SEPTEMBER 2011

CARIBBEAN HOTEL INVESTORS MANUAL

WHAT YOU NEED TO KNOW

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Introduction

The Caribbean benefits from its warm tropical weather and beautiful beaches. These natural attributes, coupled with the warmth of its people and a rich culture, attract millions of visitors to this part of the world each year. Therefore, the region's main economic sector has naturally been the hospitality and tourism industry. As a result, the industry plays a vital role as a generator of wealth and employment across a broader sphere, acting as a catalyst for growth in other areas, such as agriculture, construction, and manufacturing. Overall, the tourism industry generates over $20 billion a year for the Caribbean region and provides more jobs than any other industry.

During the last three years, the hospitality sector was significantly affected by the economic slowdown and lack of liquidity. Destinations like the Caribbean that rely on the leisure market were hit hard in particular as consumer confidence declined and other economic indicators, such as the housing market and employment numbers, showed little signs of recovery. This downturn led families to reduce their discretionary spending, which in many cases included leisure travel. Thus, visitation to the Caribbean region decreased noticeably in 2008 and 2009.

However, the Caribbean hotel market has recently shown signs of recovery, with demand levels increasing in 2010 and strengthening further through the first half of 2011 compared to the same period last year. Occupancy levels are also improving, but although marketwide average rate improved in 2010, it has remained relatively flat throughout the first half of 2011. Overall, the Caribbean lodging market's fundamentals are improving, which bodes well for the hotel industry.

Caribbean marketwide demand peaked in 2007, and we expect demand to attain levels significantly higher than the market's historical peak by the end of 2011. With strengthening demand and relatively low levels of supply scheduled to enter the market over the next few years, the Caribbean market is positioned to benefit from the eventual economic recovery. We expect that as demand levels continue to strengthen, local hotel operators will gain greater confidence and begin to yield-manage more effectively, resulting in higher average rates and overall operating performance. Despite the recent challenges, the Caribbean market is poised for recovery.

The Caribbean market is characterized by very limited inter-island travel and thus little regional demand. As such, the Caribbean hospitality and tourism sectors are highly dependent on the area's source markets and are therefore reliant on the improved performance of the economies of the U.S., Europe, and Canada, the main source markets for the Caribbean region.

Table 1 outlines the total number of tourist arrivals from the various source markets to each of the islands for 2010.

Given its relative proximity and ease of access, the U.S. has been the major source market for tourism and thus hotel demand in the Caribbean region. Table 2 highlights the total number of arrivals and total number of U.S. tourist arrivals to each of the islands for the year 2010.

TABLE 1: ARRIVALS TO CARIBBEAN ISLANDS – 2010

	Arrivals 2010				Percentage				
	United States	Canada	Europe	Other	United States	Canada	Europe	Other	Total
Anguilla	38,882	2,403	7,558	13,155	63 %	4 %	12 %	21 %	61,998
Antigua & Barbuda	81,529	17,759	86,101	45,916	35	8	37	20	231,305
Aruba	535,814	37,702	76,362	175,573	65	5	9	21	825,451
Bahamas	1,095,272	119,230	78,018	75,533	80	9	6	6	1,368,053
Barbados	134,969	72,351	212,276	112,584	25	14	40	21	532,180
Bermuda	166,016	30,402	28,498	7,346	71	13	12	3	232,262
Bonaire	14,494	1,417	15,273	3,989	41	4	43	11	35,173
British Virgin Islands									330,343
Cayman Islands	228,461	19,499	19,850	20,462	79	7	7	7	288,272
Cuba	0	945,248	809,514	776,982	0	37	32	31	2,531,744
Curacao	48,672	7,600	163,546	121,838	14	2	48	36	341,656
Dominica									76,517
Dominican Republic	1,226,367	659,063	1,184,269	1,054,844	30	16	29	26	4,124,543
Grenada	20,038	6,187	33,452	46,479	19	6	32	44	106,156
Jamaica	1,242,943	325,191	271,315	82,229	65	17	14	4	1,921,678
Martinique									476,492
Montserrat	1,134	279	998	1,614	28	7	25	40	4,025
Puerto Rico*	1,231,748	19,216	28,802	90,048	90	1	2	7	1,369,814
Saba	3,775	1,065	6,335	1,152	31	9	51	9	12,327
St Lucia	129,085	32,154	85,695	59,003	42	11	28	19	305,937
St Vincent & the Grenadines	21,551	33,498	101,118	72,141	9	15	44	32	228,308
St. Martin/St. Maarten	236,376	33,498	101,118	72,141	53	8	23	16	443,133
Trinidad & Tobago	74,229	19,510	23,524	40,854	47	12	15	26	158,117
US Virgin Islands	696,878	6,601	14,446	31,104	93	1	2	4	749,029

*Non-resident hotel registrations only

Source: Caribbean Tourism Organization and Caribbean Hotel & Tourism Association

TABLE 2: U.S. SHARE OF ARRIVALS TO CARIBBEAN ISLANDS – 2010

	2010 Total Tourist Arrivals	% Change From 2009	2010 US Share	2010 Estimated US Tourist Arrivals
Anguilla	61,998	7.1	63 %	38,882
Antigua & Barbuda	231,305	-1.3	35	81,529
Aruba	825,451	1.6	65	535,814
Bahamas	1,368,053	3.1	80	1,095,272
Barbados	532,180	2.6	25	134,969
Bermuda	232,262	-1.5	71	166,016
Bonaire	35,173	5.3	41	14,494
British Virgin Islands	330,343	7	N/A	N/A
Cayman Islands	288,272	6	79	228,461
Cuba	2,531,744	4.2	0	0
Curacao	341,656	-6.8	14	48,672
Dominica	76,517	2.1	N/A	N/A
Dominican Republic	4,124,543	3.3	30	1,226,367
Grenada	106,156	-6.4	19	20,038
Jamaica	1,921,678	4.9	65	1,242,943
Martinique	476,492	7.9	N/A	N/A
Montserrat	4,025	-1.2	28	1,134
Puerto Rico*	1,369,814	5.2	90	1,231,748
Saba	12,327	3.1	31	3,775
St Lucia	305,937	9.9	42	129,085
St Vincent & the Grenadines	228,308	-3.9	9	72,141
St. Martin/St. Maarten	443,133	0.7	53	236,376
Trinidad & Tobago	158,117	-9.9	47	74,229
US Virgin Islands	749,029	3.8	93	696,878

*Non-resident hotel registrations only

Source: Caribbean Tourism Organization and Caribbean Hotel & Tourism Association

Investment Activity

As the Caribbean market continues to show signs of recovery, it has naturally resulted in increasing investor interest in the region. Although capital for new construction remains scarce and lenders are far more stringent than they were in the past, new projects are still being funded, and the banks that have been historically committed to hospitality projects in the region are slowly beginning to resume providing capital for acquisitions and are even considering new construction financing, although on a very selective basis.

Notably, an alternative financing option for large-scale projects in the Caribbean region has been the Chinese Government, which has invested heavily in the region since 2004. According to Dr. Adam Wu, Chief Operating Officer of the China Business Network, the Chinese have already made substantial direct investments in the region, and their aim is to continue to do so. In 2009, the Chinese Government invested over $7 billion in the Caribbean on a wide range of tourism and non-tourism projects. The Chinese Government is currently financing the $2.6-billion Baha Mar project in the Bahamas and funded the Montego Bay Conference Center, which opened earlier this year. In mid September this year, the Chinese Government pledged another $1 billion in preferential loans to Caribbean Community Countries (CARICOM). It is clear that the Chinese Government is committed to investing in the Caribbean region and in particular in the region's hospitality and tourism industry.

As the Caribbean lodging market continues to improve and financing options become more available than a year ago, it is clear that hotel investment opportunities will also increase. With 32 islands nations that all feature different characteristics, the Caribbean lodging market is unique; thus investors need to understand the various markets and islands within the Caribbean before pursuing opportunities.

Investment Considerations

As noted, each of the 32 Caribbean island nations constitutes a different submarket, and operating or investing in a hotel on one island is entirely different from operating or investing in a hotel on another island. Given these factors, here are some points that investors and operators should keep in mind when pursing deals in the Caribbean.

Understanding Individual Market Trends

Although the opportunity is within the Caribbean, a thorough understanding of the specific island trends pertaining to the location of the hotel is paramount. Investors need to clearly recognize that the lodging industry is a market-by-market business that quite frequently acts in contradiction to the overall market. To illustrate this point, while the Caribbean market overall was up almost 5.0% in terms of RevPAR through the first six months of 2011, both St. Lucia and Curacao exhibited RevPAR increases in excess of 20.0%. Conversely, the U.S. Virgin Islands, one the highest-rated markets in the region, experienced a decline in RevPAR during the same period. It is therefore imperative for investors to understand the individual island market trends when making investment decisions and not to rely solely on the overall regional trend.

Market and Product Selection

The investor seeking a specific opportunity in the Caribbean needs to understand the long-term characteristics of the island to determine whether the location can support the hotel. A market study should be conducted by the investor or by an independent consulting firm. Once the investor has a good knowledge of the market or island, the next step is to identify and select the type of lodging product that is best suited for the particular destination. The study will help the investor to understand the levels of demand for a hotel and can recommend the best options in terms of product that can cater to the specific market demand for the submarket or island. For example, there are a few markets within the region that can absorb a favorably located select-service hotel.

Lender Requirements

Banks that lend on hotel projects in the Caribbean are slowly beginning to once again provide capital for acquisitions and are even considering new construction financing. However, they are mainly lending to very strong sponsors with proven track records in the hospitality industry – that is, investors that can bring a substantial amount of equity to the deal. In addition, lenders are very selective in terms of destination and product. Marginal projects will not receive funding. Projects must be well thought out, the locations need to have strong airlift, and branding is important. Financing for ground-up construction in the Caribbean is more difficult to acquire but not impossible. There are a few banks in the region that are committed to lending on hospitality projects, and some of these banks will consider new deals.

Mixed-Use Model as Development Option

Prior to the economic downturn, many hotels in the Caribbean market were developed by underwriting mixed-use projects that included a residential component for sale in order to finance the hotel development. With the backlog of stalled condominium mixed-use developments throughout the region and other parts of the world, an investor seeking to develop a hotel in the Caribbean using this approach will find it difficult to obtain financing. As credit markets tightened, the ability to borrow from U.S. banks against one's primary residence or other assets in order to acquire a second or retirement home was curtailed. Sales of resort-residential product across the Caribbean slowed considerably. Notwithstanding the direct effects of the recent slowdown, the Caribbean remains well positioned to capture second-home and retirement sales in the mid- to long-term. However, developers considering this model may need to re-think their strategy in the short term.

Understanding Submarket Operating Costs

In general, Caribbean hotel operators benefit from lower labor costs and significantly lower or no real estate tax expense compared to U.S.-based hotel operators. These savings are typically offset by significantly higher utilities and insurance costs. Again, we emphasize the importance for investors to understand the specific Caribbean market or island being considered. For example, utilities expenses for hotels in the Bahamas and the Grand Cayman are more than double the cost of the typical hotel operating in the U.S. and can be even higher on other islands. Conversely, utilities expenses for a hotel operating in Trinidad and Tobago are notably lower than this expense for a typical hotel operating in the U.S. Another example is the cost of insurance. Hotels located within the hurricane belt incur significantly higher insurance costs than properties located outside the hurricane belt. Investors often underestimate this expense. It is not surprising for a hotel situated within the hurricane belt to incur an insurance expense more than three or four times higher than a similar-sized hotel outside the hurricane belt. Understanding the various costs associated with each market or island is important to help an investor determine the estimated return on investment.

Airlift, Airlift, Airlift

Tourism to any island destination is dependent first and foremost on the accessibility of the destination. In most cases, accessibility is principally provided by air service, consisting of either scheduled commercial service or charter flights. Typically referred to as "airlift," the seat capacity and frequency of flights are critical factors that essentially control the level of tourism to any island destination. The airlift therefore also dictates the potential demand for lodging facilities. Airlift and lodging inventory can be described as a "chicken-or-egg" circumstance. Airlines will not initiate or expand flight service unless and until the lodging capacity is sufficient to support that service, providing facilities that can accommodate the guests flying to the island. In this respect, the lodging facilities effectively generate the demand. The character of the accommodations is also a critical factor, in that the profile of the tourists will be directly influenced by the caliber of the accommodations offered. For example, destinations that do not offer first-class accommodations built to the standards to which North American travelers are accustomed are unlikely to attract or support significant airlift from U.S. carriers or North American points of origin. At the same time, developers are unlikely to build new resort properties unless and until the airlift is sufficient to support the hotel(s). American Airlines recently reduced the number of flights to some locations in the Caribbean; however, JetBlue and Copa Airlines added new routes throughout the region in 2011. A firm understanding of the current and planned airlift for the specific island is critical to the investment analysis. Investors should interview local tourism and government officials as well as other operators to understand "airlift" for the specific island.

Understanding the Nuances of Business Conduct

It is important for international investors to have a local knowledgeable partner on the ground. It is difficult and can be time consuming and expensive to venture into an unfamiliar market without some type of local partner that can facilitate the process. International investors should bear in mind that the development process in the region is typically longer and not as clear and straightforward as it is in the U.S. Having a local partner that is familiar with the country, laws, and nuances of conducting and operating business locally is extremely helpful.

Conclusion

The overall Caribbean lodging industry is showing signs of improvement, and the market is expected to strengthen further and gain momentum over the next couple of years as hotel fundamentals continue to improve. Comprising 32 islands nations that are all different, the Caribbean is truly a unique lodging market. Investors considering a specific island for a hotel project should do their due diligence so that they fully understand that specific submarket.

For all interested in hotel investment opportunities in the Caribbean join us for our unique event the 2011 HVS Caribbean Hotel and Investment Conference and Operations Summit at the Atlantis resort in Nassau Bahamas on November 10 and 11 this year.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as the leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 400 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit **www.hvs.com**.

HVS CARIBBEAN is the latest addition to HVS' global network of expertise in hospitality consulting. The office is located in Nassau, on New Providence Island. HVS Bahamas specializes in the development of new hotels and resorts, especially in the Caribbean and Central America, and works with developers and other team members to conceptualize the optimal accommodation product for any particular site.

About the Author

Parris E. Jordan is the Managing Director of HVS in the Bahamas, where he oversees hospitality consulting and valuation assignments in the Caribbean, the United States, Central America, and Mexico from the HVS office in Nassau. Prior to assuming the Managing Director role, he was a Vice President with HVS in New York.

During his career, Parris has performed hundreds of complex hotel consulting and valuation assignments throughout the United States, the Caribbean, Mexico, and Central America. Clients include major investment banks, lenders, governments, private equity firms, developers, and hotel brands.

Parris holds an MS from the Preston Robert Tisch Center for Hospitality and Tourism at New York University (NYU) where he also lectured as an adjunct professor on lodging development from 2007 to 2009. Parris speaks at hotel investment and tourism conferences all over the world, including the largest such conference, the NYU International Hospitality Industry Investment Conference.

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