

## **Diamond Resorts European Collection Limited (“European Collection”)**

### **Budget Process – How Annual Management Charges Are Calculated**

#### **Who prepares the annual budget for the European Collection?**

The responsibility for the preparation of budget documentation is with the management company – Diamond Resorts (Europe) Limited.

The resorts within the European Collection portfolio comprise resorts which have a timeshare club with weekly owners and its own management company and club committee, often referred to a HOA. There are 18 such resorts in the European Collection:

1. The Kenmore Club
2. Pine Lake Resort
3. Thurnham Hall
4. Woodford Bridge Country Club
5. Cromer Country Club
6. Royal Oasis Club at Pueblo Quinta
7. Los Amigos Beach Club
8. Sahara Sunset Club
9. White Sands Beach Club
10. Club Cala Blanca
11. Club del Carmen
12. Royal Sunset Beach Club
13. Sunset Harbour Club
14. Sunset Bay Club
15. Santa Barbara Golf & Ocean Club
16. Royal Tenerife Country Club
17. Sunset View Club
18. Alpine Club
19. Royal Regency Club

Then there are resorts, referred to as hotel resorts, which have no timeshare club or HOA – there are 10 such resorts in the European Collection.

Firstly, each resort within the European Collection will set its budget.

- For the resorts with a timeshare club budgets are made by each resort’s management company and approved by HOA.
- The European Collection Board (which has two elected non-executive member directors) oversees the expenditure budgets for hotel resorts.

The management for the European Collection then prepare a budget using the budgets for the underlying resorts with the European Collection. The budget is then reviewed and approved by the Board.

#### **What is included in the annual management charge?**

Annual management charge is comprised of three components:

- Resort Operating Expenditure – wages, utility charges, taxes, laundry, grounds, entertainment, etc
- Sinking Fund\* contributions – accommodation refurbishment, leisure facility upgrades, service improvement projects (eg technology, WiFi, utility supply),
- Membership Administrative Services – reservation and service teams, trustee fees, audit & legal fees, account collection, AGM etc.

#### **What is the significance of the currency and exchange rate for the management charge?**

- Approximately 65% of the European Collection’s expenditure is in Euros and 35% is in GBP
- Approximately 80% of fees are paid in GBP (Sterling)

This of course means that more GBP currency is collected and therefore there is a need for the management company to use some of the GBP to purchase the Euro currency required to sustain operations.

The forecasted exchange rate of €1.10:£1 has been used for the budget in 2020 and it is hoped that it will be exceeded with no negative variance.

## How are management charges determined and how is the budget approved?

The budget process for the following year begins in May in the current year. However, consideration for refurbishment expenditure is prepared much earlier than this.

The preliminary preparations commence between the Finance, Resort Management and Purchasing/Construction teams. The previous year's operating expenses along with the year to date expenses form the basis of most calculations. The proposal takes into account the obligatory wage increases, living wages, utility cost increases, staffing levels, maintenance and supply contracts, housekeeping cleaning materials and tools, linen, etc. Sinking fund\* projects are also listed – refurbishments, renovations, improvements, etc along with respective estimated costs although these are subject to change and variation depending on priorities.

Over the course of the next three months – June, July and August – each resorts' expenditure and needs are individually assessed:

- Resort management teams are responsible for ensuring the most up to date costs and expenses are budgeted for ongoing operating requirements.
- Finance team are responsible for reconciling all expenses and compiling in both local and GBP currency.
- Purchasing and Construction provide quotes & costings and advise on whether any project reductions may be available before final budgets are approved.

The Euro exchange rate is constantly tracked and monitored as this is especially important for ongoing successful operations in those areas. This is an integral part of the budget process as actual rates can never be guaranteed or fixed. It means that an exchange rate for any budget is proposed based on historic trending and knowledge of any potential future impact – nationally and globally - that may affect this. To propose an exchange rate will take into account the current year's activity and the rate during the budget process timeline.

Once the discussions with the departments conclude and final versions of the budgets are drafted, all budgets are presented to each resort club HOA (committee) for approval during a formal meeting. Line by line items are discussed along with proposed sinking fund projects – the HOA has the opportunity to review and query any item. They can and often do request changes they do not feel necessary or to the benefit of members which can then result in a decrease or an increase in the budget. Each HOA formally approves their resort club budget based on all the resort needs and requirements.

The European Collection Board generally holds their budget meeting once all HOA budgets have been approved and agreed. They then consider all resorts together and finalise the costs and approve the budget.

### **\*What is a sinking fund?**

An explanation for Diamond:

***"A sinking fund is an account that owners and members contribute to as part of their management charges. This pays for any major works that are required over a period of time - such as the resort refurbishment, improvements to accommodations, building structures, communal areas as well as introduction of new services (i.e. WiFi, fibre, health and safety measures, etc.)."***

In the timeshare industry this is common in all resort club's expenses and budgets. It is the funds received from members that have been included in the annual management charges and then set aside for refurbishment and improvement projects. This is completely separate to operating expenditure funds, which are solely to run the resorts. The amount is usually based upon a percentage of the overall operating expenses and is generally averaged at 20%.

The European Collection and all resorts with a HOA have their club costs audited on an annual basis by professional auditors.

### **Additional Information for 2020**

***Historic trends of the £:€ values during the budgeting process timeline (1 July [@ €1.11] to 1 September [@ €1.10]) showed extreme fluctuations throughout with the lowest rate in this period being €1.06. There were no forecasts from any financial institution suggesting any change, especially that the rate would rebound. Whilst during September through to December has indicated that the pound has strengthened, it will only be the first quarter of 2020 when fees have been collected and are available to purchase currency that the full position on the rate will be known. The hope is that the forecasted exchange rate of €1.10:£1 which was the rate at the time the budgets were prepared and agreed will be exceeded with no negative variance, the respective surplus will be***

*credited towards 2021 fee calculations. An update will be contained within the AGM Notice (sent 28 days prior to meeting) and it will also be an agenda item at meeting.*

*Using an example of a 15000 point member:*

*For 2019, the fees were £1870.50 and €2151.15.*

*For 2020, the fees (before exchange rate impact) were £1934.10 and €2224.29 – approximately 3% increase.*

*With the exchange rate applied 2020 fees change to £1991.24 and €2190.44 which is the requested amounts from each respective currency payer – approximately 6.5% and 1.8% increase respectively as explained in the letter sent.*

*As mentioned above, there are more expenses in Euros than GBP (65%/35% ratio) so members paying in Euros will not be as impacted as much as the exchange rate applied to them is only for the GBP expenses.*