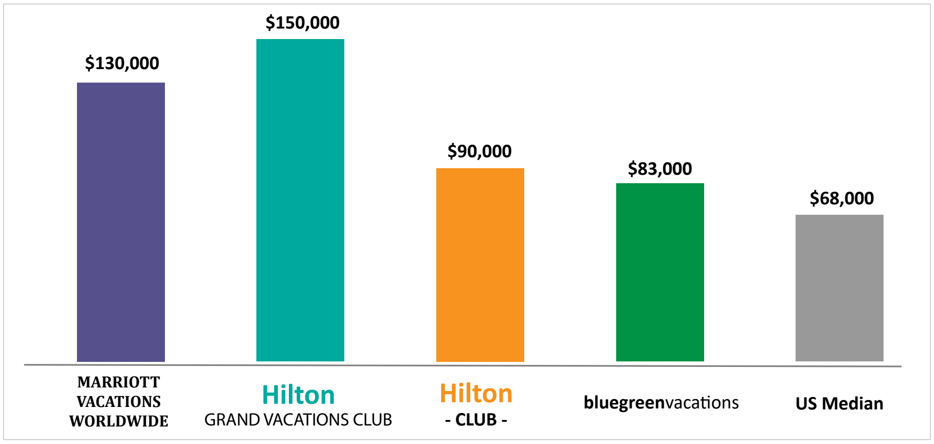
Figure 3. Timeshare ABS Pool Characteristics

Deal	Sierra 2022-3	Hilton 2022-2	Sierra 2022-2	HINTT 2022-A	MVW 2022-1	BXG 2022-A
Issuance Date	10/12/2022	8/1/2022	7/8/2022	5/25/2022	5/12/2022	4/22/2022
Total Balance ($MM)	285.7	279.5	303.9	205.4	286.4	185.0
Timeshare Program	Travel + Leisure	Hilton Grand Vacations	Travel + Leisure	Holiday Inn Club Vacations	Marriott Vacations Worldwide	Bluegreen Vacations
# of Loans	11,867	9,982	12,838	11,701	13,225	13,787
Coupon Rate (Weighted Avg., %)	14.98	13.30	14.82	14.58	13.41	15.48
Original FICO Score (Weighted Average)	731	746	733	729	726	724
Range of FICO Scores	600-850	600-843	600-818	600-850	550-844	570-844
Foreign Obligors (%)	0.02	8.18	0.20	3.08	3.90	0.20

Source: Ratings Agencies and Academy Securities

The distinct chain-scale segmentation we see across timeshare programs can drive some of the differences in pool characteristics. For example, the average customer household income across all of Bluegreen Vacations customers is significantly lower than the levels of the other operators customers (Figure 4). Bluegreen's positioning in the midscale hospitality segment most likely drives the household income difference.

Figure 4. Customer Household Income Across Timeshare Programs



Source: Investor Presentations and Academy Securities

- **Repurchasing of defaulted loans.** Developers repurchase or substitution of timeshare defaulted loans appear to be key factors holding down deal default levels. The monthly defaults stood at 0.61% in late 2022 across timeshare deals (weighted average), according to recent rating agency performance reports. The agencies note ongoing repurchase or substitution of the majority of defaulted loans. To be sure, timeshare ABS structures typically make developer repurchases and substitution of defaulted loans optional rather than mandatory. As such, investors do not have guarantee that such developer support will continue to keep defaults low. Ongoing timeshare sales and inventory availability could be some of the factors driving developers' ability to repurchase or substitute defaulted loans. Repurchase of defaulted collateral partly allows developers to procure new inventory. Recent growth in VOI sales across developers bodes well for repurchase activity. For example, Travel + Leisure saw 5% quarterly sales growth in Q3 2022 (and 45% over the past three years), according to the developer's recent financial statements. Marriott Vacations Worldwide reported 27% contract sale YoY increase in Q3 2022.

- **Industry consolidation.** Ongoing consolidation in the timeshare sector should favor the large operators that tap the securitization market. This echoes an aspect we highlighted for the self-storage space.[2] As operations become more sophisticated and technological-savvy, larger operators can benefit from economies of scale and data-driven customer acquisition. Hilton Grand vacations acquisition in 2021 of Diamond Resorts, the largest independent timeshare operator, is one example of the acquisition activity in the sector.

2 See "Self Storage: Aspects to Watch as Performance Decelerates," Securitized Products Special Topics, Academy Securities, February 2, 2023

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