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ADVISORY

2015 Caribbean Hospitality Financing Survey

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Introduction

We are delighted to present KPMG's 11th annual Caribbean Hospitality Financing Survey, highlighting lending trends in the region's hospitality and tourism industry and the outlook for the future of the industry.

Regular readers and subscribers to our survey will recall that last year we expanded our survey beyond banks to also include non-bank capital providers such as equity and mezzanine investors. At the time we stated that our new survey participants "appear to be more optimistic about the future than banks and more bullish about the potential of new markets and new products".

This more bullish trend has certainly continued this year. Our annual Caribbean Financing Confidence Barometer, which is always one of our very best indicators of prevailing financier sentiment, reveals that non-bank capital providers registered a "jaw dropping" 8.17 (2014: 7.00) out of 10 in terms of their level of confidence for the next 12 months.

Not to be outdone, financial institutions registered an admittedly more sedate 6.50 (2014: 6.00) out of 10, a confidence level which is nonetheless at the highest level since 2008, representing the sixth year in a row that confidence has grown amongst banks.

The reasons for the increased confidence levels appear to be numerous but include growth in the US economy, the main feeder market for the Caribbean, improved airlift into the region and a general feeling that those existing operators who have survived the recession are now more robust and well positioned for future growth.

Do these results mean that the Caribbean tourism industry is booming with readily available financing? If only it were that simple! These levels of confidence are encouraging but, for the time being at least, renewed confidence does not appear to be translating into readily available capital.

None of the banks surveyed think it's a perfect time to lend in the Caribbean and 13% actually stated they are currently not interested in lending in the Caribbean. Half of our bank respondents considered lending in the Caribbean to be high risk/high return and that they would need to proceed cautiously.

Non-bank providers again showed more optimism. 17% of them think it is a perfect time to lend in the Caribbean and 50% of them would critique a Caribbean lending opportunity like any other project.

In terms of emerging opportunities, responses were quite literally all over the map with 15 different Caribbean jurisdictions receiving honorable mentions as favoured countries that our respondents would be willing to lend to. Generally banks and non-banks favoured different countries. There are also quite different views on new markets and new ideas such as economic citizenship programs which received strong support and healthy skepticism in equal measure.

So how are we to interpret these findings? Without wishing to be accused of "ducking the issue" the answer would appear to be that it is actually a very unusual financing environment to predict.

Confidence is way up on prior years, there is liquidity in the system but financing is not readily available.

Clearly there remain some obstacles that are still holding back the flow of capital into the region and we explore this challenge in greater detail elsewhere in this publication.

The main Canadian banks, long established in the Caribbean, remain at the core of financing the region's tourism industry and their current outlook and strategy is very much one of the factors contributing to the current situation.

We would like to take this opportunity to thank, once again, all the contributors to this survey. We very much appreciate your continued support and invite you to encourage others to participate as obviously the more feedback we receive the more valuable our findings will be.

Sincerely,

KPMG's Caribbean Travel Leisure and Tourism Group



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Industry Outlook

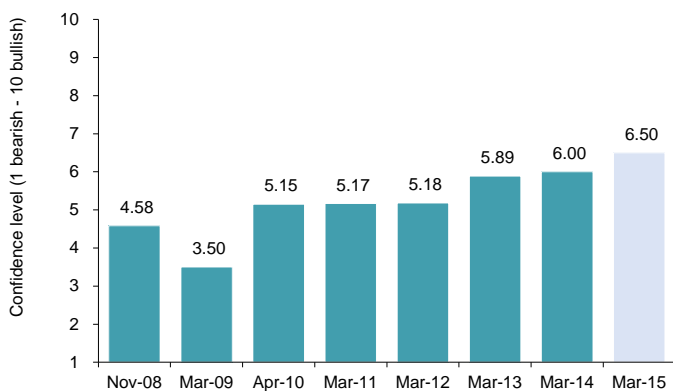
From an academic perspective, we are at a fascinating stage in the economic cycle. However, from the prospective of an investor or developer it must be an incredibly frustrating time.

Banks are the most confident they have been since 2008 and equity investors and non-bank capital providers are even more optimistic and yet capital is far from being readily available.

On a scale of 1 (bearish) to 10 (bullish), bank confidence in Caribbean tourism is higher than it has been for nearly a decade. Our Caribbean Financier Confidence Barometer shows a rating of 6.50 which is considerably higher than at any point since before 2008.

As can be seen below, confidence levels reached an all-time low in 2009. However, our Caribbean Financier Confidence Barometer has now risen for its sixth year in succession and is nearly double 2009 levels.

Caribbean Financier Confidence Barometer - Banks

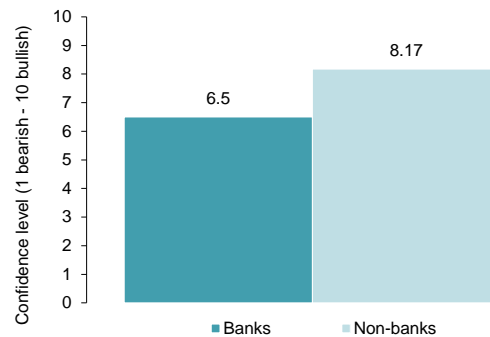


Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey

Non-banks are even more confident than banks.

The level of confidence of the non-banks is really at very high levels that must bode well for the future particularly given that equity and mezzanine finance are typically more difficult to secure than bank finance.

Caribbean Financier Confidence Barometer



Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey

When will meaningful growth in tourism return to the Caribbean?

Both banks and non-banks show a similar pattern in terms of when they think growth will return. Some think it has already returned, others think it will not return until 2017 or beyond but relatively few think it will return in 2016.

Again the non-banks exhibit greater optimism with half of the population of respondents believing growth has already returned and a third believing growth will not return until 2017 and beyond. The equivalent percentages for banks are a slightly more conservative 43%, and a slightly more pessimistic 43%, respectively.

Clearly, opinions on this subject are polarized. Optimistic respondents think growth is already here while pessimists think there is still a long way to go. There seems little support for a position between these two extremes.



BANKS:

It has
already
returned

43%

2016

14%

2017 and
beyond

43%

NON-BANKS:

50%

17%

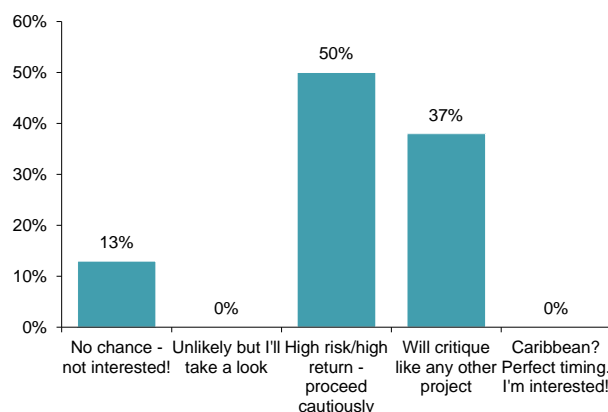
33%

Financing Trends

Finally, after so many difficult years of austerity and with so much enhanced confidence, financing must now surely be readily available?

It appears from our survey responses that the situation is not quite so simple.

Banks' willingness to lend in the Caribbean



Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey

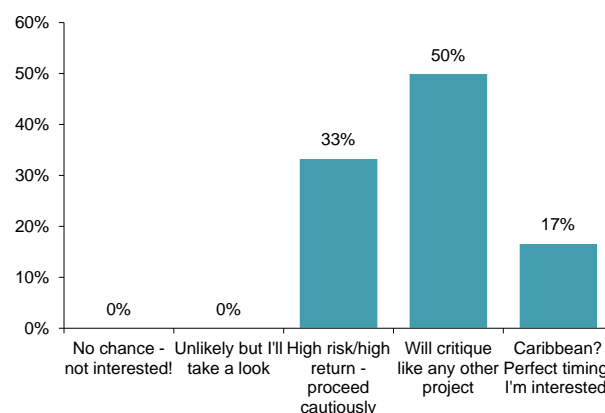
None of the banks think it is a perfect time to lend to the Caribbean's hospitality sector and 13% actually stated that they are not interested at all. The majority of bank respondents (87%) indicated that either they considered Caribbean lending opportunities to be high risk/high return and so they would proceed cautiously (50%) or they would critique Caribbean opportunities like any other project (37%).

As stated previously, the main Canadian banks have long been key financiers of the Caribbean tourism industry. Their operational performance and management of credit risk in the region relative to Canada have come under intense scrutiny (e.g. "Trouble in Paradise": Toronto Globe and Mail - February 2015) and generally they are under increasing pressure to reduce costs in the region.

Non-banks were typically more bullish with 17% saying that it is the perfect time to lend to the Caribbean with 33% intending to proceed cautiously and 50% willing to critique like any other project.

When specifically asked what projects had been financed in the last year, the banks' comments were very informative – again revealing an extremely cautious, conservative lending approach. Approved borrowers were in "established" locations with a "proven trading performance" and most loans were to existing operators for renovation, expansion, refinancing etc.

Non-banks' willingness to lend in the Caribbean



Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey

"Established location dominant & managed hotels - proven trading performance & major reinvestment strategy."

"Hotel refinancing and/or expansion to established operators."

"Renovation, expansion, and acquisition of existing hotels."

"Building and renovating apartments."

"Smaller hotels - upgrades & renovations."

Why so conservative?

Banks explained why the more favourable economic environment is generally not yet translating into more available capital for tourism related projects.

“Most lenders in the region have limited additional lending capacity for the hospitality sector given most have not had significant reductions in their exposures aside from loan amortization.”

“It’s hard to accept the level of risk being proposed.”

“The correct mix of capital is the critical factor, not the total amount.”

What were the major lessons learned during the economic recession?

Most responses related to increased sponsor recourse and risk management.

“Any unsecured risk needs strong sponsor support going forward.”

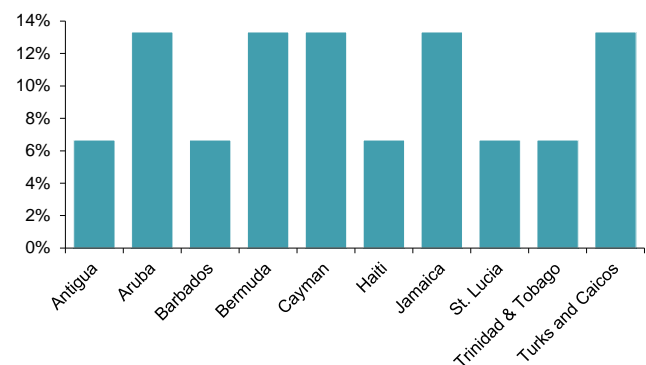
“Increased focus on sponsor recourse (i.e. cost overruns/ completion guarantees).”

“Improved underwriting & due diligence capability.”

“Leverage & DSC ratios adjusted downwards to reflect repayment risk in hospitality sector.”

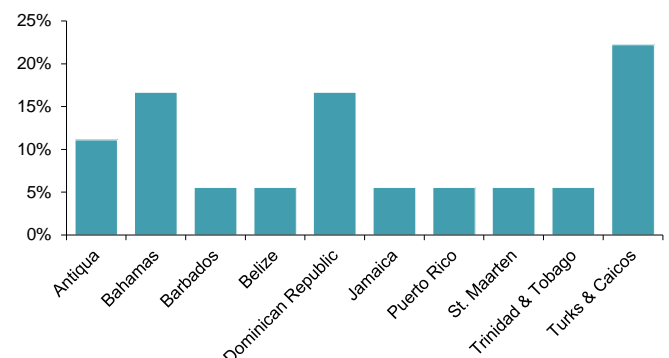
When looking at which location in the Caribbean financiers are most bullish about in terms of lending opportunity, responses were again highly informative with numerous different jurisdictions being mentioned and banks and non-banks tending to differ regarding those countries in which they are most inclined to fund projects. Only five countries made both lists: Antigua, Barbados, Jamaica, Trinidad & Tobago and Turks & Caicos.

Banks' top countries for new lending



Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey

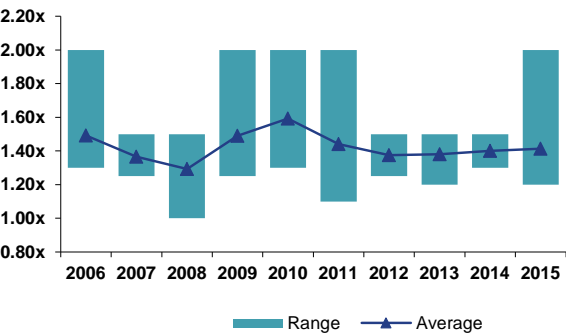
Non-banks' top countries for new lending



Source: KPMG International, KPMG's 2015 Caribbean Hospitality Financing Survey

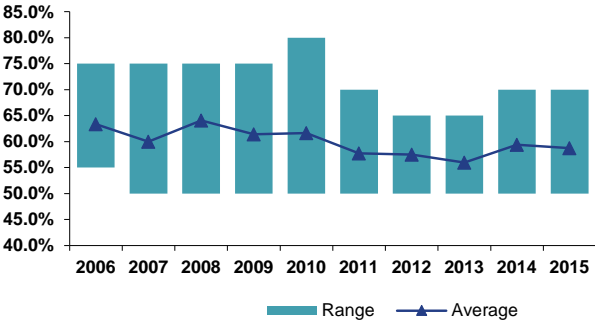
There have not been any dramatic changes in average loan terms. The “headline” issue is not really loan terms but the availability of loan finance, or lack thereof.

Debt service coverage ratio



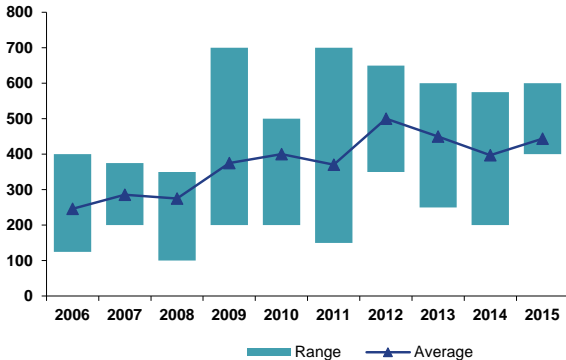
Source: KPMG International, KPMG’s 2015 Caribbean Hospitality Financing Survey

Loan to value



Source: KPMG International, KPMG’s 2015 Caribbean Hospitality Financing Survey

Interest rate margin (bps)



Source: KPMG International, KPMG’s 2015 Caribbean Hospitality Financing Survey



Other Trends

When asked to identify the current issues of critical interest to hoteliers, the banks and non-bank communities were consistent in their views as they were last year. Airlift was again identified as the most critical issue cited by 88% of bank respondents and 100% of non-bank respondents. Ability to secure debt financing was the second most critical issue for banks (75%) and also very important for non-banks (83%) who this year elevated the issue of crime (100%) to an issue of critical importance.

Numerous other issues were raised such as the role of government, the impact of new taxes, e.g. VAT, the impact of high utility costs, the need to maintain competitiveness versus other regions such as Central and South America and the need to invest in infrastructure.

"Airlift must be in place - the field of dreams of building it and it will come will not work for sourcing financing."

"Guaranteed airlift and capacity."

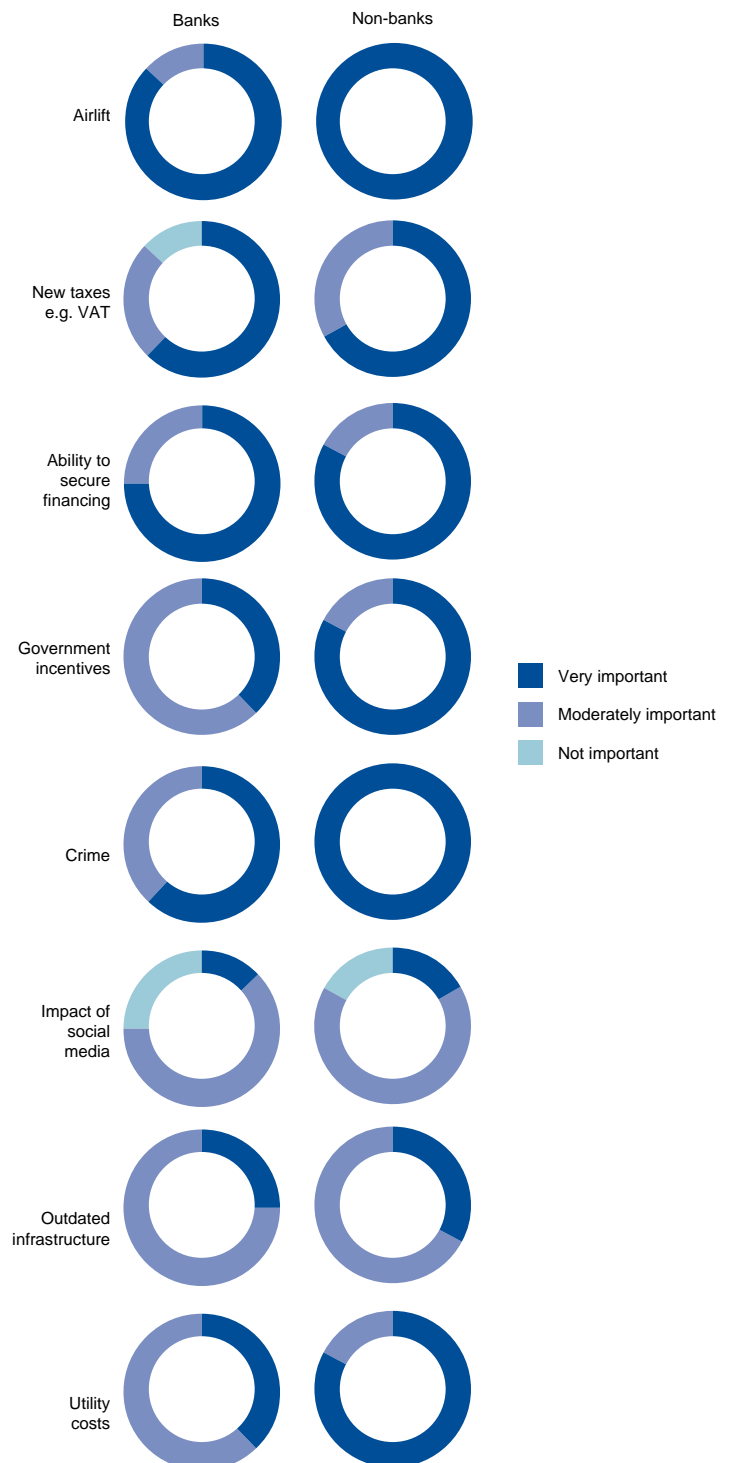
This year we received more appeals to regional governments than in previous years with some very clear messages from the financing community.

"Existing or new governments pro-tourism that understand the positive impact of our industry and are investor friendly."

"Need a progressive government, who has political 'room' to take risks that may not be very popular."

"Government needs to take long term view and make bold decisions."

"Convincing governments to focus on their key industry by creating sustainable investment policies that remain reliable and are not knee jerk."



Non-bank survey participants



Last year we expanded our survey beyond lending institutions to equity investors and other non-bank capital providers.

It was the right decision. There is no question that they have brought a different perspective to many aspects of the region's financing environment.

As has been well documented elsewhere in this survey, non-banks are generally more optimistic about the future than banks and bring a fresh approach to a whole host of issues.

When asked why the more favourable economic environment does not appear to be translating into available capital, they provided interesting insight.

"Too many over ambitious deals in the 2003-2008 period that went bust, banks were burned and some high profile investors lost. Deals are smaller and more manageable now but banks are not yet back in and the market appears to have shrunk for debt."

"Secondary debt is now looking at the market and seeing opportunities (family office capital, institutional equity groups). We believe the secondary debt market will be the only source for new development debt in the coming 24 months or more."

"Strong increase in ADR and revenues, increases in real estate sales etc. for over 3 years but yet almost no new projects because no conventional lending."

Many of the non-banks alluded to the aforementioned impact of the seemingly changing approach to the region taken by the Canadian banks and their comments were largely very consistent.

"The banks don't seem to yet have the appetite to look at the new facts and trends. The large banks tend to group all the Caribbean in one pot and the deal sizes don't seem to be big enough to get them to carve out segmented areas that are showing strong growth and stability."

"Canadian banks which have large market shares are now more conservative."

"Hard to tell how long it will take for the existing players to 're-engage' – Canadian banks...are still 'gun shy' from the recent crises...However, indications are that they are becoming more bullish in the residential sector, which is a likely precursor to more active lending in the commercial sector, including hospitality."

Notwithstanding the above, unquestionably banks will remain at the very core of the region's tourism industry but non-banks are playing an increasingly important role.

Emerging opportunities

We asked survey participants what single new opportunity excites them most and fills them with optimism about the future of the tourism industry in the Caribbean. Many of the high profile projects and/or regional developments were named including:

- Baha Mar – Bahamas
- America's Cup – Bermuda
- Dart Realty – Kimpton project – Cayman
- Cuba

Some respondents preferred to cite a combination of factors.

"The industry is benefitting from a number of factors: really no major new supply in the region excluding The Bahamas (Baha Mar), new air lift to the region, expanded airports and infrastructure, a general improvement / updating of hotel product and service levels, and an improving US economy coupled with a couple of cold severe winters in the North East region that have boosted demand."

Some of the most interesting comments we received were in response to our question about untapped geographic markets and new concepts.

"The Asian market has the most potential, given its population size and growing middle and upper income market."

"Chinese cruises around the Caribbean. Stopover in several cities."

The topic of economic citizenship has attracted a lot of attention in recent years. It does appear that opinions on this subject are very polarized – respondents were either very positive or very negative.

"Economic citizenship is not a model we will pursue."

"Economic citizenship seems to be a good idea."

"Economic citizenship programs are a fad. Not sustainable and once a few bad buyers taint the system it could be over."

"Citizenship for investment will continue to grow in importance. This is especially important for the broadening of the market to Latin America and Asia."

There was general recognition that very little new room inventory has been introduced in the region and generally this seems to be viewed as a positive feature in the context of improving operating performance of existing projects and correcting prior excess supply.

When asked what type of hospitality projects (asset types and locations) they are looking to invest in over the next 12 months, non-banks indicated that high end villas, single family branded, serviced residential developments and business hotels would be of most interest.



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 in more than 18 countries in 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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