Caribbean Hospitality Financing Survey

Now, for tomorrow

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Contents

We are delighted to present the 2021 Caribbean Hospitality Financing Survey, highlighting financing trends in the region's hospitality and tourism industry and the outlook for the future.

Introduction

What extraordinary events we have all experienced over the last 16+ months. The coronavirus pandemic has had such a devastating impact on so many lives and on the physical and mental well-being of millions. We are sure everyone's hearts go out to all those affected directly by the pandemic.

No one could have predicted a disaster of this magnitude. In Caribbean terms it has been like a Category 5 hurricane except that this catastrophic event did not continue its journey after a day or two, allowing time for recovery efforts and assistance. It has stayed in place for many months, as the damage continued to unfold.

From a business perspective, the impact on financial well-being and livelihoods of owners and employees is clear.

Businesses were lost in some cases and the financial health of others seriously damaged. Many lost the work of a lifetime and yet it was not the fault of business owners nor employees nor any stakeholder.

Most insurance policies did not cover claims for business interruption caused by a pandemic while usual sources of oversees assistance were unavailable, as governments were preoccupied dealing with their own responses to the pandemic.

Our report finds 60% of respondents believe COVID unquestionably has been the greatest threat to tourism in their lifetimes — which puts the pandemic in perspective when considering the scale of previous catastrophic events such as 9/11 and SARS, and major hurricanes such as Ike, Irma, Maria, Ivan and Dorian.

Of course, the tourism industry has been hit harder than most, with airports closed for months, widespread travel restrictions, rigorously applied quarantine measures and other health protocols such as social distancing and wearing of masks.

How can a tourism industry survive such conditions? How can resorts possibly continue?

And yet … the results of our survey illustrate the remarkable resilience of the region's tourism industry.

In the prevailing circumstances, a 2020 Caribbean Financing Survey was not possible and so the 2021 Survey has been particularly eagerly anticipated. The results are worth the wait and provide hugely valuable insights into how the financing community views the impact of the pandemic on the future of the region's tourism industry.

Notwithstanding what will hopefully be a once-in-a-lifetime event, the confidence levels of the financing community are at remarkably high levels, particularly for the non-bank sector comprising private equity firms, family offices, developers and others.

Pre-pandemic, the Confidence Barometer, which records the financing community's confidence levels in our tourism industry, had recorded an amazing sequence of nine consecutive years of increased confidence levels from 2009-2018, with a downward correction in 2019.

Where are we now post pandemic? The confidence of banks is at 5.83 out of 10, just 8% down on pre-pandemic levels. Non-banks rank at an extraordinary 8.96 out of 10, the highest level since non-banks were first surveyed in 2015 and more than double the confidence level immediately prior to the pandemic. It is the non-banks who are currently the major source of inward investment into the Caribbean and who are really driving the changes in the financing landscape.

How can these remarkable results be explained? It is a difficult question but one to which the survey responses provide some answers. Results vary across the region and by different business models, but it is clear the surging real estate market is unquestionably a major factor driving the confidence levels.

Stakeholders in resorts and condo-hotels with real estate components are exhibiting huge confidence. The survey also reveals a rapidly growing market sector of privately owned villas and villas for rent, some separate and distinct from traditional resorts, others managed by established resort management companies. Either way, they have created an ecosystem satisfying the needs of villa owners or renters.

The real estate market has boomed even in jurisdictions that have welcomed few tourists post-pandemic as many investors, mainly high net worth ("HNW") individuals, look for a Plan B or Plan C in case this pandemic continues or similar events become part of the "new normal". The family offices of these HNW individuals, coupled with private equity funds, are driving the real estate growth, which is predominantly taking place at the very high end of the market.

The effects of COVID will unquestionably feature strongly in future surveys. No-one knows how events will unfold but the results of this survey certainly offer enough positivity to allow everyone to look forward with renewed optimism.

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Industry outlook

The impact of COVID

Given the period under review it was inevitable that the subject of COVID would dominate responses in this survey.

Some 60% of respondents stated that COVID has unquestionably been the greatest threat to tourism in their lifetime.

When asked to specify the single biggest impact COVID has had to date on financing decisions involving Caribbean tourism projects, the responses provided insights into how financiers were able to get through the pandemic and how the financing landscape has changed.

Some responses clearly indicated the biggest impact for them were tough financial lessons learnt; others were surprised at the rate of recovery. A lack of financing was also raised, along with the increased cost of doing business.

Financial disciplines

Many respondents reflected on the financial lessons learnt.

"Need strong Balance Sheet."

Cash flow

The old maxim "cash is King" appears to be more relevant than ever following the pandemic.

"Ensure proper working capital."

Speed of recovery

Several respondents remarked on their surprise at the speed of recovery once restrictions were lifted.

"The pace of recovery of international leisure travel to the region."

"Cautiously optimistic now as pent-up travel demand seems to be spurring visits."

Availability of financing

Other respondents commented on the increased difficulties of securing financing.

"The willingness of banks and non-bank lenders to finance hotel projects at all. Those that will consider lending require strict and unattractive covenants."

"Lack of financing"

"Slightly more cautious with larger projects that do not have HNW group as equity partners."

Cost of doing business

One feature of the new landscape appears to be an increased cost of doing business.

"Spike in material costs and shipping."

Confidence levels

There was no 2020 Caribbean Hospitality Financing Survey for obvious reasons and so it is useful to look at where confidence levels were pre-pandemic.

Confidence levels for banks had increased for an astonishing nine years from 2009-2018 before experiencing a 11% downward correction in 2019.

The confidence levels of non-banks had exceeded those of banks every year since their first participation in the Survey in 2015. However, in 2019 there was a considerable 42% downward slide in non-bank confidence levels.

So, in short, going into the pandemic, confidence levels appeared to have peaked after many years of annual increases and had seemingly just started on a downward trend. The question at that point was whether this would be just a temporary correction or the start of a less confident financing community who were envisaging a possible downturn in economic activity. Some respondents were even contemplating the dreaded "R' word – recession.

So, what are the current confidence levels of the financing community post COVID?

The results do not disappoint.

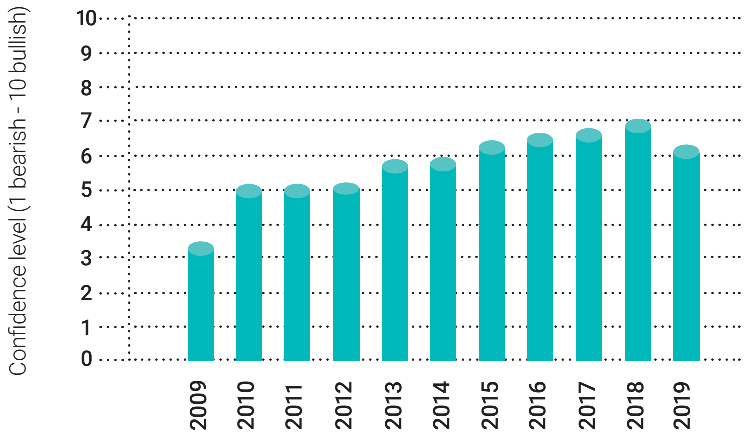
They are, in fact, remarkable, particularly for the non-bank sector. The banks' confidence levels are only **8% lower** than they were before the pandemic. However, the non-banks are far more bullish. Their confidence is at a level of 8.96 out of 10 which is **more than double** the rate pre-pandemic. Indeed, they have the highest confidence levels since 2015 when non-banks first participated in the survey.

These results represent a reassuring response, given the extent to which respondents are responsible for literally billions of dollars of investment in the Caribbean tourism sector.

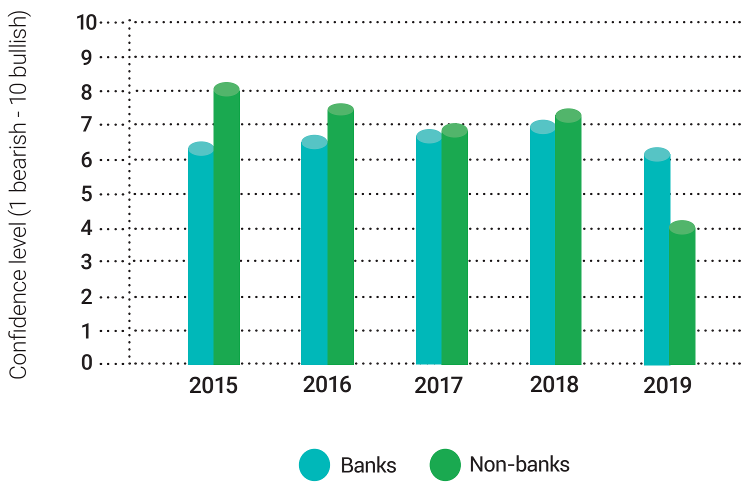
How can these confidence levels be explained? Other survey comments provide the context.

None of the non-banks has disposed of equity stakes in Caribbean tourism projects pursuant to the pandemic. **All** of them anticipate making new investments in Caribbean tourism projects in the next 12 months. **The majority** report already having made new investments since the outbreak of the pandemic.

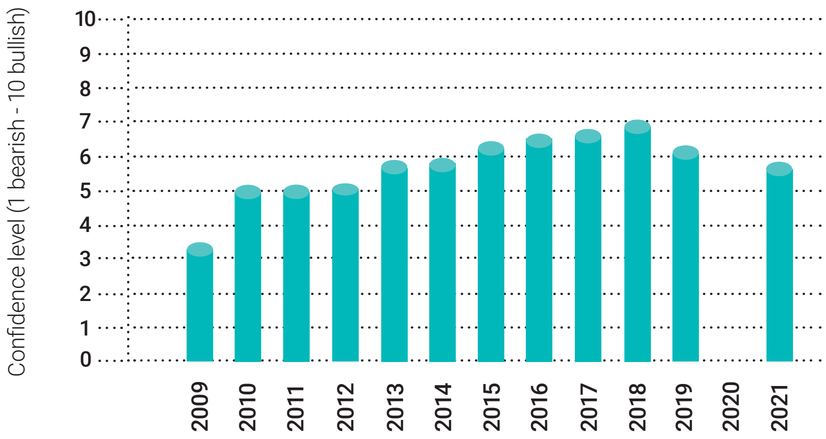
Caribbean Financier Confidence Barometer - Banks



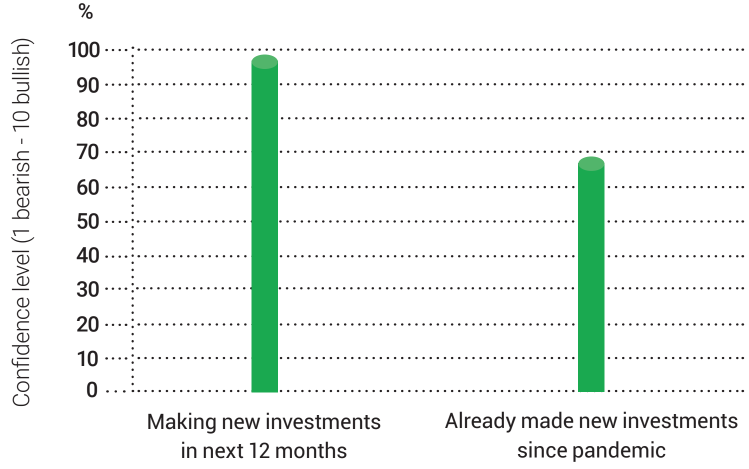
Caribbean Financier Confidence Barometer - Banks versus Non-banks



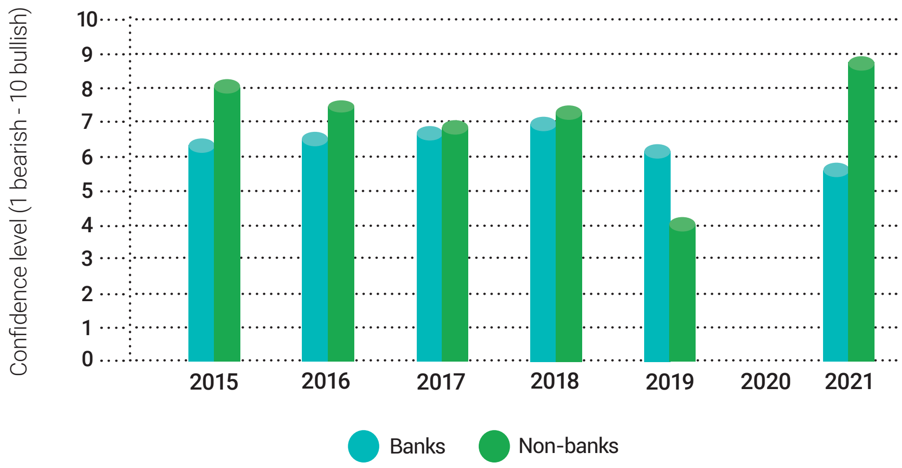
Caribbean Financier Confidence Barometer - Banks



Non-banks' appetite for investment



Caribbean Financier Confidence Barometer - Banks versus Non-banks



Banks are noticeably more cautious than non-banks. Some 40% report lending, but only to existing clients with strong track records, while 60% report lending but taking a more conservative approach compared to the pre-COVID period.

Banks also appear to deserve credit for how they have handled the pandemic's impact on their clients. None reported that any of their clients had gone out of business as a consequence of COVID, while respondents also assisted their tourism industry clients in various ways. These included deferring debt service payments and restructuring. In return they imposed a wide range of restrictions on payments (including dividends, and intercompany transactions), increased reporting requirements and requiring additional security if available.

It remains to be seen how borrowers cope with the revised terms of their loans, although they will no doubt have benefited from the financial disciplines imposed by lenders.

On a cautionary note, what confidence there is among banks could still evaporate. Some 20% of banks anticipate that more than 10% of their tourism industry clients will go out of business within the next 12 months.

Real estate

While confidence is high across the board, our survey found results vary by geography and by business model. The region's real estate market features more prominently this year than in previous Caribbean Financing Surveys and is clearly a factor, possibly the major factor, driving high confidence levels.

The majority of non-bank respondents report seeing their stakeholders and other HNW individuals contemplating investments in Caribbean tourism projects as part of a Plan B or Plan C strategy for an alternative base to live and work from home in the Caribbean for extended periods in the event of further outbreaks of COVID and similar pandemics.

If we factor in the Caribbean's "eternal summer" climate, outdoor lifestyle and proximity to North America, then it becomes more tempting for people to work from home in the Caribbean, particularly if your island home jurisdiction has a private air terminal and excellent telecommunications — which, sadly, many islands in the region still lack.

Asked about non-negotiable characteristics that a destination must have to attract such investors, respondents nominated:

"Open outdoor spaces and high-quality amenities."

"Direct commercial flights from major US airports."

"Excellent air access, telecom, security, health care options."

"FBO. Excellent telecoms plus tax advantages."

"Good infrastructure."

"Good internet. Safety."

"Safety, reliable Wi-Fi, natural amenities, airlift."

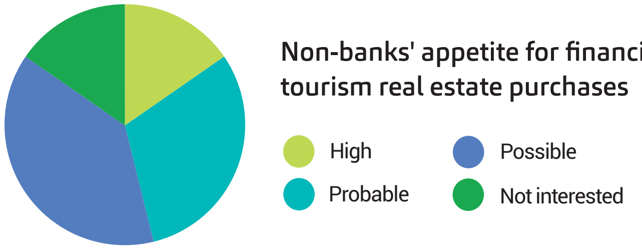
"Ease of access, eco-system of services and activities, telecom, stable political environment."

"Rule of law, labor and lift."

Not surprisingly resorts and condo-hotels with a real estate component are beneficiaries of the strong market but it appears that the biggest growth market is privately owned villas and/or villas for rent. The growth of this sector represents one of the major insights generated from an analysis of responses to the survey. These villas are sometimes serviced by established resort management companies whilst others are separate and distinct from traditional resorts. Either way they have created an entire ecosystem satisfying the needs of the villa owners or renters by creating jobs in services such as landscaping, catering, security and daily activities.

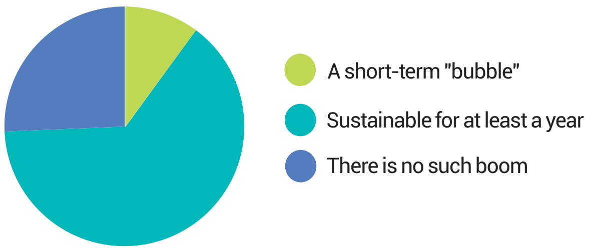
The appetite of non-banks for financing tourism real estate purchases predicated on future rentals varies, but only 15% indicate they are not interested. Nearly half have a high or probable level of interest. Taken as a whole, it seems likely that financing will be available, if required, to fund continued investment in this area. Some 60% of banks say it is "possible" they will finance tourism real estate purchases, and only 15% rule this option out. Suffice to say we can expect to see continued growth in this sector.

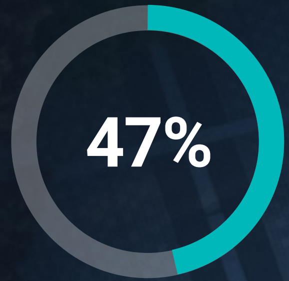
Non-banks' appetite for financing tourism real estate purchases



How long will the real estate boom last? Two thirds of respondents believe it is more than just a short-term "bubble" and will continue for at least a year.

How long will the real estate boom last?





of respondents believe that growth is predominantly at the very high end of the real estate market.

42% believe growth is at both the high-end and mid-market with just **11%** believing it is right across the board.

Tourism real estate growth

Gold star award

Which governments in the region were considered by respondents to have provided the best support to their local tourism industry? Many received praise.

"Island governments in Dutch Caribbean provided wage subsidy to private sector and other subsidies, funded by the Government of the Dutch Kingdom."

"Cayman Islands due to their control of the issue."

"Turks and Caicos did a great job and still is."

"Dominican Republic- High vaccination rate. Jamaica - Resilient corridor."

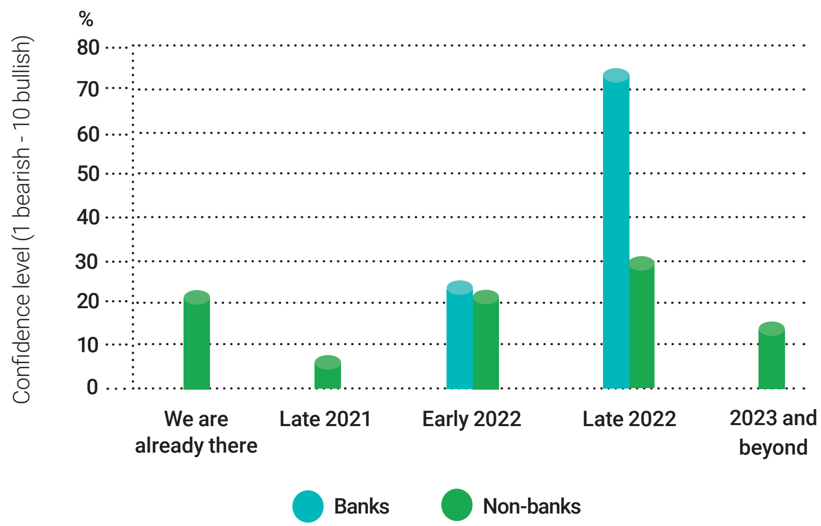
"Bahamas, Antigua."

Timeline

When asked when the number of tourists visiting the Caribbean would return to pre-COVID levels, respondents' opinions varied but most suggested we are not there yet. Certainly most banks suggest it will be late 2022 before we get back to pre-Covid levels and even the more optimistic non-banking sector respondents are, overall, in agreement. Some even think it will take until 2023 and beyond for tourist numbers to fully recover. It is worth noting that experiences vary across the region.

Some destinations have already returned to pre-COVID levels. However, respondents were asked for their views on the region as a whole.

Timeline for pre-COVID tourist numbers in the Caribbean



Financing

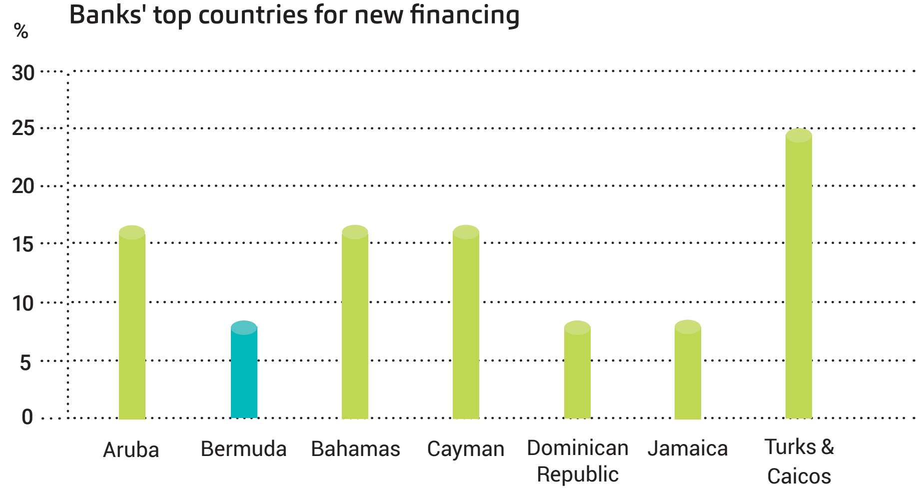
During pandemic

During the last 16+ months banks say 80% of their primary financing activities have involved the restructuring of existing financing agreements and 20% has been financing of new builds.

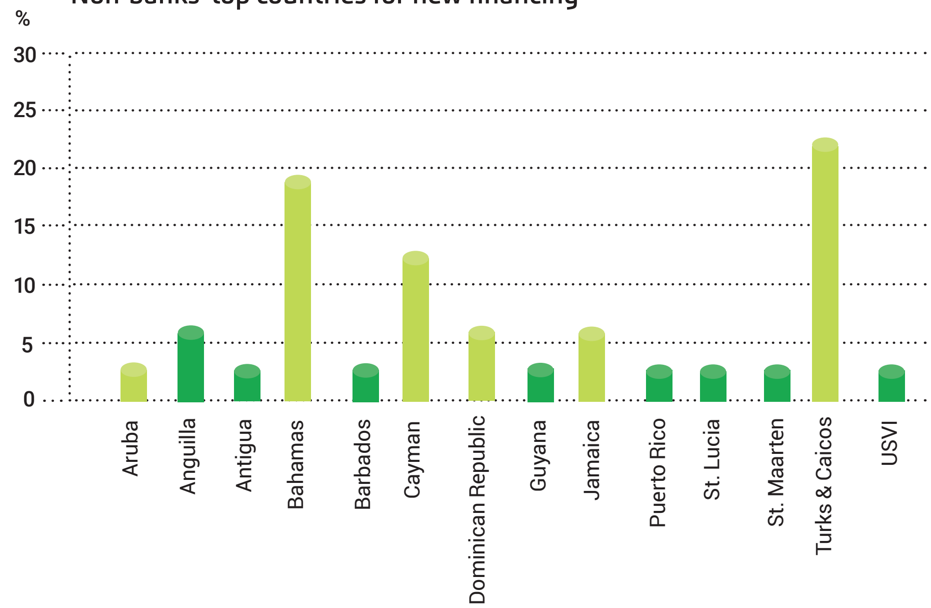
Top countries

When we looked at which destinations in the Caribbean have financiers that are most bullish, 14 different destinations were put forward, of which 6 were nominated by both bank and non-banks and which are highlighted in Green on the right.

Banks' top countries for new financing



Non-banks' top countries for new financing

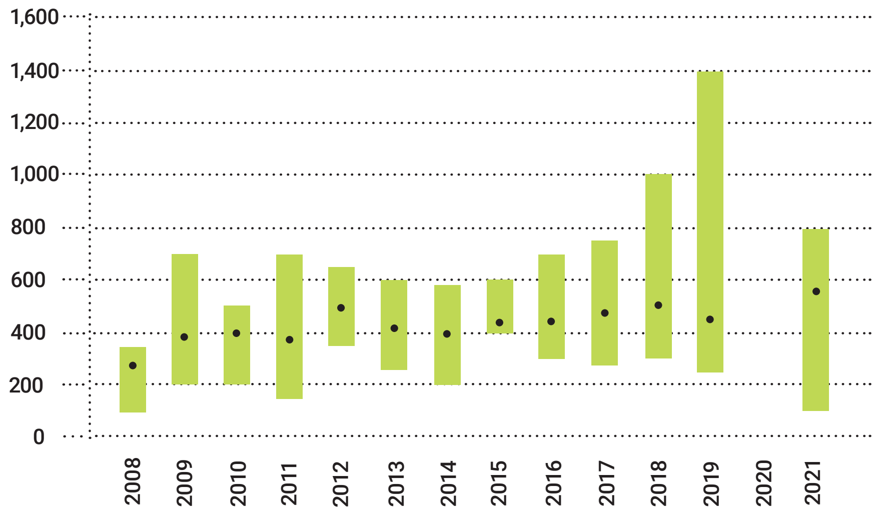


Terms

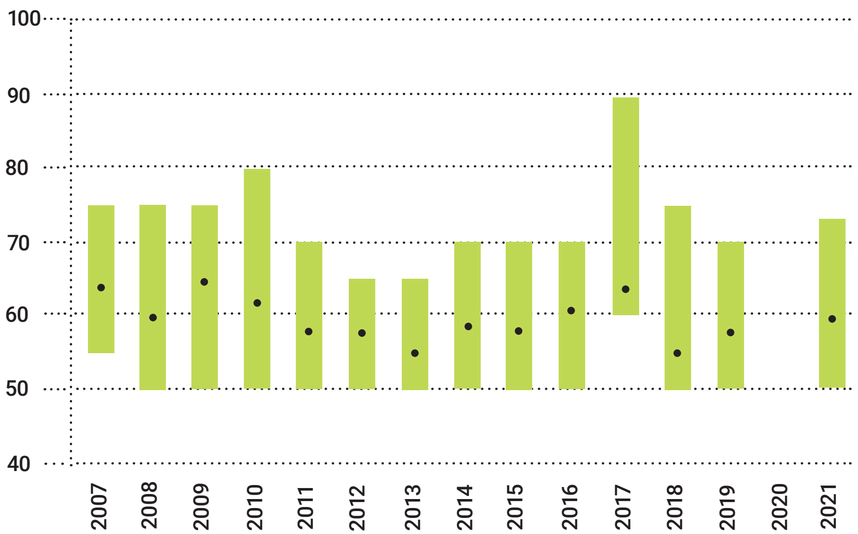
The terms of financing have not changed significantly since 2019.

Debt service coverage ratio

Interest rate margin (bps)



Loan to value



Banks stated that a strong equity component was their most critical covenant.

The debt service coverage ratio required has risen slightly, to around 2 on average. The loan-to-value ratio is hovering around 60% and average interest rate margin is approximately 500 basis points. These terms are not unexpected particularly at a time when financiers are calling the shots. The bigger challenge is whether financing is available.

Availability of finance

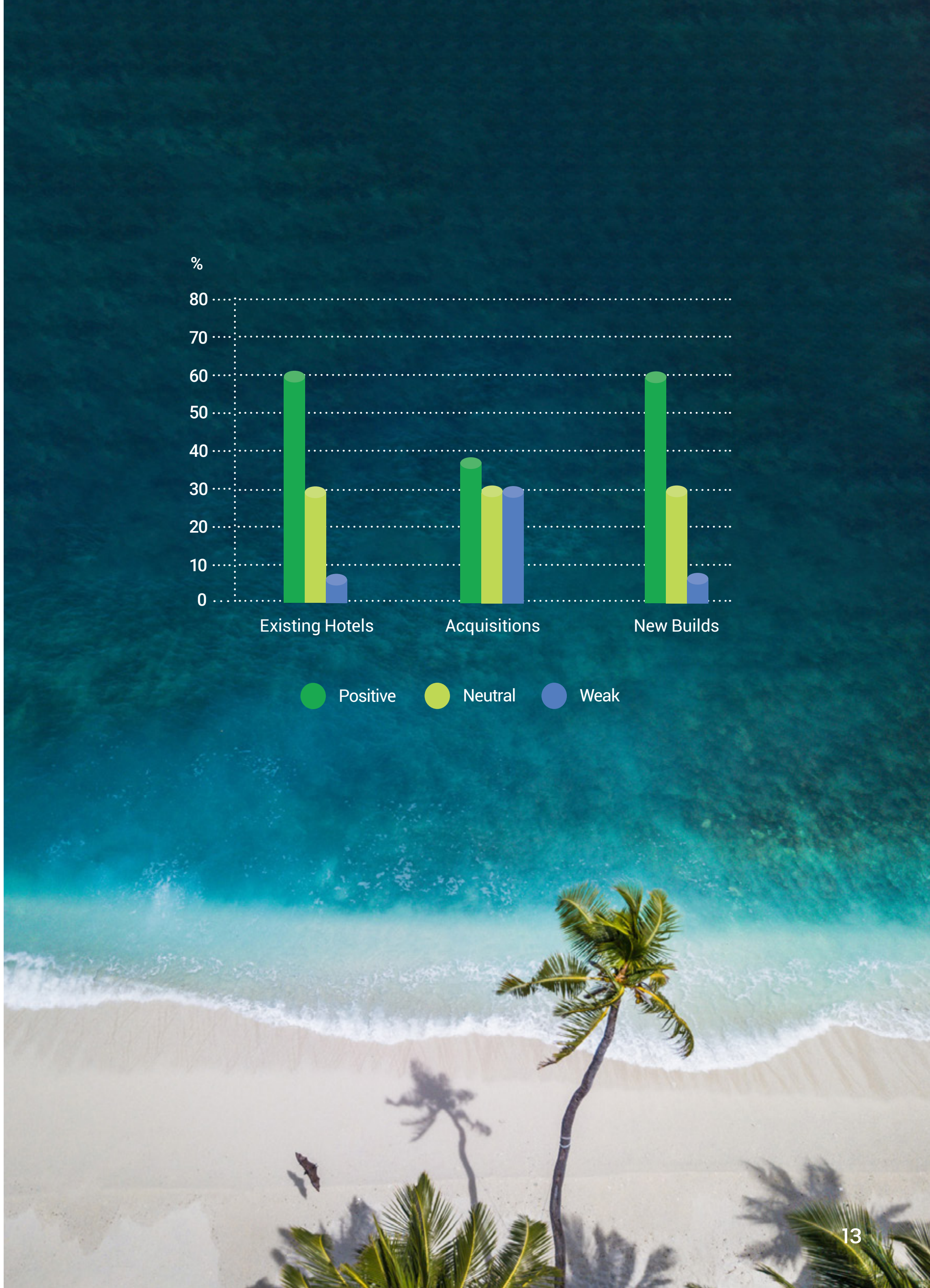
Financiers indicate they are generally positive about financing tourism related projects in the Caribbean for all categories.

The level of positivity for existing hotels and new builds may be a little surprising but many existing hotels are taking this opportunity to renovate and/or restructure and some of the new builds have been planned for some time and are backed by HNW investors with a strong track record. Some of the new inward investment is also in new builds rather than acquisitions.

When asked if deals are often too small in the Caribbean, and whether there is insufficient scale to make the investment worthwhile, approximately half of the respondents agreed that this was an issue and was a reason why institutional funds are largely not available in the Caribbean.

For those for whom scale is an issue, their minimum investment amount varied significantly. For some it was as high as US$200m. Most fell in the US$25m – US$75m range but several made it clear they would still be interested in transactions in the US$2m – US$10m range.

As we have seen throughout this survey, non-banks are leading the charge in terms of current financing of Caribbean tourism projects. We asked them what statement most accurately reflects their post pandemic rationale for investing in Caribbean tourism projects. Some 54% said they applied the same rationale and metrics as before the pandemic, while 31% said their rationale was opportunistic and that the pandemic had led to more opportunities with greater value. The remaining 15% said their investments were linked to their stakeholders' intention to spend more personal time in the Caribbean which impacted investment targets.



Other trends

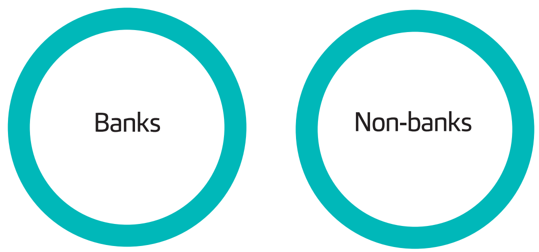
The critical issues impacting financing activity in the region are once again very clear.

It is no surprise that airlift was yet again identified as the most critical issue for all banks and all non-banks.

Crime is again the second most important issue for non-banks, cited by 86%, matched by the impact of health-related issues — the latter becoming more important compared to previous years, thanks to the effects of COVID. For 83% of banks, the availability of debt and equity was the second-most important issue with crime and health next most important.

- Very Important
- Moderately Important
- Not Important

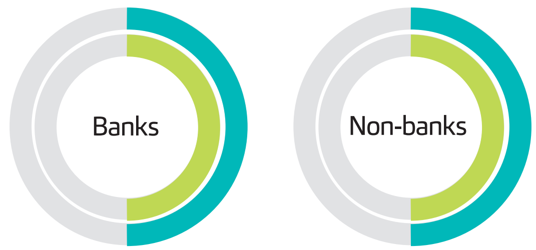
Airlift



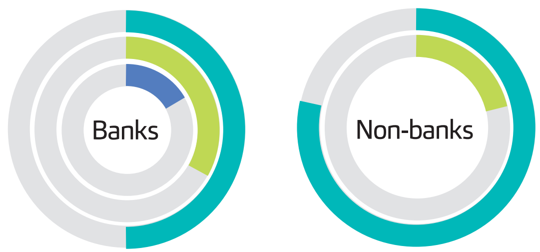
Crime

Utility costs

Government incentives



New taxes

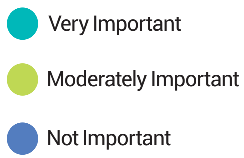


Outdated infrastructure

Debt & equity financing

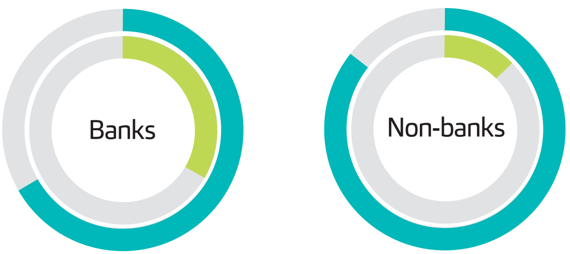
Immigration issues

Impact of social media



Absence of exit strategy

Health issues (e.g. COVID)



Quality of telecommunications

When asked what other issues impact their financing activity, respondents listed difficulties finding suitable employees, quality (or lack thereof) of day-to-day banking services and the need for no restrictions on currency flow.

Many respondents (50% banks, 43% non-banks) considered it was becoming more difficult to conduct business in the Caribbean – one of the few cautionary notes coming out of the survey.

Banks' view on level of difficulty to conduct business in the Caribbean

More   Less   Just the same

Non-banks' view of level of difficulty to conduct business in the Caribbean

In terms of how these critical issues impacting financing activities can be mitigated, respondents emphasized the need for a "joined up" macro approach to tourism.

"Integrated tourism strategy."

However most respondents looked firmly towards government for leadership in tackling these issues.

"A proactive government that recognizes issues and effectively deals with them."

"Strong government understanding and support."

"Investment by governments in infrastructure."

"Sustained airlift, political stability."

"Greater government support."

"Deter illegal immigration. More efficient government department processing."

New financing landscape

Announcing a "new landscape" can sound presumptuous but it is difficult to imagine a catastrophic event like COVID lasting for 16+ months and it not leading to dramatic changes in the financing landscape, which may have changed forever in some respects.

What does this new financing landscape look like?

We have already identified several changes, such as the increased cost of doing business, the increased role of real estate and residential components of resort developments, the thriving high-end real estate market, the accelerated emergence of the private villa market, owned or rented, the enhanced profile, and inward investment role of family offices and private equity, to name just a few.

We asked respondents where their focus would be over the next 12 months in terms of asset type. Their answers reinforced these trends.

"Remote eco-luxury high end resorts serving multi-generational family customers."

"All real estate. Marina related."

"Working capital needs of regional portfolios of hotels."

"Beachfront, water view and water access."

"Luxury serviced small foot-print residential developments."

"New luxury development with residential component."

"Villa resorts."

"New tourism for sale product with a mixture of villas and multi-unit."

It is hard to say there were any winners pursuant to COVID but unquestionably some business models appear to be more sustainable than others.

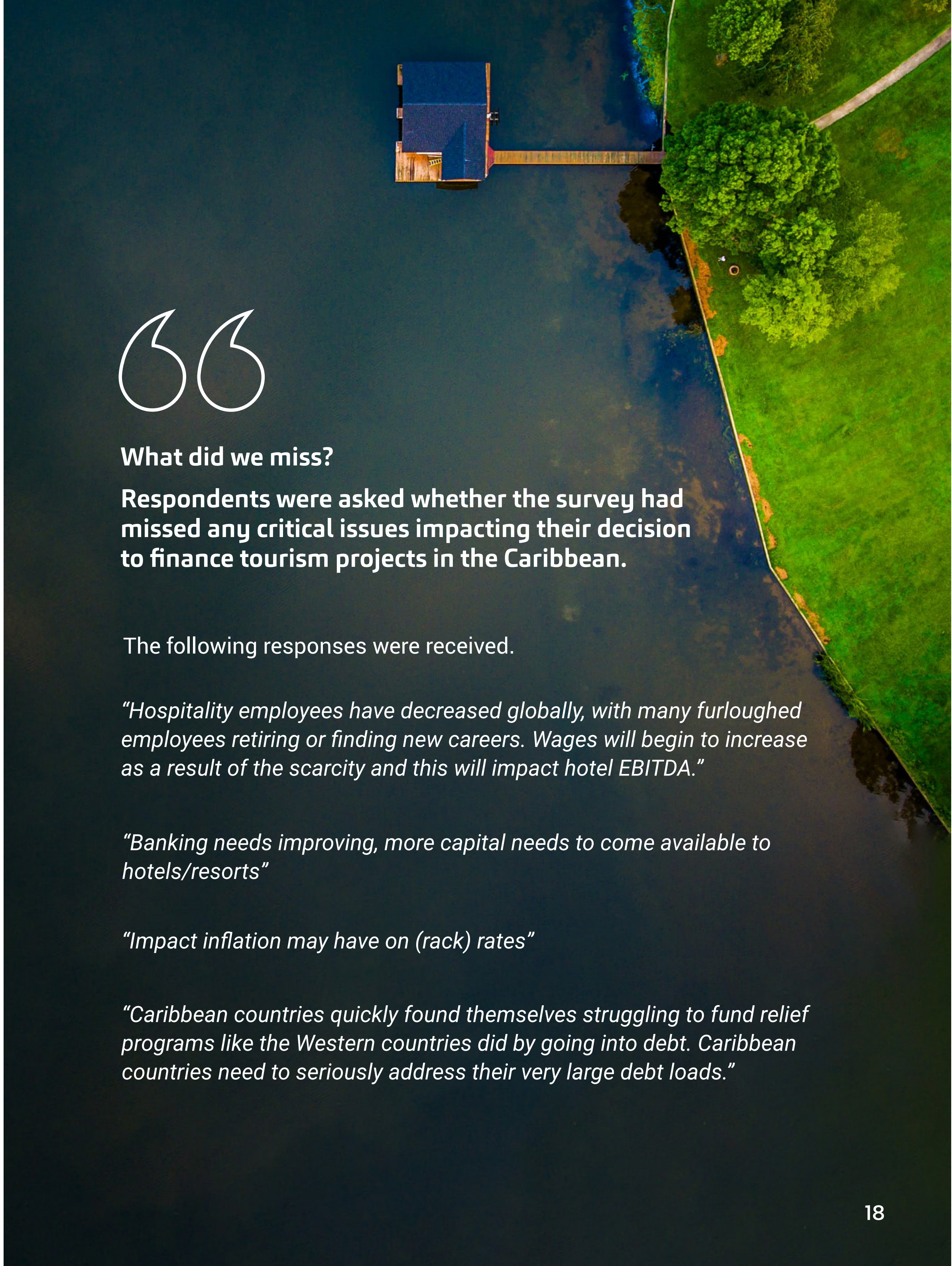
84% **16%**

Some 84% of respondents believe low-volume, high-end destinations now have more sustainable business models than high volume mid-market destinations, while 16% believe high volume mid-market destinations have the more sustainable business model.

Four out of five respondents believe resorts and condo-hotels with a real estate component are more sustainable than European Plan Hotels, the sustainability of which was supported by just 11% of respondents. The sustainability of all-inclusives was supported by only 5% of respondents.

Overall, 83% of banks and 77% of non-banks believe Caribbean destinations servicing the North American market appear to have a more sustainable business model in a post-COVID environment than destinations with a diversified portfolio of source markets. The latter was supported by 17% of banks and 23% of non-banks with no support from respondents for destinations primarily servicing the European market or other markets.

Clearly proximity to home when traveling is an important factor during these times.



What did we miss?

Respondents were asked whether the survey had missed any critical issues impacting their decision to finance tourism projects in the Caribbean.

The following responses were received.

“Hospitality employees have decreased globally, with many furloughed employees retiring or finding new careers. Wages will begin to increase as a result of the scarcity and this will impact hotel EBITDA.”

“Banking needs improving, more capital needs to come available to hotels/resorts”

“Impact inflation may have on (rack) rates”

“Caribbean countries quickly found themselves struggling to fund relief programs like the Western countries did by going into debt. Caribbean countries need to seriously address their very large debt loads.”

Excitement and Optimism

We want to conclude the Survey on a positive note and the responses certainly justify that.

> When asked what single new opportunity excites the respondents and fills them with optimism about the future of the tourism industry in the Caribbean, we received responses which were consistent with all the other major Survey responses.

“Peoples realization that they can work remotely and therefore can spend much more time in a warm location.”

“Off-grid resort projects for ultra-luxury.”

“Stand alone villas within a resort.”

“Better critical health care options.”

“Working capital needs of large hotel groups.”

“All-inclusive conversions.”

“Boating related.”

“Villas.”

…… and perhaps the most telling comment:

“The fact that the industry survives something like Covid against all odds.”

We concur – there is no better way to sum up the resilience of the region’s tourism industry and explain why this latest survey is characterized by positivity and optimism.

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