KPMG

2016 Caribbean Hospitality Financing Survey

Travel, Leisure & Tourism

May 2016

Introduction

We are delighted to present KPMG's 12th 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.

This is the third year where we have expanded our survey beyond only banks to also include non-bank capital providers such as equity and mezzanine investors. It is becoming increasingly clear that "non-banks" provide a different perspective to the financing issue and they are proving to be a very welcome addition to our survey.

Non-banks are consistently more confident than banks about the prospects for Caribbean tourism over the next 12 months registering an average of 7.56 out of 10 in terms of their level of confidence versus 6.67 out of 10 for banks. They are also more willing than banks to contemplate a lending opportunity in the Caribbean with 13% of non-banks expressing a very strong willingness to lend in the Caribbean whilst no banks expressed the same opinion. However, 13% of the non-banks indicated they had zero interest in lending in the region with none of the banks falling into this category. As expected most respondents' opinions fell within these two extremes but the general mix of responses for non-banks indicated a greater willingness to lend than banks, as can be seen on page 5 of this report.

Although banks' confidence levels were not as high as those of non-banks, it should be noted that they still rose for the seventh year in succession from 6.50 out of 10 in 2015 to 6.67 in 2016 and are now at levels almost twice those experienced in 2009. Furthermore, whilst non-bank confidence levels at 7.56 out of 10 are nearly a full point above banks they have fallen from 8.17 out of 10 last year, a figure which we described at the time as being "jaw droppingly" high.

So what are we to make of these findings? It is not straightforward. However, when looking at the responses received not only this year but in recent years a clearer picture emerges. The financing environment appears to be very positive with high levels of confidence but this is not translating into readily available capital.

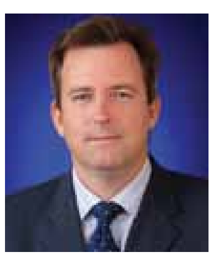
When asked what type of hospitality projects had been financed in the past year, there was not a great deal of activity, particularly given the positive nature of the financing environment. Most financing activity related to existing properties—renovations, refinancing, acquisitions—with virtually no greenfield development.

So again we must conclude that there are clearly obstacles that are holding back the flow of capital into the region. We must continue our search to identify those obstacles and try to remove them, or at least dilute their negative impact. We elaborate on these challenges elsewhere in this publication.

Canadian banks have, for many years, been the primary financiers of developments in the region's tourism industry. It is now widely recognized that the landscape has changed.

Almost without exception respondents indicated that there has been a change in the "major players" lending in the region and that the long-term traditional lenders are not as dominant as they once were. There was not quite as much unanimity as to whether this constituted a fundamental and sustainable change. Somewhat surprisingly, the banking community seems more inclined than the non-banking community to believe the changes are fundamental. In any event traditional lenders are unquestionably more conservative than they once were and this is one of the factors holding back the flow of capital.

However, there are also other challenges. There are numerous structural issues that are considered critical by financiers. For example good airlift is considered a must. This is consistent with the conservative nature of current financing - existing projects, strong management teams and good airlift all appear to be prerequisites if a project is to receive serious consideration from financiers. Projects that do not fit this template, for example greenfield developments with no direct airlift, are finding it very difficult to find financing and will continue to do so.



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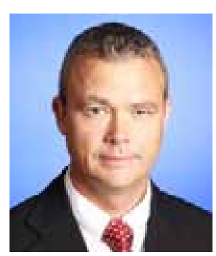

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KPMG in Bermuda

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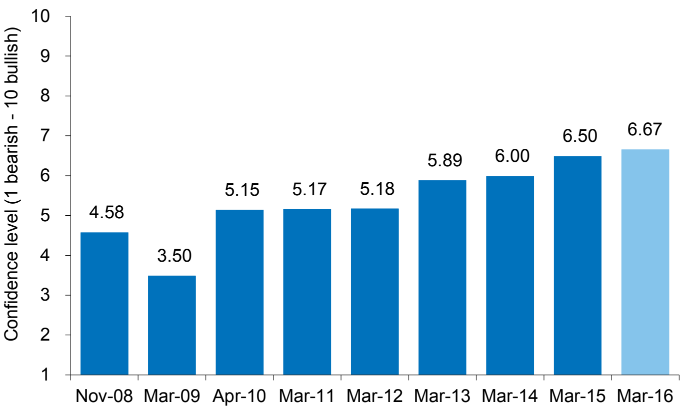
Industry Outlook

Confidence is higher than it has been for many years, liquidity is high and yet there is no readily available capital for tourism projects in the Caribbean.

This seemingly paradoxical state of affairs has been prevalent for several years now and appears to be strengthening and becoming more acute rather than resolving itself.

Banks are more confident than they have been in the last 10 years and their confidence levels have increased every year for the last seven years, as can be seen below.

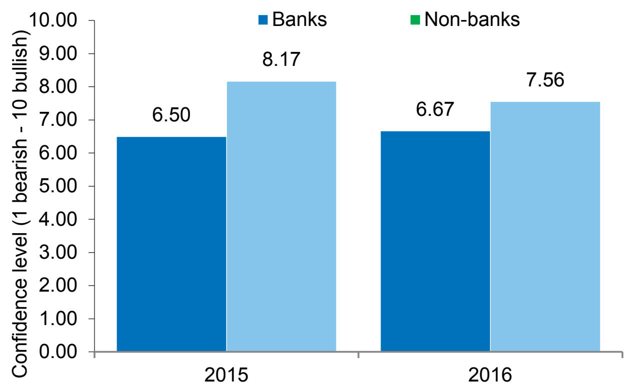
Caribbean Financier Confidence Barometer - Banks



Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Non-banks are even more confident than banks.

Caribbean Financier Combined Confidence Barometer



Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

The differential in confidence between banks and non-banks is not as acute as last year because non-banks confidence levels have dropped slightly albeit remaining at very high levels.

When will meaningful growth in tourism return to the Caribbean?

Most (67%) of non-banks think meaningful growth has already returned to the Caribbean whilst half of bank respondents feel the same way.

As we saw last year those respondents who do not think meaningful growth has already returned tend to think there is still a long way to go. For example, 33% of both banks and non-banks think it will be at least 2017 before meaningful growth returns.

When will meaningful growth in tourism return to the Caribbean? (continued)

	It has already returned	2016	2017	2018 and beyond
BANKS:	50%	17%	33%	0%
NON-BANKS:	67%	0%	22%	11%

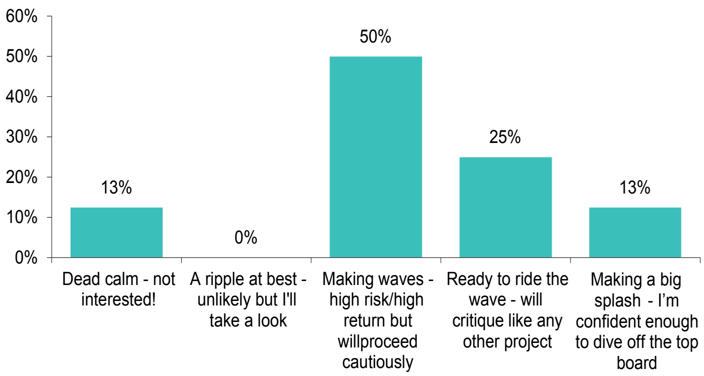
Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Financing Trends

Consistent with our findings last year, none of the banks think it is a perfect time to lend to the Caribbean hospitality sector although 14% of the non-banks do think it is a perfect time to lend.

While all the banks are at least somewhat interested in lending to the region, 13% of non-banks claim to have no interest at all.

Non-banks' willingness to lend in the Caribbean



Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

"We currently hold investments in the Caribbean and plan to increase our holdings in the next 12 months."

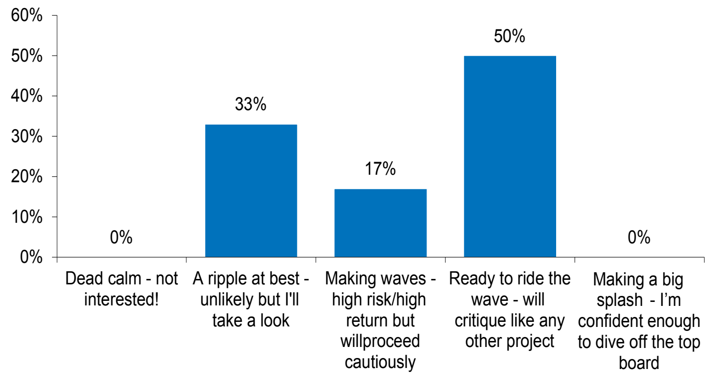
"We have never invested in the Caribbean but are considering entering the market in the next 12 months."

"We previously held investments in the Caribbean and are not considering re-entering the market in the next 12 months."

For the majority of respondents with opinions falling between these two extremes non-banks generally expressed a greater willingness to lend.

When specifically asked what projects had been financed in the last year it was clear that there had not been a great deal of activity and the approach to lending was very conservative in nature. Typically lending was restricted to existing properties for renovations and refinancing with some acquisitions.

Banks' willingness to lend in the Caribbean



Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

"Acquisitions and renovations. No greenfield developments."

"Hotel expansions, acquisitions…"

Why so conservative?

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

"...bank debt is scarce and very limited. Likely banks will continue to have a reduced appetite for large hospitality loans going forward."

"...investors have only just started to look to return, post the economic crisis, but they remain conservative and selective..."

Non-banks provided an excellent explanation of what happens as soon as you move away from the preferred template comprising almost mandatory characteristics such as good airlift.

"For A assets in A markets with good airlift, strong sponsors, and branded product—there is a tranche of high yield debt and preferred equity available. As the product turns to B assets or B markets, the availability of capital dries up very quickly."

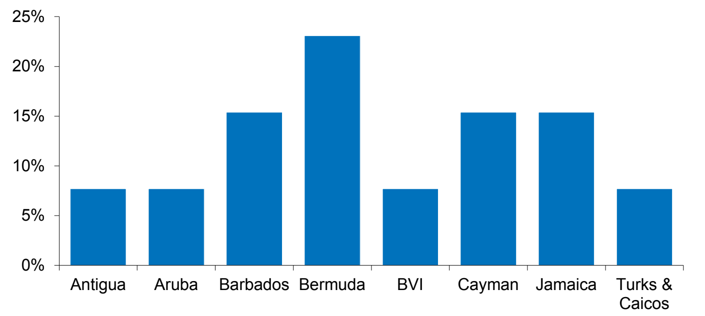
They also provided additional insight on the conservative financing environment.

"...there is fear of non-completion of projects."

"Effects of 2007/8 still with us."

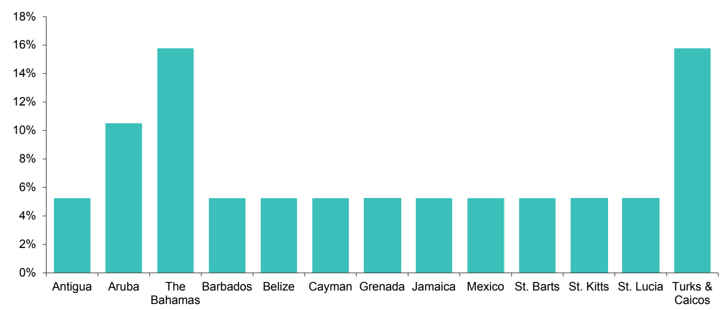
When looking at which destinations in the Caribbean financiers are most bullish about in terms of financing opportunities, the responses were very informative. The large number of destinations nominated by respondents supports the argument that the financing landscape has indeed changed and increasingly there is evidence of financiers favoring certain jurisdictions rather than the region as a whole. Only six countries were nominated by both banks and non-banks and, for non-banks in particular, the countries nominated differed greatly from one respondent to another.

Banks' top countries for new financing



Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

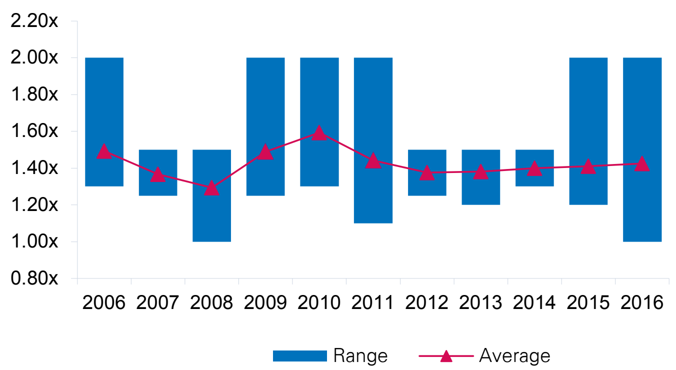
Non-banks' top countries for new financing



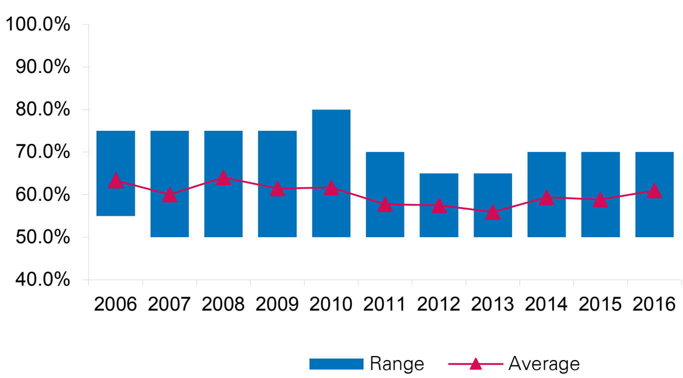
Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Regarding the terms of financing there have been no significant changes - if anything a slight "softening" of terms. The big issue is not the terms, rather it is whether or not financing can be secured. It is highly unlikely that there is anything in the average loan terms that will prevent an investor moving forward if they have reached the fortunate position of seriously negotiating such terms with a financier.

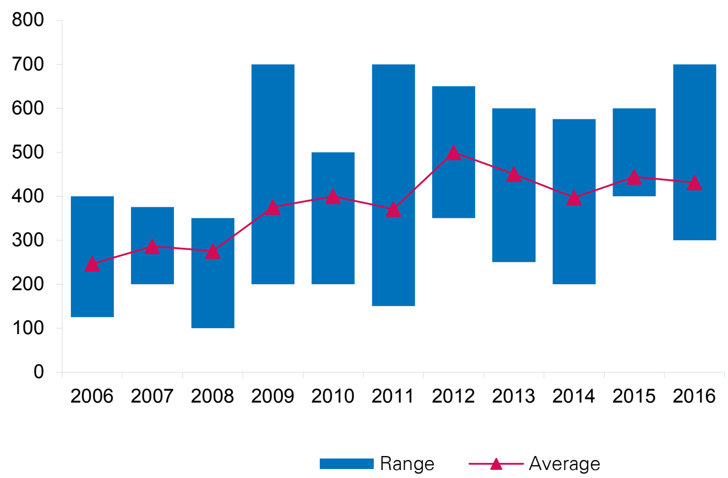
Debt service coverage ratio



Loan to value



Interest rate margin (bps)

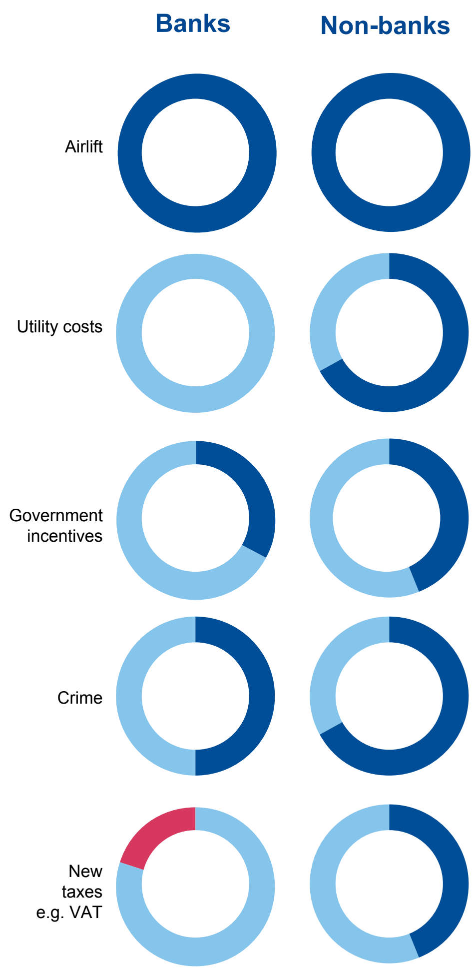


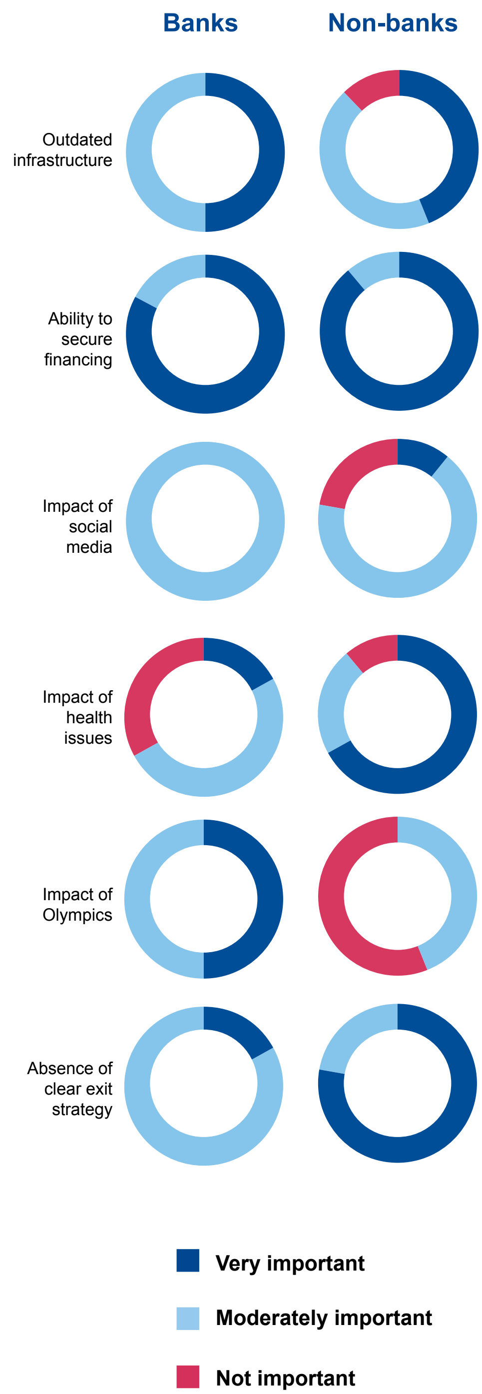
Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Other Trends

No longer can anyone in the region claim not to understand the critical issues impacting financing activity in the region. For several years there has been remarkable consistency in the responses of the financial community. Once again airlift was identified as the most critical issue by all banks and non-banks. Again the ability to secure debt and equity financing was the second most critical issue for banks (83%) and non-banks (89%).

"We are interested in all destination(s) with a well established airlift."





Source: KPMG International, KPMG's 2016 Caribbean Hospitality Financing Survey

Impact of Cuba and the U.S.

Cuba

This year, for the first time, we introduced a specific question on Cuba and its potential impact on the region. We were a little surprised at the relatively cautious nature of responses received. We expected very passionate, somewhat extreme views on this "hot" issue.

This suggests that financiers perhaps feel that the Cuba issue is a little "overblown" or, alternatively, the region may not fully comprehend Cuba's potential impact and may be underestimating it.

Responses concentrated on Cuba's impact on existing volume markets such as the Dominican Republic, Mexico etc, and acknowledged there would be an initial curiosity impact but stopped short of acknowledging long-term sustainable impacts.

"Cuba will draw interest from Mexico and the Dominican Republic once basic infrastructure is improved."

"Cuba will attract the curious tourist in the early days, shifting market share from the Caribbean."

U.S economic cycle

There is no doubting the dependency of the Caribbean region on the U.S. as a source market for capital and tourists. Whilst other regions are seen as viable sources (see emerging opportunities section) the U.S. will remain the primary source market for the foreseeable future. Accordingly we solicited views from respondents as to what stage they consider the U.S. economy to be in the economic cycle and what impact they anticipate the forthcoming U.S. elections will have on the tourism industry in the region. There seems to be a consistent view that the U.S. economy is approaching its peak. In terms of the impact of the U.S. elections on the Caribbean the responses were again less passionate than expected with little impact being predicted although there appeared to be a slight expectation that a Republican White House would have a more positive impact on the region.

"A Republican White House has always favoured the Caribbean…"

"Possible, but overall limited impact."

Emerging Opportunities

We asked survey participants what single new opportunity excited them most and filled them with optimism about the future of the tourism industry in the Caribbean. In terms of single events or projects, The Americas Cup in Bermuda in 2017 received an honorable mention.

However, most respondents preferred to concentrate on factors such as improvements in key performance indicators and the general financing environment.

"Reality is the fundamentals such as ADR, and REVPAR are improving, and airlift is improving. These are the items that influence optimism."

"...solid investable assets are beginning to present themselves."

"...write downs/asset sales have been completed & thus now provide some capital/ capacity to increase lending in the sector."

In terms of new activities that could boost activity in the region, Economic Citizenship was raised again, as in prior years. On this subject responses were passionate and polarized.

"Economic citizenship - Growing the economy via an increase in population, then spending and then GDP."

"CIP is of very little interest and filled with Reputation Risk for a bank - do not envisage participating in this scheme."

We have already addressed the importance of the U.S. as the region's primary source market for capital and tourists. When asked which other markets have the most potential we received a wide variety of responses - China, Latin America, Canada, U.K and, less predictably, Turkey.

In closing, we return to the issue of the change in landscape. Almost without exception respondents indicated that there has been a change in the "major players" lending in the region and most believe this is a fundamental and sustainable change. With change comes opportunity and whilst easy to find negatives with the new landscape we have strived to highlight some opportunities.

We found support for a sustainable alternative to traditional debt financing—expensive perhaps but satisfying a particular need.

"...this tranche of specialty/ high-yield debt will remain in the Caribbean as an alternative to traditional bank financing when it does eventually return. The cost of capital will float between 300 and 700 basis points above what a traditional bank will do. Borrowers will be willing to pay this for execution or to create a higher LTV."

We also found some evidence of the market adapting to the new landscape.

"Alternative capital providers have introduced new financing options."

"...variability of each transaction is leading to customized solutions for each project...a refinance or full-exit is unclear so project IRR's cannot be determined upfront."

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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