KPMG's Caribbean Travel, Leisure and Tourism Contacts

Please contact the KPMG member firm represented in your country if you have any questions. KPMG member firms are represented throughout the Caribbean region, and have a specific knowledge and understanding of the business, cultural, economic and political facets of conducting business in each country.

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KPMG

2018 Caribbean Hospitality Financing Survey

Travel, Leisure & Tourism

May 2018

Introduction

We are delighted to present KPMG's 14th annual Caribbean Hospitality Financing Survey, highlighting financing trends in the region's hospitality and tourism industry and the outlook for the future of the industry.

As we have mentioned previously the expansion of our survey beyond just banks to also include non-bank capital providers such as equity and mezzanine investors has been a welcome addition to our survey.

Typically non-banks have provided a significantly more confident outlook about the prospects for Caribbean tourism than banks but last year we noticed a much closer alignment of positions which continued this year. Confidence levels of banks increased yet again for an amazing ninth year in a row. Confidence levels of non-banks also increased. Overall non-banks remain more confident than banks registering 7.43 out of 10 in terms of their level of confidence versus 7.11 out of 10 for banks.

For both banks and non-banks to exhibit these high levels of confidence would be very positive at any time but for them to do so following what can only be described as a catastrophic 2017 hurricane season for the region, represents very welcome, positive news.

The 2017 hurricane season was undoubtedly the major event since our survey last year and so naturally it featured very heavily in the questions asked of, and responses received from, survey respondents.

Generally financiers have taken a stoic, practical approach to the hurricanes realizing that they represent an inherent risk of conducting business in the region.

However, there is no question that lessons learned from the hurricanes will change the financing landscape moving forward.

The adequacy of insurance coverage will need to be improved in certain cases not just in terms of amount of coverage but also type of coverage such as business interruption coverage.

There are also lessons to be learned for insurance companies, particularly in terms of speed of their response. The quality of construction will also receive more attention and adherence to codes of construction will be non-negotiable.

We received very positive feedback generally in terms of financiers' appetite for issuing senior debt not just for expansions and renovations but acquisitions. The survey also highlighted an increasing number of financiers willing to consider new builds.

This year most financiers think the region is approaching the peak in terms of its economic cycle whereas last year they thought the region was still in the recovery phase.

Financing terms are much the same. If anything they are hardening slightly in terms of loan to value and interest rate margin.

Clear messages were again received about the importance of infrastructure to facilitate inward investment and associated financing.

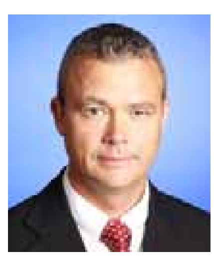
Factors such as airlift, control of crime, replacement of outdated infrastructure and the very topical subject of ability to recover from hurricanes were all cited as critical factors.

Canadian headquartered banks have for many years been the primary financiers of developments in the region's tourism industry. However it is now firmly established that the landscape has changed, although the Canadian banks remain very much part of that new landscape. The consensus view appears to be that they are *"back in the market but more selective than before"*. Other *"players"* are predominantly local banks who are increasingly participating in syndicated deals, U.S. funds, pension funds and insurance companies and development banks who are also active in the marketplace.

In conclusion, given the catastrophic events of the 2017 hurricane season, there is a remarkably high level of confidence in Caribbean tourism amongst financiers. However, for new and existing applications financiers will be scrutinizing insurance coverage and quality of construction more intensely than they may have done prior to Irma and Maria!

Gary Brough
Head of Travel, Leisure & Tourism

KPMG Islands Group



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Industry Outlook

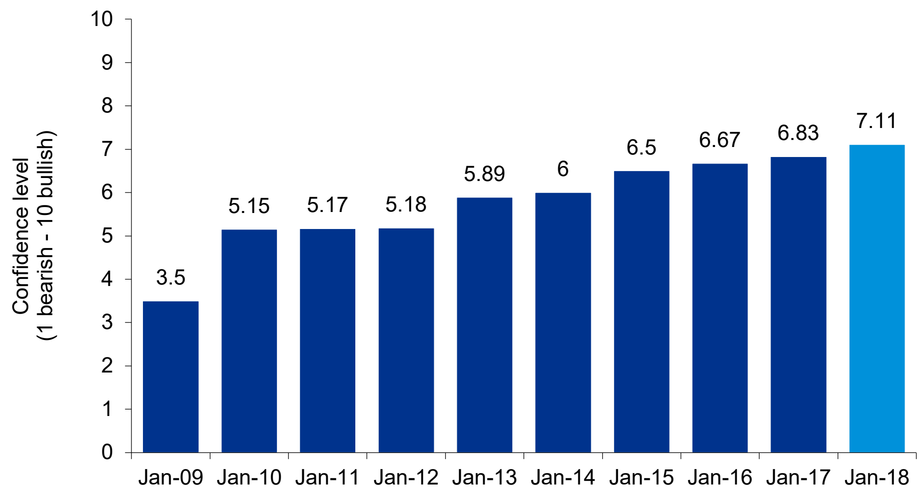
Confidence levels remain high

Confidence levels for banks have increased for an astonishing ninth year in a row notwithstanding a disastrous hurricane season.

The confidence levels of non-banks also increased and are still higher than for banks (7.43 out of 10 versus 7.11 out of 10).

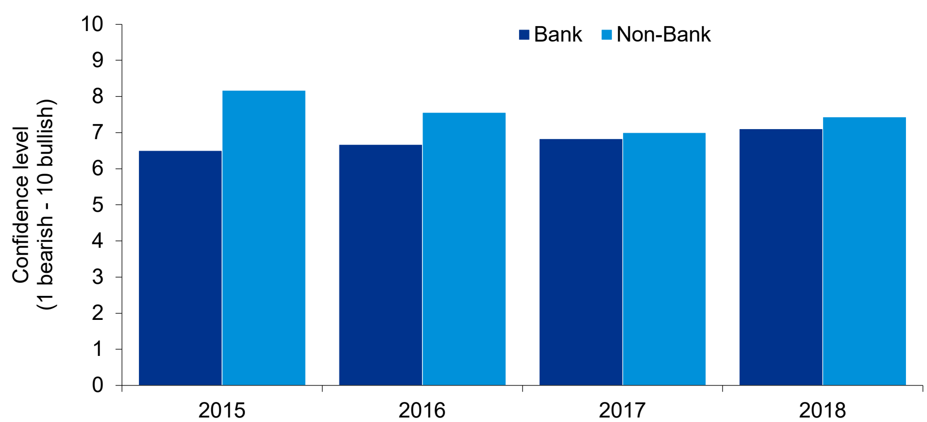
The steady increase in confidence of the banks appears to reflect their relative success at working their way out of an extremely difficult period for them following the 2007 recession. Initially they followed a very cautious path financing renovations and expansions primarily for existing, established clients. They now appear to be taking a less cautious path with acquisitions being given favourable consideration by the majority of banks (see below) and even some new builds are being considered.

Caribbean Financier Confidence Barometer - Banks



Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

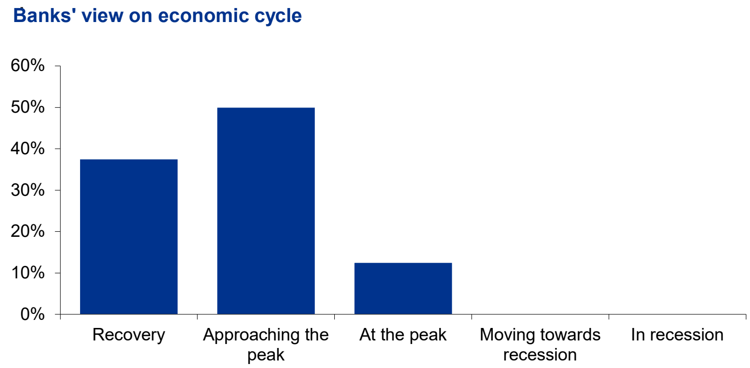
Caribbean Financier Confidence Barometer



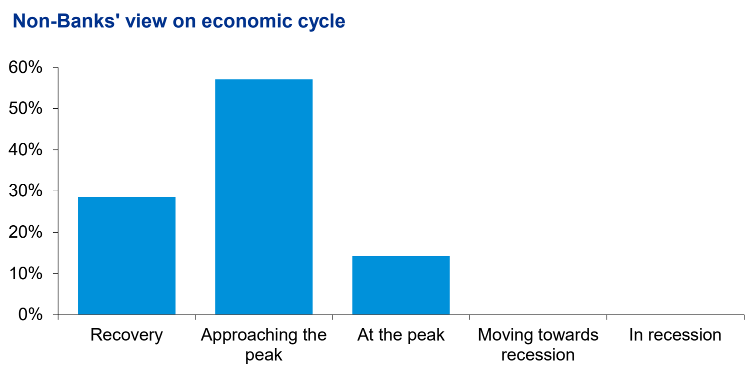
Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

State of economic cycle

Last year the overwhelming majority of banks (66%) and non-banks (86%) believed that the Caribbean was still in the recovery stage of the economic cycle. This year half of the banks and 57% of non-banks think the economy is approaching the peak, a distinct movement from one phase of the economic cycle to the next.



Source: KPMG International,
KPMG's 2018 Caribbean Hospitality Financing Survey



Source: KPMG International,
KPMG's 2018 Caribbean Hospitality Financing Survey

New landscape

In recent years there has been a unanimity of opinion that the financing landscape has changed. In that regard the traditional lenders such as the Canadian banks are not as dominant regionally as they once were but they still remain very much part of the new landscape.

This year we tried to give more definition to the new landscape, what it looks like and what the new role of the Canadian banks is.

77% of bank respondents consider the best description of the new role of Canadian banks is that they are *"back in the market but more selective than before"* with the balance (23%) seeing little activity from the Canadian banks. 57% of non-banks saw little activity from the Canadian banks with 43% seeing them back in the market in a more selective role.

So who else is financing tourism projects in the region?

We received lots of different responses to this question, many referring to local and regional banks.

"Local banks are aggressive and are participating in syndicates."

"Local banks."

Availability of capital

Generally respondents seemed to think there is finance available for strong projects with the right metrics and stakeholders.

"Sufficient liquidity in our key markets for hotel sector."

"More capital is now available."

However, the opinions are not unanimous.

"Liquidity remains a problem (or opportunity)."

"Irma and Maria will have a lasting response, also the fiscal situation of many Caribbean governments hinders US$ investment, especially in markets with currency controls."

Hurricanes

The 2017 hurricane season had a devastating impact on the region's tourism industry. Several destinations experienced direct hits from two major hurricanes; Irma and Maria. Hurricane Irma was one of the strongest Atlantic hurricanes on record.

Accordingly, our survey questionnaire, and the responses thereto, featured the hurricanes extensively– their impact, lessons learned, adequacy of insurance coverage, response of insurers and the impact generally on the financing of tourism projects in the region.

Remarkably the confidence of both banks and non-banks increased this year despite the impact of the hurricanes.

Furthermore, when asked what impact the hurricanes had on their current appetite for financing tourism projects in the region, all non-banks stated that their appetite was unchanged, likewise 75% of banks.

The general approach appears to best be reflected by the following quote from one of our respondents:

"Lending has not changed as there seems to be annual challenges (Zika, Brexit, Hurricanes etc.)"

This stoic, practical approach should not be mistaken for a *"business as usual"* approach. Many important lessons were learnt.

Insurance

The issue of insurance, the adequacy of coverage and the approach taken by insurers received a lot of attention.

"Insurance is key"

"Have cash available to rebuild quickly as insurance companies are slow to pay out"

"Borrowers must have adequate insurance"

Insurance coverage

Only 28% of banks and 40% of non-banks thought existing insurance coverage was adequate. 43% of banks and 60% of non-banks considered coverage could be better and 29% of banks thought coverage was inadequate.

Response of insurers

The insurance industry received mixed reviews in terms of how they responded to claims submitted. Half of banks and a third of non-banks thought treatment was fair but half of all financiers thought the response of insurers was slow.

"Varies across the region- feedback from clients has been mixed between fair but slow in some instances"

"Extremely slow in some cases"

"In our case the insurance company will not be insuring assets in the Caribbean moving forward and all incentives on their part to pay what was agreed is non-existent"

Insurance policies

There is no question that a lot of policies will be revisited.

"We've had all large hotel property policies externally reviewed prior to the 2018 season. 100% of their reviews required that policy coverage be corrected or supplemented"

"Business interruption and staying current on valuations could be improved"

Construction

The quality of construction also featured heavily.

"You have to build and design according to code and do not cut corners"

"If built properly, no issues"

Jurisdiction by Jurisdiction

In terms of which jurisdiction recovered quickest from the effects of the hurricanes, the Turks and Caicos Islands ("TCI") was overwhelmingly highlighted. Some of the reasons cited for TCI's quick recovery were strong infrastructure and building codes and a major effort by the local business community.

Jurisdictions most negatively impacted by the hurricanes in the opinion of the financing community include St. Maarten, Puerto Rico and the Virgin Islands both U.S. and British.

Financing opportunities

Financing opportunities appear to be available to aid recovery.

When asked what projects are respondents financing following the hurricane, they stated:

"Renovation projects"

"High end well built projects in a market with sound infrastructure"

Appetite for issuing senior debt

One of the most positive set of results we received was in response to a question as to what appetite financiers had for issuing senior debt for different types of tourism related projects in the Caribbean.

Nearly 90% of banks and all non-bank respondents said they had a positive appetite for issuing senior debt to existing hotels for refinancing, expansion and renovation.

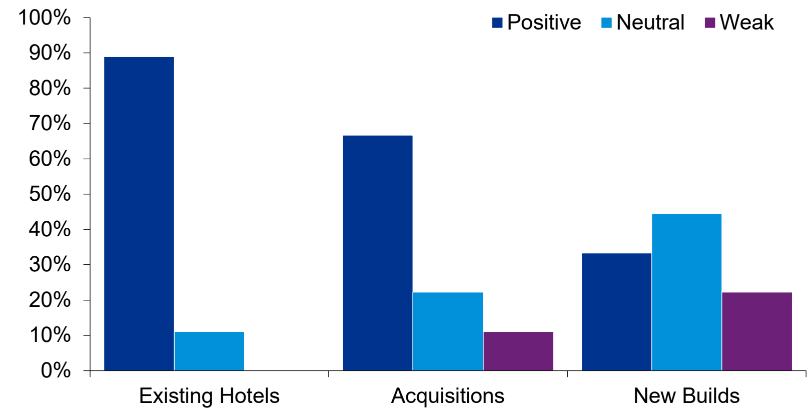
Approximately 86% of non-banks had a positive attitude towards financing acquisitions as did 67% of non-banks.

Not surprisingly, new builds were a more difficult category to register a positive attitude but 33% of banks and 43% of non-banks had a positive appetite for new builds.

These are really high percentages, particularly for financing existing hotels and acquisitions. Whereas previously financing applications for new builds were almost dismissed entirely, a sufficient critical mass of financiers are now willing to consider such applications.

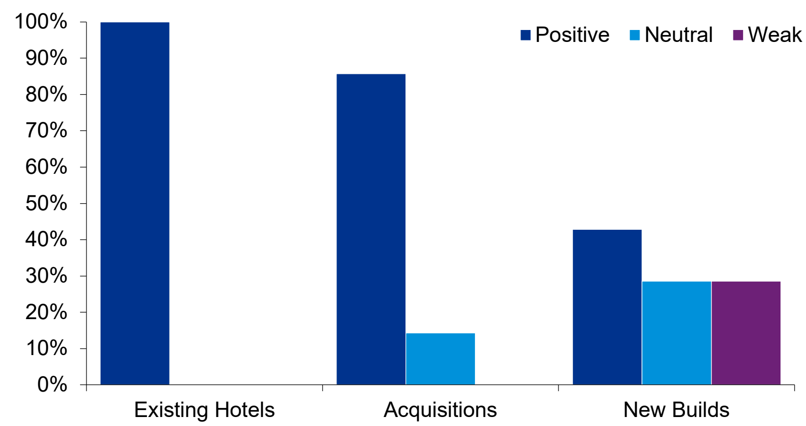
This appetite for financing is illustrated by our survey respondents. When asked what types of hospitality projects they have financed over the past year and where their focus will be over the next 12 months, their interest covered the entire spectrum.

Banks' appetite for issuing senior debt



Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Non-Banks' appetite for issuing senior debt



Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

"Looking at greenfield and expansion of business hotels"

"Resorts, marina, port"

"Hotel acquisition and resort development"

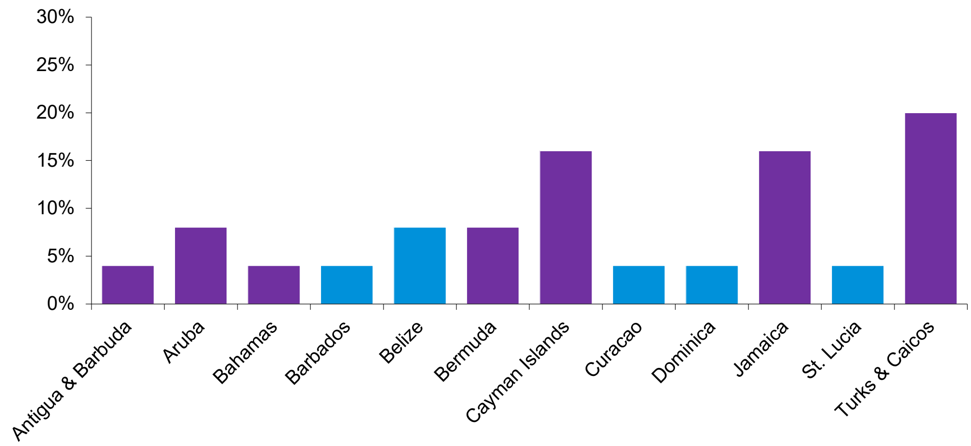
"Brand new hotels and boutique hotels"

"Hotel, condo-hotel, resort, casino"

Financing Trends

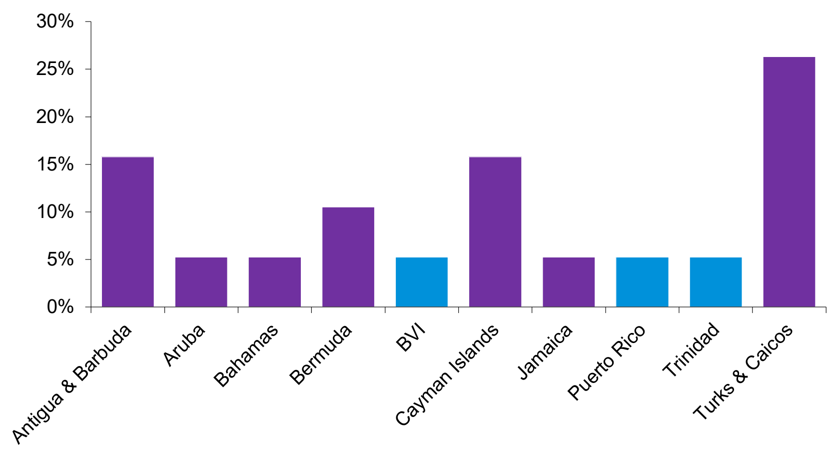
When we looked at which destination in the Caribbean financiers are most bullish about there were 16 different destinations put forward of which only 7 were nominated by both bank and non-banks and which are highlighted in purple. This further corroborates the position seen in recent years that the financing landscape has changed and that the new landscape involves financiers favoring a small number of jurisdictions for whatever reason rather than financing projects across the entire region.

Countries Banks' most bullish about



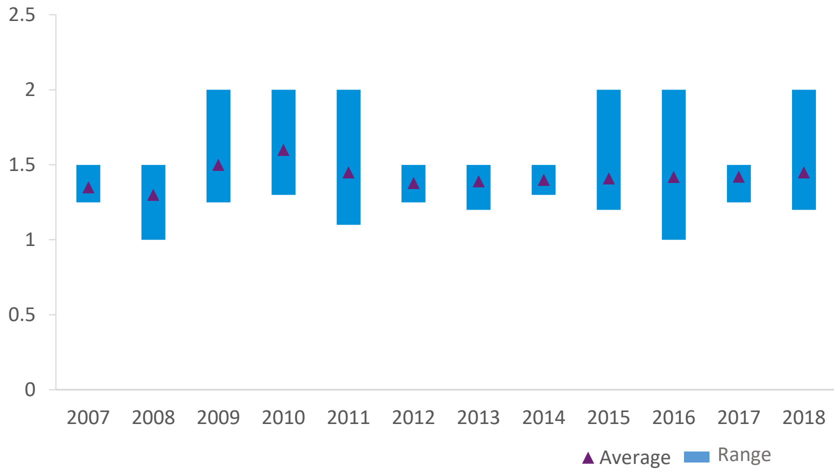
Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Countries Non-Banks' most bullish about



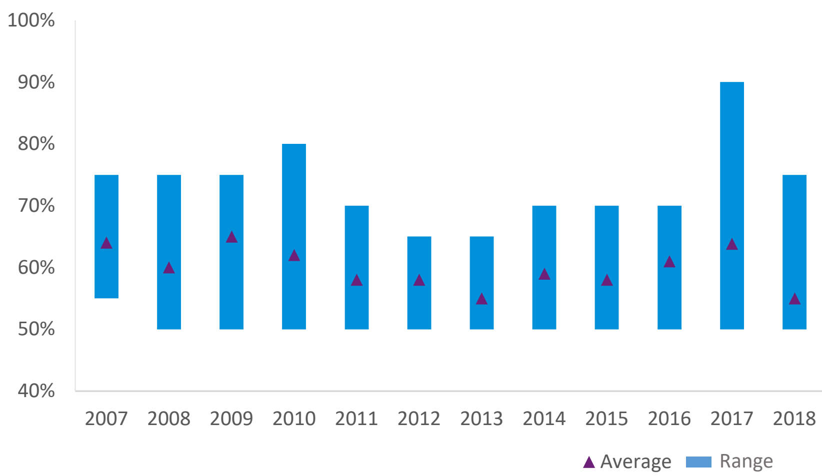
Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Debt service coverage ratio



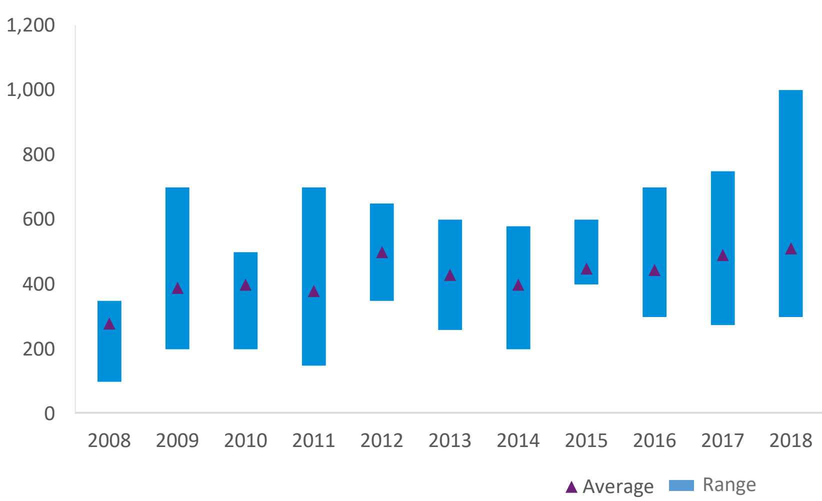
Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Loan to value



Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Interest rate margin (bps)



Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Regarding the terms of financing there have been no significant changes since last year although any changes have tended to be negative from a borrower's perspective. For example the average loan to value ratio has fallen to 55% and the average interest rate margin is now over 500 basis points, partly attributable to a higher range of rates offered.

However, once again the big issue is not the terms but whether or not the financing is available.

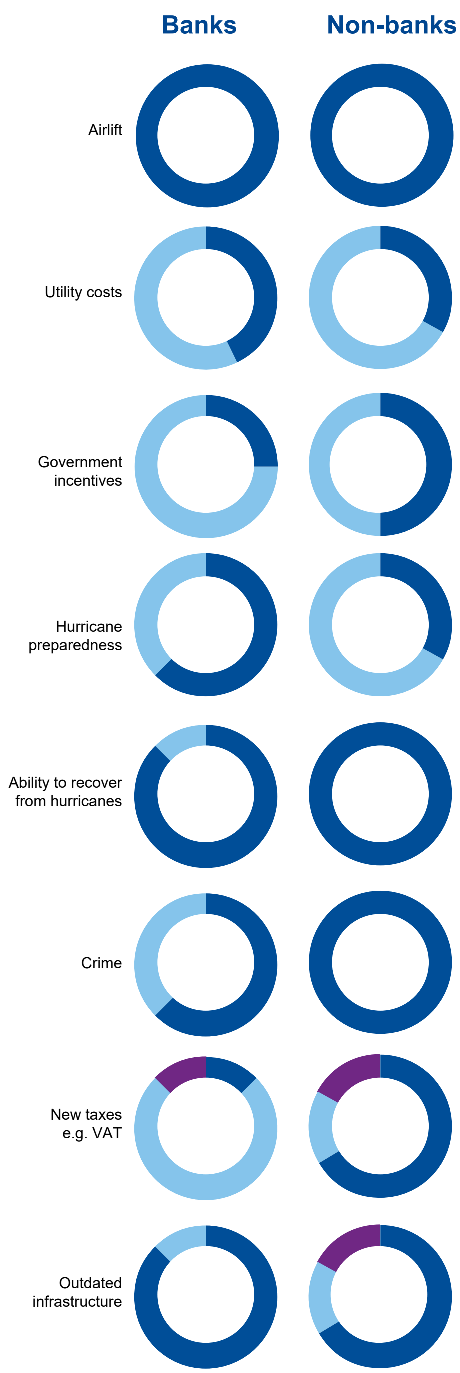
It is highly unlikely that there is anything in the average loan terms that will prevent an investor moving forward should they be fortunate enough to be presented with such terms.

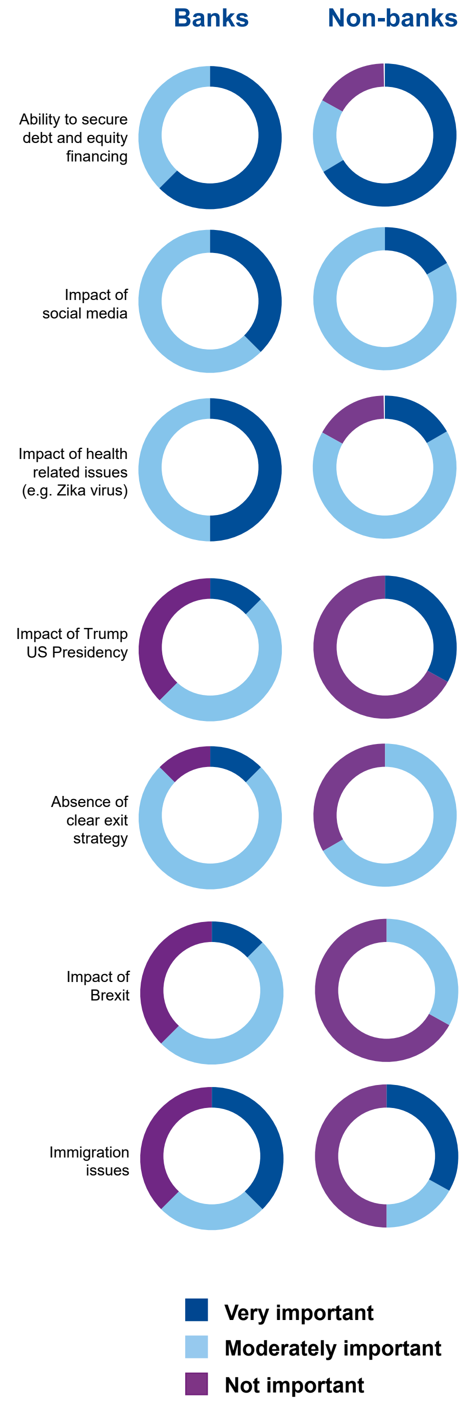
Other Trends

The critical issues impacting financing activity in the region are once again very clear.

Airlift was yet again identified as the most critical issue for both banks (100%) and non-banks (100%).

For banks the second most important issues were the ability to recover from hurricanes (88%) and outdated infrastructure (88%). Non-banks were unanimous (100%) in terms of the importance of crime and the ability to recover from hurricanes.





Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Respondents had some ideas on how these critical issues could be mitigated which involved a role for governments in the region.

"...strong governance..."

"...by government in collaboration with private sector.."

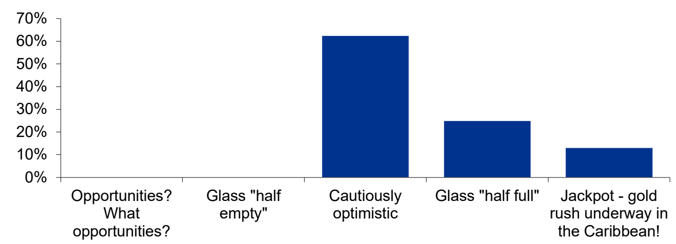
"...proper planning..."

Spectrum of opportunities

We asked financiers to consider the Spectrum of Opportunities for lending in the region.

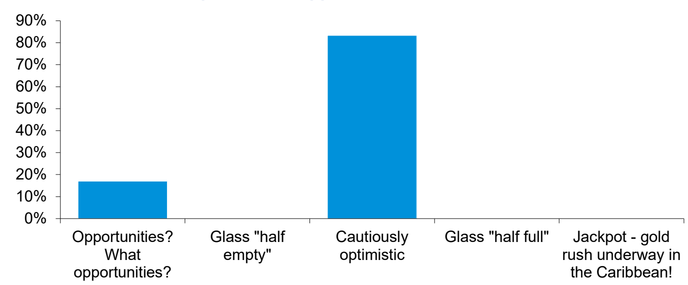
For the first time in many years some (13%) of banks think it is a perfect time to lend to the Caribbean tourism industry. These respondents chose the *"gold rush underway in the Caribbean"* option available to them which is as optimistic a view as you will ever get from a bank! Several other banks consider their glasses to be *"half full"*. None of the banks are anything less than cautiously optimistic. Remarkably banks are more bullish in this respect than non-banks who are overwhelmingly cautiously optimistic (83%) with none of them being anything more bullish than *"cautiously optimistic"*.

Banks' reaction to "Spectrum of Opportunities"



Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

Non-Banks' reaction to "Spectrum of Opportunities"



Source: KPMG International, KPMG's 2018 Caribbean Hospitality Financing Survey

We asked survey participants what was the most *"out of the box"* innovative opportunity they could think of for the regional tourism industry in 2018.

Some comments appeared to be linked to the effects of the hurricanes.

"Demolition of sub par properties and replacement with newer innovative products aimed at the next generation"

"Renovation and purchase of assets"

Others relate to specific destinations

"Cuba"

and others related to sustainable tourism

"Environmental tourism"

"Focus on cultural tourism"

When asked, what single new opportunity excites you the most and fills you with optimism about the future of the tourism industry in the Caribbean, we received the following responses amongst others.

"Airlift to the region has improved and continues to improve which is essential to the industry"

"Strong US economy"

When asked what opportunities respondents see for the region's tourism industry in 2018 and beyond

"Airport Financing"

"Many opportunities for new resorts due to the depth and diversity of our cultural and culinary offering"

"Focus on building a more sustainable approach for existing and new products and services, especially the damaged areas to be constructed"