Caribbean Hospitality Financing Survey

2022

Now, for tomorrow

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Introduction

What a roller coaster ride we have all been on in recent years. Just as we move past the two-year anniversary of the outbreak of COVID and start to see some semblance of normality return to the travel business, a major conflict breaks out in Europe, the nature of which is potentially more serious than many of us have experienced during our lifetimes.

This is bringing with it an acceleration of inflationary concerns and supply chain problems from a business perspective. Investors hate uncertainty. It's a cliché but one that has been proven many times over. Given the uncertainties, potential investors in the region's tourism industry must surely be running for the hills? Not at all according to our survey results, which once again bring refreshingly good news for this the most critical industry in the region.

Our Confidence Barometer, which records the financing community's confidence levels in the Caribbean tourism industry, is consistently the most popular feature of our survey. This year it shows record levels of confidence amongst the banking community; levels that are now approaching those of the traditionally less conservative non-banking sector represented by private equity firms, family offices, developers and others. The confidence level of banks this year is 7.40 out of 10, the highest level since we started our survey in 2009.

The confidence level of the non-bank sector is even higher at 8.31 out of 10; albeit slightly down from the barely sustainable level of 8.96 last year, which is the highest level registered since this sector started to participate in our survey in 2015. The consistency of high confidence levels amongst both the bank and non-bank sectors is reassuring.

Does this all mean we need to revisit the "investors hate uncertainty" maxim? How can they be so confident when there appears to be so much uncertainty? The reality is that their confidence levels are high because in the current financing environment, the Caribbean hospitality industry is considered to be relatively stable with little uncertainty
in many important respects.

For example, all regional tourism markets are now open to a greater or lesser extent and travel restrictions have been greatly eased. Furthermore, tourists in our main feeder market, North America, are keen to travel again and make up for perceived time lost due to the pandemic. As people review their lifestyle choices post pandemic, it seems vacations are increasingly considered to be an essential budgetary item rather than a discretionary spend. Where are they traveling to?

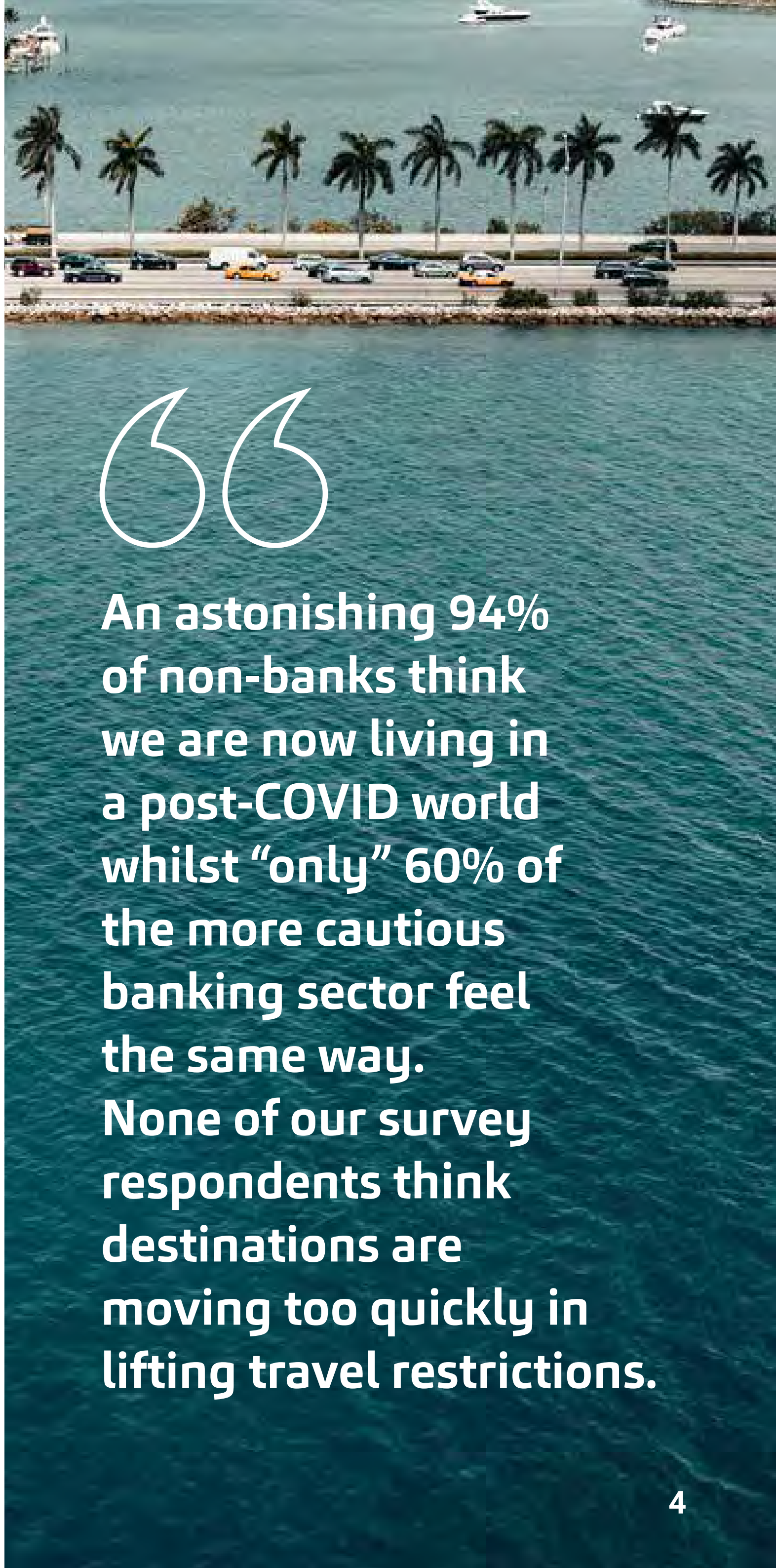
Somewhere close to home like the Caribbean is the answer for many and whilst there is now more paperwork and preparation needed when traveling, tourists are getting used to testing, providing contact details etc in much the same way that post 9/11 we are all now used to removing laptops, belts and shoes when passing through security.

An astonishing 94% of non-banks think we are now living in a post-COVID world whilst "only" 60% of the more cautious banking sector feel the same way. None of our survey respondents think destinations are moving too quickly in lifting travel restrictions.

How about the impact of the conflict in Europe? It is obviously a serious concern, but the Caribbean has always been considered a safe haven at such times for many North Americans who will be tempted once again to stay relatively close to home when planning their vacation.

Another reason why investors will not be running for the hills any time soon is that they have far too much cash to take with them as luggage! Liquidity remains high and for many investors, eg funds, surplus cash has to be deployed pursuant to governing covenants. However, the future of many traditional homes for excess liquidity such as global stock markets is very uncertain. So where are funds being deployed?

We know US$ billions of funds are already being deployed in the Caribbean tourism industry by participants in our survey. Furthermore, 88% of our non-bank respondents intend to make new investments in Caribbean tourism projects over the next 12 months. 50% say their deal flow and pipeline is stronger than before COVID. 80% of banks have a deal flow and pipeline that is at similar levels to before COVID or stronger than before COVID.



> **An astonishing 94% of non-banks think we are now living in a post-COVID world whilst "only" 60% of the more cautious banking sector feel the same way. None of our survey respondents think destinations are moving too quickly in lifting travel restrictions.**

The most popular home for cash deployed is some form of real estate investment.

All banks in our survey believe liquidity will be invested in real estate rather than in stock markets or held as cash and 75% of all non-banks feel likewise.

If you are a realtor, developer and/or have a real estate component to your development project then this is your time. It is hard to imagine when you will enjoy more favourable conditions.

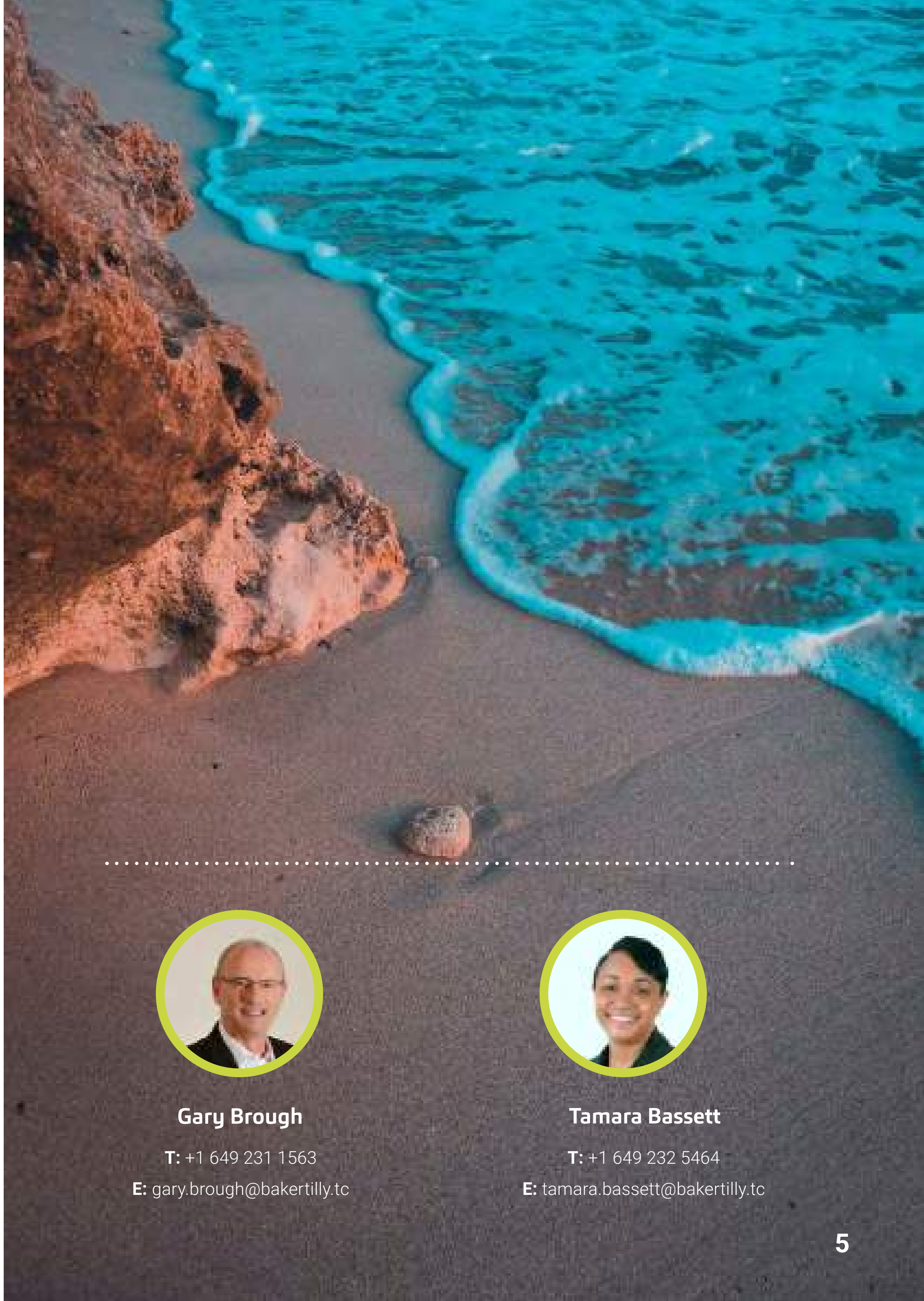
We have all experienced real estate growth before, but this market appears to have some legs to it.

56% of non-banks (80% banks) believe the current real estate boom will last for the next 12 months and another 44% of non-banks (20% banks) think it will last considerably longer.None of our respondents thinks this is a real estate bubble.

However, there are always cautionary notes. Unquestionably a cloud on the horizon is inflation. Rates have been very low for 30 years or so and we have become somewhat complacent. Inflation rates are increasing and increases are being rapidly accelerated by issues such as the European conflict and the associated recent surge in fuel prices along with supply chain problems caused by COVID. The majority of banks believe the rate of inflation will be 4-6% over the next 12 months as do 56% of non-banks with 38% of non-banks believing the rate will be more than 7% over the next year.

Our respondents acknowledge that protecting themselves against high rates of inflation is going to be difficult but they are already raising the subjects of "rate rises" and "cost cuts". It remains to be seen whether inflation rates will stabilize as global tensions ease or whether they will continue to grow and force us into parts of the economic cycle no one wants to inhabit. The dreaded R word for recession is being whispered very quietly in some pessimistic quarters.

In conclusion, it really does look like we will continue on our roller coaster ride for at least another 12 months. Our peaks will likely outweigh our troughs and will be characterised by an increased number of visitors to the region, more inward investment and a continued real estate boom. Our gains will be offset by rapidly growing inflation, vulnerability to global events and periodic setbacks to our ongoing management of the pandemic.



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Confidence levels

Our clients and contacts inform us that our Caribbean Financier Confidence Barometer is the highlight of our survey for them as it always highlights the current direction of travel.

This year is no different.

Our Barometer measures how confident financiers of regional tourism projects are when considering the prospects for Caribbean tourism over the next 12 months. In our experience banks are considerably more conservative than non-banks. In fact confidence levels of non-banks have exceeded those of banks every year but one since their first participation in the Survey in 2015.

Last year non-banks registered their highest level of confidence yet at a remarkable 8.96 out of 10. Banks were noticeably more cautious registering a highly respectable confidence level of 5.83 out of 10.

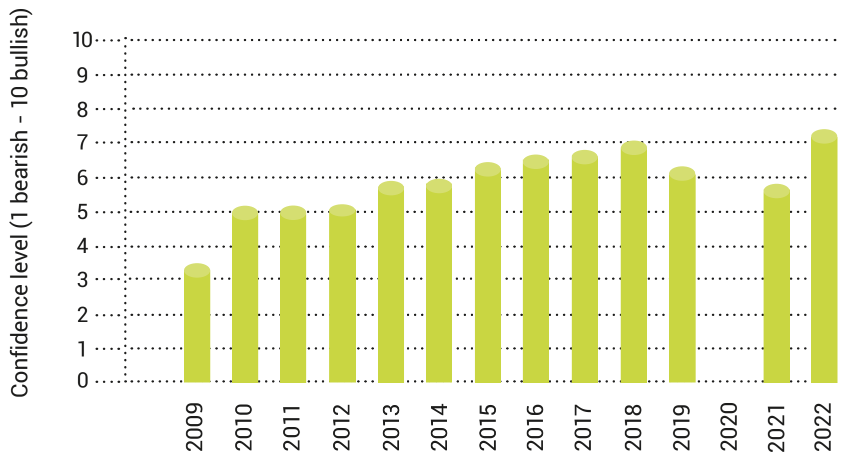
This year the confidence of banks has increased to its highest level of 7.40 since we started this survey in 2009. Non-bank confidence levels remain higher than for banks at 8.31 out of 10.

The most reassuring aspect of this year's results is the consistency of opinions between banks and non-banks. There is usually a significant "confidence gap" between the two communities which can largely be attributed to their inherent nature with banks typically being more conservative and risk averse than non-banks.

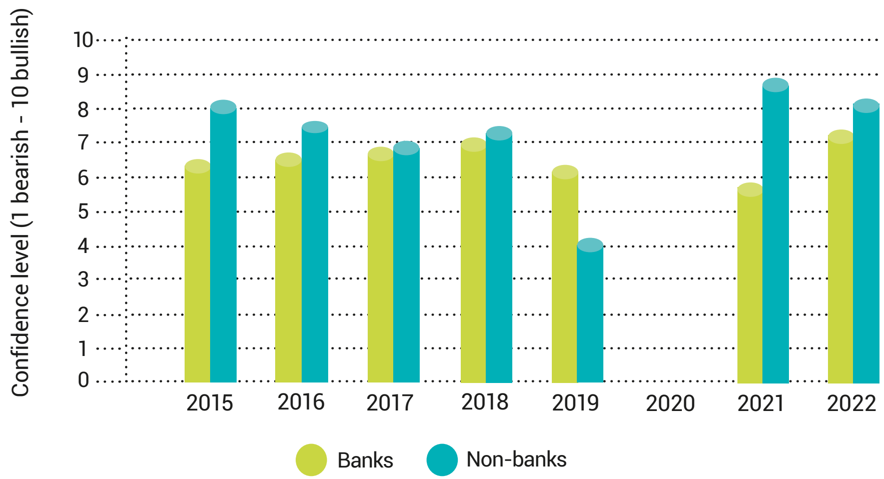
What is the reason for this year's very high confidence levels?

Over the last couple of years banks have, admirably, spent a great deal of time with their tourism related clients helping them survive the pandemic. In fact 80% of banks state that not a single client of theirs went out of business as a consequence of COVID and none of the banks believe that a material number (>10%) of their tourism industry clients will go out of business over the next 12 months. This is a major success story as 20% of banks had expressed such concerns last year.

Caribbean Financier Confidence Barometer - Banks



Caribbean Financier Confidence Barometer - Banks versus Non-banks



No survey was conducted in 2020 due to the pandemic

In a sense, banks seem to feel they may now be over the worst in terms of effects of the pandemic and they can look forward to the future with confidence. They are now all actively lending although most are taking a more conservative approach than they were before the pandemic. The skeptical amongst ourreaders would suggest they were already conservative pre-pandemic!

Another major reason for the high confidence levels is market sentiment. Most people have seriously re-evaluated their lifestyle choices during the pandemic and vacations have now become an absolute must have for many people who also want to catch up on perceived time lost.

"People want to GET OUT AND TRAVEL"

"People want to live now"

"Pent up demand"

"Post pandemic revenge tourism. Changing views on work-life balance. Growth of travel of millennials and digital nomads"

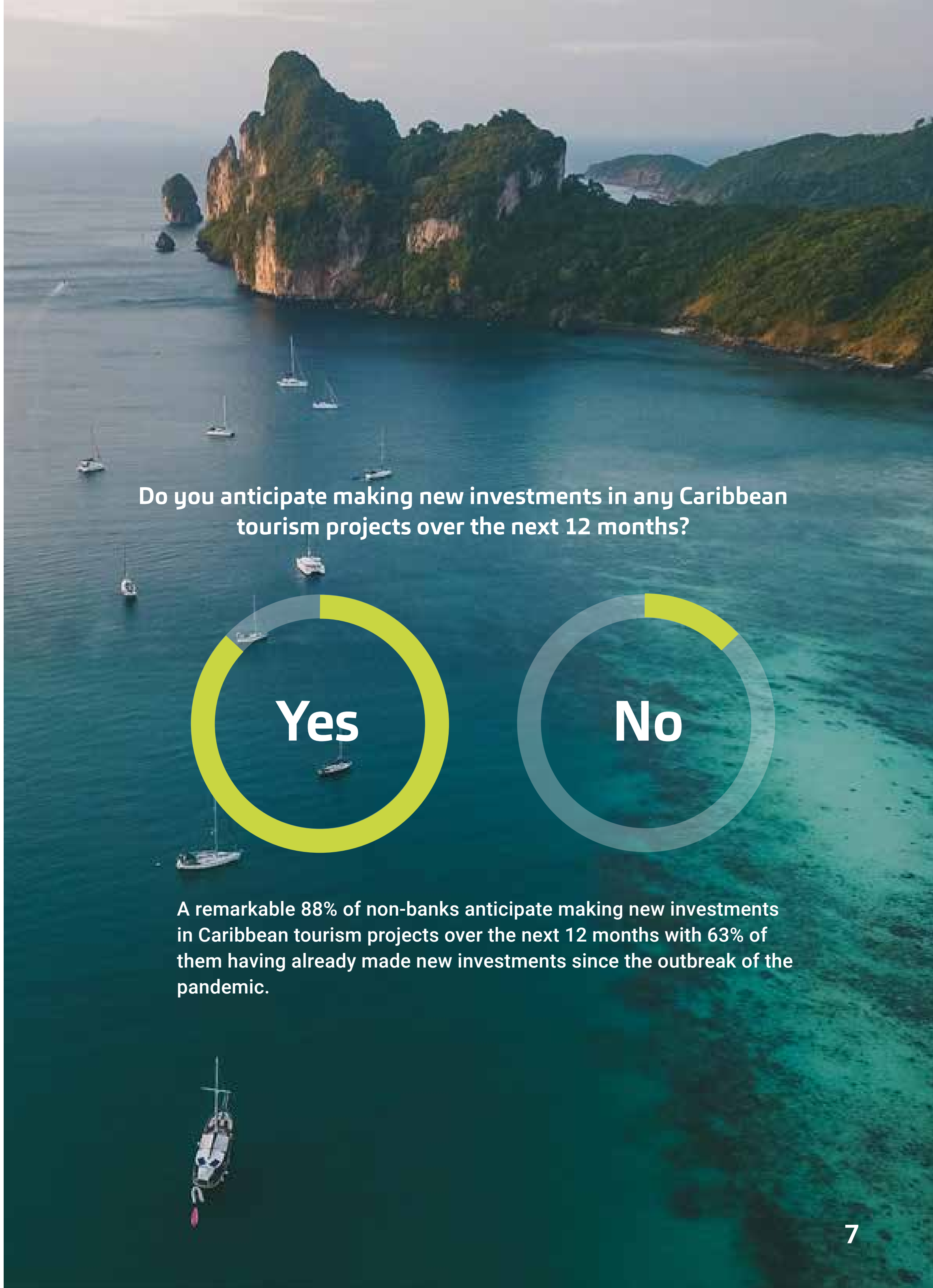
"Based on performance past months and bookings"

"Because the pent up demand from Covid and the amount of savings Americans have as discretionary income"

Interestingly, 38% of non-banks (20% banks) believe the number of tourists visiting the Caribbean over the next 12 months "will go through the roof", and the majority of both banks and non-banks believe numbers will at least return to pre-COVID levels. A couple of our respondents did raise some notes of caution regarding the Russian/Ukraine crisis and its potential impact on travel.

"Still a bit hesitant due to the Russia crisis currently emerging"

"Strong demand now, but tourism is negatively impacted by global recessions and Ukraine crisis may cause this"

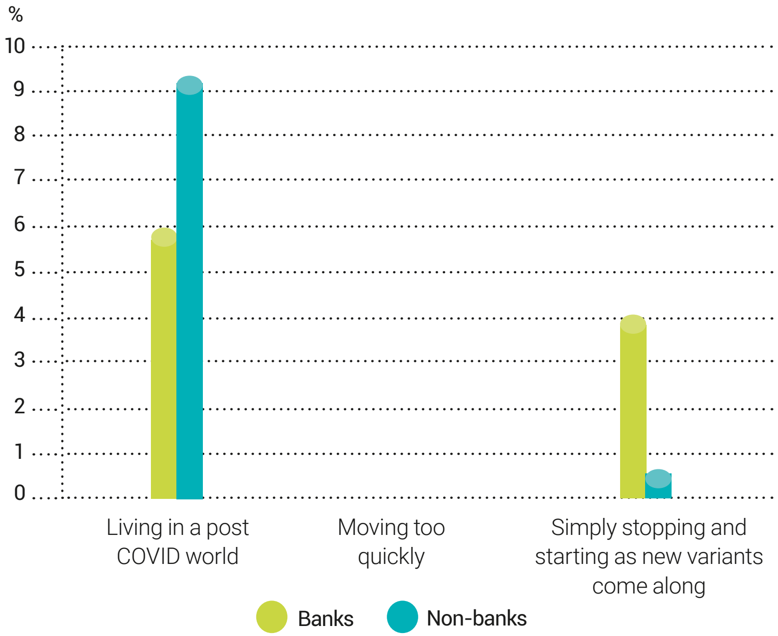


A remarkable 88% of non-banks anticipate making new investments in Caribbean tourism projects over the next 12 months with 63% of them having already made new investments since the outbreak of the pandemic.

COVID – What is the current position?

Regionally and globally all countries appear to be lifting travel restrictions to a greater or lesser extent.

Are we all moving too quickly? Not at all according to the banks and non-banks who all believe it is time to take this step. In fact, 94% of non-banks (60% banks) seem to believe we are now living in a post COVID world whilst only 6% of non-banks (40% banks) believe we will be stopping and starting as new variants come along.



When asked to specify one major permanent change in the regional tourism financing landscape as a consequence of COVID a couple of respondents clearly felt we are back to business as usual.

Absolutely "NOTHING"

"None"

However, most respondents do feel that there have been permanent changes.

"Lenders are much less afraid of the Caribbean Region"

"Growth of villa rentals"

"Poor government ability to weather financial storms caused by tourism disruption"

"The reduction in lending partners"

"More syndication"

"Risk profile changed to reflect higher market volatility"

"Forcing desperately required efficiencies at all government levels from immigration to development approvals"

"Force majeure terms"

"Insurance coverage for pandemics. Lease and labor agreements containing pandemic clauses"

Real estate

Liquidity remains high and for many institutions the challenge is deciding where to deploy that surplus liquidity. Funds and other non-bank entities are often mandated to deploy surplus cash but many potential homes for investing surplus funds are considered too risky and uncertain.

Unquestionably the Caribbean hospitality industry has been a beneficiary of this excess liquidity. Our respondents are responsible for literally US$ billions of investments in the region and we have seen over 88% of non-banks expect to make further investments in Caribbean tourism projects over the next 12 months.

When asked how surplus liquidity is likely to be deployed, all our banking respondents expect it to be invested in real estate rather than in stock markets or held as cash and 75% of non-banks feel the same way.

If you are a realtor or have a real estate component to your development then this is your time and you should “make hay while the sun shines”, as it were. There is no indication that this is a real estate bubble that can burst at any time. In fact, when presented with this option regarding their expected life cycle of the boom, none of our respondents selected it.

There is seemingly no great rush to capitalize on real estate holdings as the growth appears to be sustainable. 56% of non-banks (80% banks) believe the current real estate boom will last for the next 12 months and another 44% of non-banks (20% banks) think it will last considerably longer than 12 months.

On a cautionary note the mere holding of real estate is insufficient to attract inward investment no matter how attractive that holding may appear to be to stakeholders. As will be seen in the other trends section of this report, factors such as good airlift are considered non-negotiable by investors. All banks and 87% of non-banks believe that real estate growth is predominantly at the very high and/or mid-market level of the market.

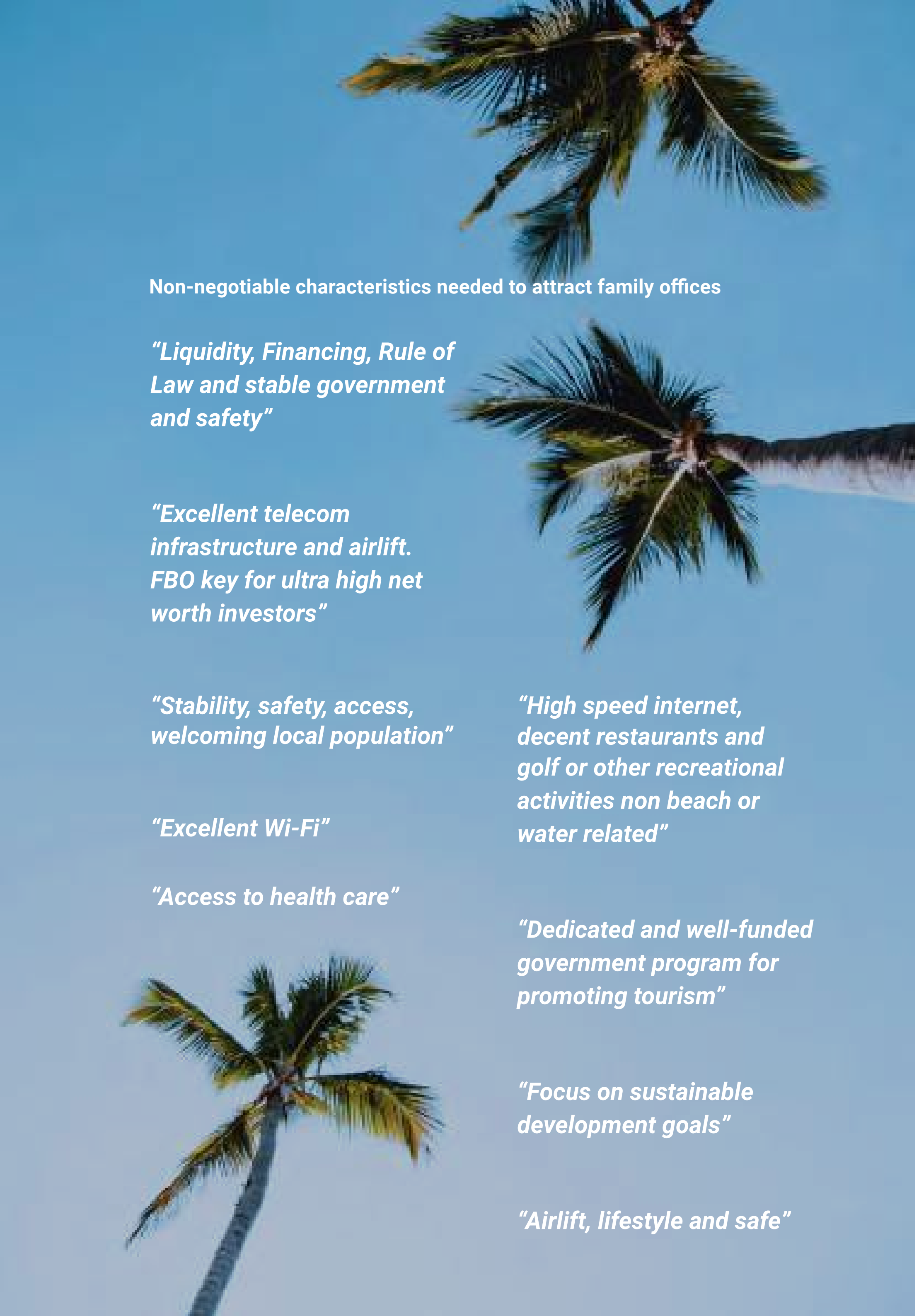
Regional financiers – composition of market

Who are the major financiers of hospitality projects in the Caribbean region? Periodically we like to report on this subject from a very macro perspective as we observe material changes in the financing landscape.

Last year in our first survey post-pandemic, a great deal of attention was given to the enhanced investment in the region by family offices representing High Net-Worth (HNW) individuals. Attracted to the Caribbean first and foremost by the merits of investments on a "stand alone" basis, many of the lifestyle attractions of the Caribbean in a post pandemic world such as its eternal summer, preponderance of outdoor activities and proximity to North America were certainly positive features acknowledged by family offices as influencing their investment decisions.

In fact 75% of non-bank respondents believe there is a lifestyle component to the investment of family offices in the region and they should know!

It seems "working from home" in the Caribbean continues to be a potential growth market for the region. For HNW investors, the Caribbean represents a viable Plan B or Plan C as an alternative base to live and work for extended periods in the event of further outbreaks of COVID and similar pandemics.



Non-negotiable characteristics needed to attract family offices

"Liquidity, Financing, Rule of Law and stable government and safety"

"Excellent telecom infrastructure and airlift. FBO key for ultra high net worth investors"

"Stability, safety, access, welcoming local population"

"Excellent Wi-Fi"

"Access to health care"

"High speed internet, decent restaurants and golf or other recreational activities non beach or water related"

"Dedicated and well-funded government program for promoting tourism"

"Focus on sustainable development goals"

"Airlift, lifestyle and safe"

This enhanced interest in the region of very HNW individuals via their family offices is a very positive development for the region post pandemic and 60% of our respondents this year are seeing continued increases in that interest. However, such investments are not unconditional. For example, there must be good airlift, excellent telecommunications, safety, an established rule of law and stable government. Jurisdictions interested in attracting family offices would be wise to critically assess their performance in these areas as this is a very competitive landscape.

On the banking side, Canadian banks have long since dominated the region. However, as a consequence of some strategic disposals and general downscaling for various reasons they no longer dominate to the extent they once did. They do, however, remain a major player and arguably the major player.

Our respondents do however report increased activity from regional banks, specifically Trinidadian commercial and merchant banks and Jamaican credit funds receiving honourable mentions, along with an enhanced presence of European banks, primarily Spanish, Dutch and French. U.S debt funds also appear to be relatively recent and important players.

Taken as a whole there appear to be more and varied participants in the regional financing marketplace. Some are clearly newcomers testing out the market to a certain extent. A reservation expressed by a respondent that there appears to be a temporary reduction in lending partners suggests that we are in a transitional phase and it will be interesting to see which of these new players develop a sustainable interest in the region and which are simply passing through.

Interestingly, most non-banks (69%) think the risk profile of regional tourism financing opportunities is improving sufficiently to attract new institutional investors although only 20% of banks feel the same way.

A positive recent trend appears to be the increased number of syndicated transactions. Syndicated deals have never been particularly prevalent in the region but their recent prominence is encouraging particularly as it is a way to allow new market entrants to "dip their toes in the water" en route (hopefully!) to a more permanent interest in the region.

Availability of Financing

When we looked at which destinations in the Caribbean have financiers that are most bullish about providing finance to that country 17 countries were put forward, of which 11 were nominated by both banks and non-banks and which are highlighted to the right in dark green. Those in light green were nominated by either a bank or non-bank but not both.

Some of the reasons cited by respondents as attractions are as follows:

"Cayman Islands - safety, political stability"

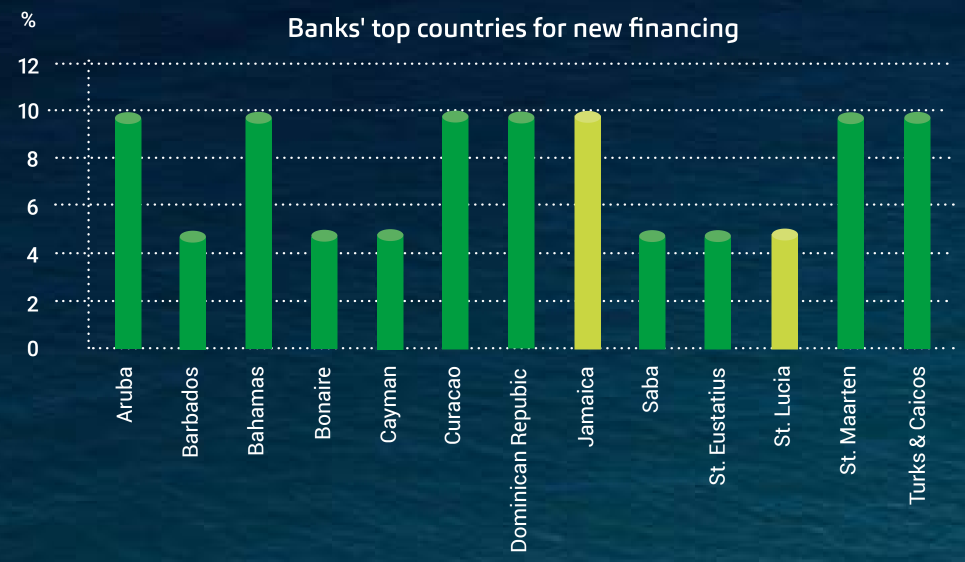
"Anguilla, T&C and Bahamas - knowledge of the markets and growth prospects"

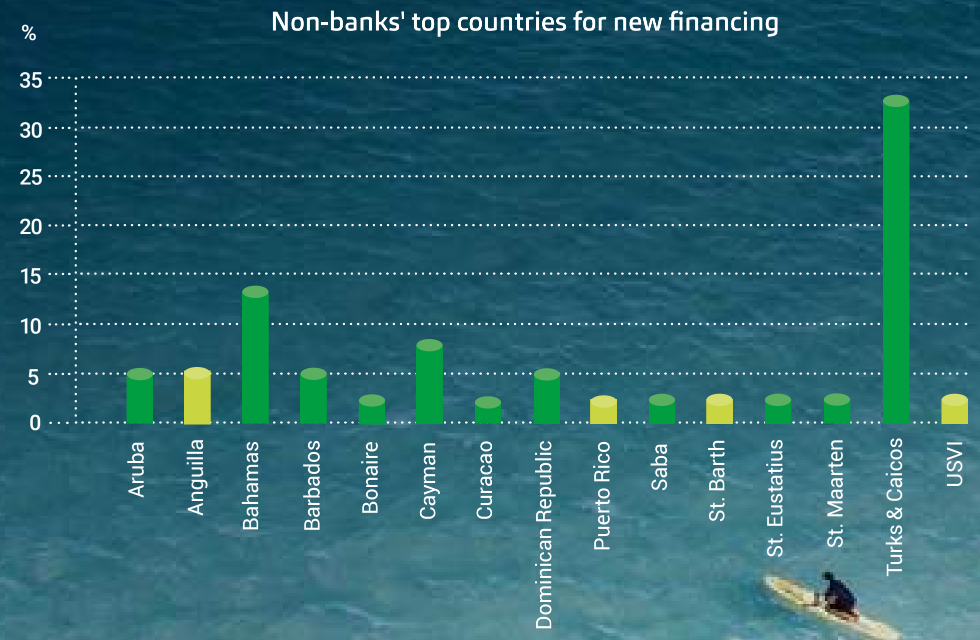
"Bonaire - Curacao – Saba. These islands are new to tourism market, and are showing double digit growth"

"Bahamas and TCI proximity to USA and US$ currency"

"TCI – High barriers to entry, excellent airlift"

"Barbados, TCI, Dominican Republic"





Nature of financing over last 12 months

As per our survey last year, most banks indicate that their primary financing activity over the last 12 months has been the restructuring of existing financing arrangements.

Nature of financing anticipated for the next 12 months

Looking forward to the next 12 months there appears to be a strong emphasis amongst banks on funding renovations and refurbishments. However, there does appear to be a broadening of scope even extending to the financing of new builds.

Borrowers

The majority of banks are engaged in more transactions involving all-inclusives, a business model which has seemingly been validated by the large recent Apple Leisure transaction along with the entry of big brands into this sector of the market.

Amongst the non-bank community there appears to be a very strong concentration on villa developments particularly in luxury markets along with residential components of hotel and resort development.

Scale

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

For those for who scale is an issue, their minimum investment amount varied significantly. For some it was as high as US$150m. Most fell in the US$10m -US$50m range but several made it clear they would still be interested in transactions in the US$1m – US$10m range.

Availability of finance

There was strong support for funding all options presented to respondents including, somewhat surprisingly, new builds.

Inflation

We are certainly used to enjoying clear blue skies in the Caribbean but we are also all too familiar with stormy weather and of course an increasing exposure to major hurricanes.

This survey, taken in its entirety, is very much the bearer of good news. However, based on survey responses, there is a major cloud looming on the horizon in the form of inflation. Whether that cloud develops into a major hurricane remains to be seen but it is certainly an issue that needs to be kept sharply in focus for any investor.

For approximately 30 years we have enjoyed low inflation rates along with associated relatively low interest rates, and we may have become relatively complacent in this regard.

However, inflationary fears have emerged quickly, accelerated by the recent conflict in Europe which has brought a surge in fuel prices. Supply chain problems caused by COVID have also resulted in upward pressures on prices in the construction and automotive industries and generally elsewhere in the economy.

Inflation is now a major issue considered by the financing community. Nearly all over respondents are worried about inflation with the majority of banks (60%) and nearly half (43%) of non-banks stating they are very worried.

The majority of banks believe the rate of inflation will be 4-6% over the next 12 months as do 56% of non-banks with 38% of non-banks believing the rate will exceed 7% over the next year.

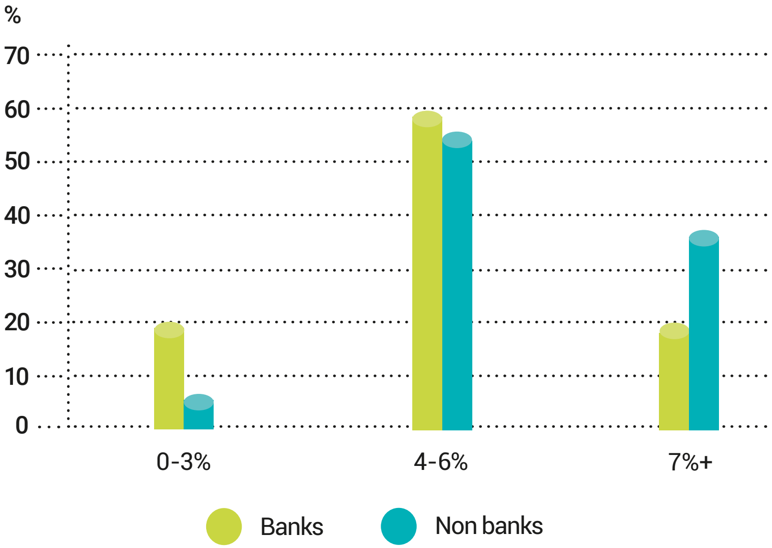
The speed and magnitude of the increase in inflation rates has caught everyone by surprise. How survey respondents protect their own institution against the effects of high inflation rates remains something of a work in progress.

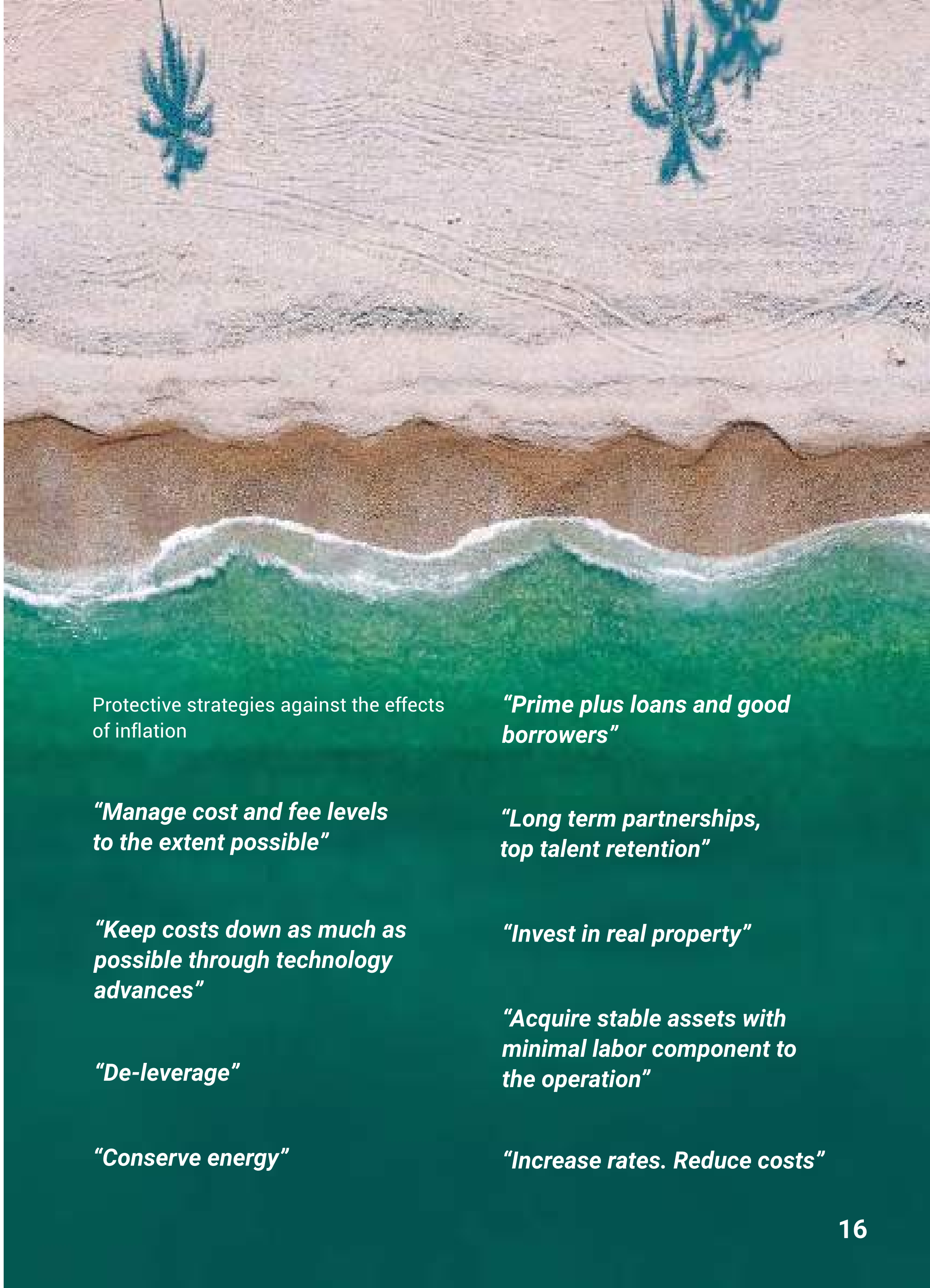
However, raising lending rates and cutting costs have already been mentioned by respondents. Retaining top talent and the enhanced use of technology are very sensible ideas. It does appear that in inflationary times there will be an even stronger trend for financiers to favour long established existing relationships. Inevitably higher costs will be passed on to the consumer one way or another.

It also appears from survey responses that inflation will likely add to the aforementioned growth in the real estate sector with tangible assets considered to be relatively safe investments in inflationary times and a hedge against inflation.

How big a problem higher inflation will prove to be in the long-run remains to be seen. It could stabilize as global tensions ease. Alternatively it could continue to grow and move economies into areas none of us wish to inhabit. We are certainly not there yet but there are already mumblings of the R word for recession amongst the most pessimistic of the financing community. Thankfully they remain barely audible mumblings at the moment!

Best estimate of the rate of inflation over the next 12 months





Protective strategies against the effects of inflation

"Manage cost and fee levels to the extent possible"

"Keep costs down as much as possible through technology advances"

"De-leverage"

"Conserve energy"

"Prime plus loans and good borrowers"

"Long term partnerships, top talent retention"

"Invest in real property"

"Acquire stable assets with minimal labor component to the operation"

"Increase rates. Reduce costs"

Gold star award

Globally, all governments, including superpowers, struggled initially with their responses to the COVID pandemic and so it is no surprise that small, regional governments like those in the Caribbean could find the challenges brought by the pandemic overwhelming.

However, it is reassuring to see a wide variety of governments put forward by our respondents as worthy of applause for various reactions in this uncertain landscape.

“Puerto Rico, and Dominican Republic. Fast response to deal with Covid and implement workable travel policies”

“Barbados for sure having been ahead of the game”

“U.S. - saw the positive impact in the U.S. Virgin Islands French - generally supportive vis a vis St. Martin & St. Barth”

“Cayman Islands, fastest reaction to immediate threat”

“Turks and Caicos, worked closely with private sector tokeep economy open and minimise travel disruption”

Other trends

The critical issues impacting financing activity in the region could not be clearer. Once again airlift is the most critical issue for all respondents. It really is a non-negotiable factor. Crime pretty much falls into the same category, second at 81.25% for non-banks and approximately the same for banks.

Availability of financing is particularly important for the banking community and shares top spot for them with airlift.

We reiterate the point made earlier when reporting the bullish responses regarding the real estate sector. Whilst there is tremendous potential for investment in that sector at the moment certain factors such as good airlift, control of crime and being able to enjoy a safe environment are non-negotiable for financiers.

Very Important

Moderately Important

Not Important


Debt & equity financing
Banks
Non-banks
Immigration issues
Banks
Non-banks
Impact of social media
Banks
Non-banks
Very Important
Moderately Important
Not Important
Absence of exit strategy
Banks
Non-banks
Health issues (e.g. COVID)
Banks
Non-banks
Quality of telecommunications
Banks
Non-banks

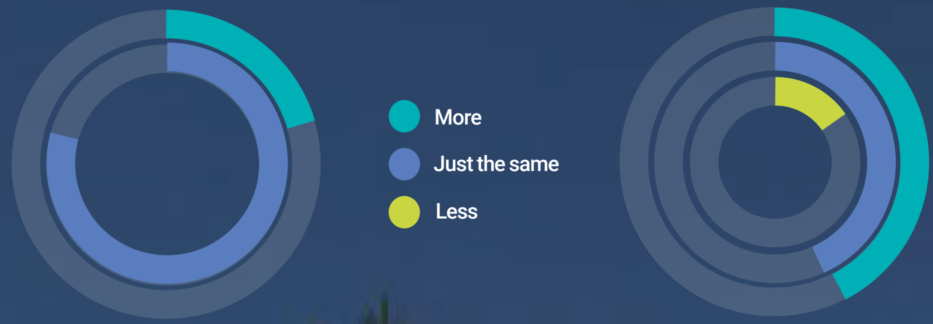
When asked how these critical issues impacting financing activities can be mitigated, respondents emphasised, as they have in the past, a need for a "joined up" macro approach to tourism at the local and regional levels.

Most respondents believe the level of difficulty of doing business in the Caribbean remains just the same as in prior years. However, there is a significant minority of 20-25% who consider it is becoming more difficult to conduct business in the region.

This is a concern that regional governments need to keep their eyes on and which is consistent with the comments to the right from financiers on the strong role they see for governments in terms of how the critical issues impacting financing activities can be mitigated.

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

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



"Governments need to continually invest in their country's infrastructure"

"Public / private initiatives to improve infrastructure"

"Continued proactive local and national government support"

"Government investment"

"Government - tourist boards"

"Make a pact amongst all islands for achieving Sustainable Development Goals by a certain date, like 2030"

"Support at the destination level"

"Clear outlining of government strategy"

Reasons to be cheerful!

We asked our respondents what single new opportunity excites them the most and fills them with optimism about the future of the tourism industry in the Caribbean. Here are some of their responses.

“Seeing/hearing how everyone loves the Caribbean”

“Increased airlift and new infrastructure such as the new airport in St. Lucia”

“Serviced horizontal residential”

“Continued commitment to improving access - e.g. Tradewinds doubling fleet of Pilatus planes”

“The advancement of low density eco luxury developments”

“Investment in airports and infrastructure”

What did we miss?

Respondents were asked whether our survey has missed any critical issues impacting their decision to finance tourism projects in the Caribbean. The following responses were received:

“The subject of climate change and the need for adherence to Sustainable Development Goals ('SDG') for the Caribbean “

“‘Exit options’ for financiers”

“The ability of borrowers to execute and experience”

Baker Tilly's Caribbean Leisure and Tourism contacts

Please contact the Baker Tilly member firm represented in your country if you have any questions.

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