

Trending Issues and Challenges Facing Caribbean Hospitality Development

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The Caribbean hospitality industry continues to strengthen as hotel operating fundamentals have exhibited continuous growth following the global economic downturn that began in the last decade. The Caribbean hotel market has shown steady improvements in average rate, occupancy and RevPAR since 2010. As STR shares, Caribbean-wide average daily rate increased every year since 2011 and notably by 4.3% year to date through June 2015, compared to same period last year. And Caribbean-wide RevPAR improved every year since 2011. These trends are driven mainly by the increases in average daily rate. Moreover, with limited new supply scheduled to enter the market coupled with a favorable forecast for higher levels of tourist arrivals, the overall market is expected to continue to strengthen even further. However, the one major challenge still facing the region is the limited amount of financing available for new construction, which in turn limits opportunities for developers to build new hotels.

The Re-Emergence of the All-Inclusive

The re-emergence of all-inclusive hotels is taking great strides, as it is a fast growing sector. It seemed to fall a little under the radar, as independents and brands now have their own vacation club programs. But the all-inclusive hotel is back and better than ever with their creation of ultimate loyalty programs. Neil Kolton, Director of Resort Sales & Service for the Caribbean and Florida at Interval International, sees the all-inclusive ultimate loyalty programs to be appealing to the same demographic attracted to timeshares.

When the all-inclusive segment saw its lull, the emergence of such programs occurred in the traditional, timeshare resort; these were usually residential with the home away from home feel. Developers began selling such programs as an alternative to vacation purchases. All-inclusives have now joined in, and as Kolton has noted, it has become a very popular product offering. The all-inclusive product is similar, but it is not real estate. Rather it offers distinct amenities to customers such as special VIP privileges, early check-in and late checkout, good locations throughout the property, and at times a discount on the all-inclusive fee.

Javier Coll, Executive Vice-President & Chief Strategic Officer (CSO) of Apple Leisure Group believes that the all-inclusive hotel has long since been a trend, but is definitely now on the rise. The emergence of the high-end, all-inclusive hotel is a catalyst in such a rise. Apple Leisure Group is a vertically integrated business made up of tour operation companies, travel agencies and resort brands. Coll remarks that 99% percent of his customers chose to stay in all-inclusive resorts. Fifteen years ago, there would be a mixture between the all-inclusive and the traditional hotel, but that trend has in fact slowly faded.

Also 15 years ago, Apple Leisure Group developed the first set of high-end all-inclusives. "We believe that we are pioneers when it comes to that sector," remarks Coll. Most of Apple Leisure Group's all-inclusive properties are located in Cancun, Riviera Maya, Montego Bay, and Punta Cana. Interval

Summary

The Caribbean hospitality industry has experienced growth with the re-emergence of all-inclusive hotels and vacation clubs. As operating performances continue to strengthen, more hotel financing opportunities are available for the future.

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International's Neil Kolton also sees most all-inclusive properties in Mexico, Jamaica, and the Dominican Republic. He also sees more space for those all-inclusives to grow in areas such as Aruba and St. Maarten.

Why has the all-inclusive market stayed so concentrated in the Caribbean? Coll says for the most part, it comes down to costs. Operating all-inclusive hotels is expensive, as there needs to be a large workforce on hand twenty-four hours a day, multiple restaurants, and other guest amenities. In some of the Caribbean islands, they find lack of goods, which makes the operation even more expensive with import costs. Some islands, such as St. Thomas, have extremely high payroll making it impossible to fund the hotel with such high wage costs. In Mexico, where the wage rate is less than it is in St. Thomas, the all-inclusive operation is much more feasible. According to Coll, the only two options for investment on islands like St. Thomas is to charge an extremely high nightly rate, or change labor laws. Both, of course, are nearly impossible to do.

On islands with little to no all-inclusive presence, the issue may also be the need for better-qualified data. There are many misconceptions when it comes to the all-inclusive industry, and with some education, developers would realize that their position is in fact outstanding.

Financing in the Caribbean

The current financial trend in the Caribbean, according to Robi Das, Managing Director of NGKF Capital Markets in the Miami office, is that there is a risk component factored into the pricing of any investment in the region. Given the specific investment opportunity, the risk can be determined to be high or low based on various factors that are important to the specific investors or lenders. As the pricing and terms are being properly discovered, the market in the Caribbean is seeing increased activity but shifting along this risk paradigm.

All around growth in the Caribbean region is leading to increased revenue and competitiveness. Das remarks that a popular misconception about the Caribbean real estate market is that it is tied to the US real estate market, when it is actually more dependent on the global equity market indices. "If the stock markets are doing well, then individuals of both high-net worth and otherwise are more likely to feel the wealth-effect and pursue investments or longer-stayovers in the broader region."

When it comes to more development-related and institutional sized-investments, private equity lenders are more present than the traditional banks. On lending Das notes, "The holy grail of lending is proving to be senior lender-type protections with mezzanine style pricing and options. Said protections are essentially coming in the form of preferred equity. These transactions take on a waterfall structure when it comes to distributions based on a "pay-per-performance model." These financial structures have allowed for a secondary market to develop in the Caribbean.

Javier Coll brings in a different perspective when it comes to financing. "It is not a coincidence that in areas where the all inclusive is well established, there is financing available." Coll talks to the pertinence of the all-inclusive market. "These projects are viable, and so the banks are willing to finance. The whole economy surrounding the all-inclusive market in turn is healthy. For the government, supporting the all-inclusives is much more than supporting just the hotel industry, as it has a holistic affect on the entire economy.

High-yield opportunities in the Caribbean are currently taking the form of joint venture structures in the high barrier to entry markets with economic trends moving in the right direction. Let's be sure not to confuse high-yield with high barrier to entry. An example of a strategy associated with a high barrier to entry market in the Caribbean is found in a current landowner with a very well located asset. Many of these owners have been through the downturn and are now looking for the right pricing or structure to monetize their asset. A natural disconnect is found between the current land owner and the investor though, as the owner has, in many cases, been contributing to the asset in real dollars for an extended period of time and must allocate risk associated to a future strategy versus receiving a payment—which

is in today's dollars. The investor, on the other hand, is looking towards the future strategy rather than the legacy investment, and is pricing the risk associated with their cost of capital and regional risk factors.

The Citizenship by Investment Program is also creating great opportunity for investment in the region as a source of development capital. Usually citizenship is gained by birth, inheritance, marriage, or naturalization, but the Citizenship by Investment Program grants citizenship to those who invest capital in the nation's development. This has proven to be extremely successful in St. Kitts and Nevis, which has had this program since the early 1980's. A recent example of this is the development of Christophe Harbour, Kittitian Hill, and the Park Hyatt in St. Kitts. This program is easily compared to the EB5 structure found in the United States. The EB5 allows for foreign nationals who invest money in the United States to obtain visas. The CBI Program has its own intricacies and is common throughout Eastern Caribbean countries. Das adds, "As more countries participate in this form of development program, it may result in a bit of a pricing war. Since tourism is the primary industry and there are limited exports, the CBI program effectively becomes one of the largest exports."

What the Future Holds

The Caribbean hotel market continues to strengthen, as exemplified by the strong operating performances of hotels throughout the region. We expect that the appetite of the lending community will increase further in the near future. As the U.S. market continues to become more competitive, thus placing downward pressure on yields, many international investors are seeking alternative markets to generate higher returns, and the Caribbean market offers this opportunity. Of course, the savvy and experienced investors will weigh the risk and reward while seeking out opportunities in the region. The all-inclusive product continues to be an attractive investment opportunity for those who understand this type of product. As the high-end all-inclusives continue to emerge, combined with ultimate loyalty programs within those hotels, the segment allows for a developed client base who will be fiercely loyal. While hotel financing in the region continues to improve at a slow pace, we are optimistic on the prospects for greater improvement. It is our belief that the availability of financing for the regional hotel market will continue to strengthen more vigorously as a result of both low levels of new supply and the tightening yields for hotel projects in the U.S.

About Parris E. Jordan



Parris Eric Jordan is the Chairman of the Caribbean Hotel Investment Conference & Operations Summit (CHICOS) and the Managing Director of HVS in the Caribbean, where he oversees hospitality consulting and valuation assignments in the Caribbean, the United States, Central America and Mexico. CHICOS, which was founded by Jordan in 2011, is an annual event which brings together international investors and operators as well as leading hotel investment decision makers, including governmental representatives and international industry and opinion

leaders, to discuss the markets, developments and opportunities for hotel growth in the Caribbean region. Parris's hospitality-industry expertise extends to hotel market and feasibility studies, appraisals, valuations, operator searches, and target market and global expansion strategy development for prominent international hotel brands. Parris holds a Masters from the Preston Robert Tisch Center for Hospitality and Tourism at New York University, where he has also lectured as an adjunct professor on lodging development. Parris holds a Masters degree from the Preston Robert Tisch Center for Hospitality and Tourism at New York University where he also lectured as an adjunct professor on lodging development. Please contact Parris at or +1 (917) 902-2314.